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by Bill Ely

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From the Chairperson—It's the Summer of 2010 ...

by Larry Stern

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by Jay M. Jaffe

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Information Technology—A Double-Edged Sword

by Andrew Chan

Technology has transformed the way we do business. We can make timely, informed decisions by extracting meaningful business information from a multitude of recorded data, literally in seconds. We can improve our customer satisfaction by automating the order processes and letting our customers check their online status. However, information technology is a two-edged sword. It can seriously damage your business if you don't handle it properly.

[Full article]

Insurance Solutions: Why Customizing Is Crucial

by Jim Mooradian and Bryan Lambert

One size does not fit all when it comes to some insurance solutions. Whether you are planning for your own insurance needs or a client is seeking your advice about insurance plans, it may be useful for you to recognize that employers and employees often misunderstand the types of coverage they own.

[Full article]

The Potential Impact of President Obama's Financial Regulatory Reform on Start-Up Companies

by Michael Baker

President Obama released his plans for financial regulatory reform on June 17, 2009.1 While the proposals are not entirely surprising given the state of the economy, they do reflect a potential fundamental shift in the regulation in our capital markets. This paper outlines the extent of the issues facing a start-up company due to the Administration's proposals, and offers solutions to the problems facing these entrepreneurs.

[Full article]

ERM Executive Compensation

by Nian-Chih Yang

Enterprise Risk Management (ERM) enhances a company's long-term stock growth. Executives' buy-in is essential for the success of ERM. The proposed Stock Performance Protection Plan (SPPP), with the inducement of stock performance floor protection, encourages the executives to fully participate in ERM. The insurance companies have a long history of partnership with their clients to manage the various risks their clients face. The SPPP can be the vehicle for the insurance companies to help their clients control risks and attain long-term growth. [Full article]

VOTE! SOA 2010 Elections Open. Let Your Voice Be Heard.

The SOA 2010 elections are open. Online voting is open 24 hours a day from August 9 through September 3 at 5 p.m. Central Daylight Time. View the 2010 president-elect candidates as they discuss their platforms. Learn more about candidates for president-elect, vice president, board of directors and section council positions. Visit the Q & A page to better understand the nominating and election process. If you have questions, e-mail elections@soa.org. Most importantly, VOTE! It's important and it's easy! Let your voice be heard!
[More]

Are You Prepared for CPD Attestation?

Be sure you're ready when attestation opens on November 1. If you know your compliance path, have tracked your CPD credits, and are sure the SOA has your e-mail address, then you're ready to attest. We'll send out information about attestation via e-mail. Once you get the link, log in to the membership directory to attest compliance with a few mouse clicks. Learn more about this simple, but important process.
[More]

Koppel to Speak at SOA 2010 Annual Meeting & Exhibit

We're gearing up for this year's meeting and yes, we have Ted Koppel—the man who has given us years of insight into the biggest news stories of our time and who is offering his take on current events as an NPR news analyst. We've also lined up plenty of networking opportunities and great sessions with hot topics. Join us October 17&-20 as we head to New York, a city on the move. Vibrant. Electric. And we plan to infuse that energy into this year's meeting. Be there—in the city that doesn't sleep.
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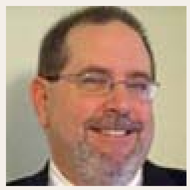

Issue Notes from the Editor

by Bill Ely

In this quarter's issue of *The Independent Consultant*, we continue to offer ideas for the actuarial entrepreneur.

- In "From the Chairperson," Larry Stern discusses past and future activities of the Entrepreneurial Actuarial Section (EAS).
- Jay Jaffe highlights lessons learned from the International Association of Consulting Actuaries' session at the IAA meeting in Cape Town, South Africa.
- Andrew Chan offers insight into the need to manage information technology in a small firm.
- Jim Mooradian and Bryan Lambert explain why customization is essential in the employee benefits area.
- We continue to publish a selection of submissions from the EAS-sponsored Papers Competition held last summer. Our featured essays "The Potential Impact of President Obama's Financial Regulatory Reform on Start-Up Companies" by Michael Baker and "ERM Executive Compensation" by Nian-Chih Yang.

Enjoy the Issue!

Bill Ely is director, Actuarial Services for a five-state region of Coventry Health Care. He may be reached at brely@cvty.com or 402.995.7088.

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From the Chairperson

It's the Summer of 2010 ...

by Larry Stern

Usually the start of the summer months brings a slowdown in activity. Children are out of school. We take vacations (what's that!?!). It's generally just a period when business takes a breath from the activity at the beginning of the year, and before we all realize come September, the year is almost over. I don't know about your business, but mine is still going full force. With the economic crisis recovery, there is new capital available to deploy to those in need. It's a scramble to get to clients on a first-come, first-served basis, because come September the capacity will likely be depleted.

But I would like to take a few minutes to remind us what has been happening with the Entrepreneurial Actuaries Section (EAS) in the past month and what's coming up. All activities are planned with the section membership in mind. If there has been a theme to our goal for the year, it is communicating with you about ways to network effectively to grow your business. Here are a few examples:

1. Since my last column, we successfully conducted a webinar in early May entitled, "Professionalism for Actuaries in Entrepreneurial and Non-Traditional Roles."This was highly attended; approximately 120 open lines (where several individuals could have been together at each location). The underlying purpose of this webinar was to provide an opportunity to receive "professionalism" continuing education credit. (I have discovered other SOA sections are following our lead to do the same.) More importantly, the main themes presented provided the opportunity for attendees to discuss potential conflicts with the professional code of conduct in our daily routines and engagements, which for most of us falls outside the realm of

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traditional actuarial activity. For those of you who were unable to participate, this webinar is still available on the SOA website.

The webinar was scheduled for 90 minutes. There was limited time at the end of presentations for a Q & A session. We have therefore asked the presenters to post discussions on the EAS LinkedIn group. You will also see posted discussion topics from several of the EAS Council members, which brings me to another example of ways for you to network.

2. Many SOA sections have created groups on LinkedIn. We are among them. When you really think about the purpose for this kind of social networking, it makes perfect sense for the EAS to sponsor such a group. Our purpose is to provide an opportunity to communicate with you and vice versa. It also provides you an opportunity to express opinions on issues of importance to you and your business.

   I know this network has existed for a few years. As an "old dog," I have been reluctant to learn new tricks. I had been receiving invites from former/current colleagues and acquaintances, but never really understood what it was all about. My adult children have been "facebooking" and "tweeting" for a long time. I have to admit I never really got it. It took me until earlier this year to realize how useful it can be when I needed to do some research for a client. I posted a discussion about the topic and almost instantly received responses. It turned into a financial gain for both my client and me. And, it resulted in my gaining new contacts I would not have made otherwise.

   The EAS LinkedIn group has the highest level of membership participation compared with the other sections with LinkedIn groups. Here is the breakdown as of this writing:

   - EAS, 25.6 percent
   - LTC, 22.4 percent
   - Technology, 9.2 percent
   - Reinsurance, 8.0 percent
   - Financial Reporting, 7.5 percent
   - Marketing & Distribution, 6.5 percent
   - Investment, 5.6 percent

   Note: All but the Technology group are subgroups of the SOA group.

Since completing my profile on LinkedIn, I have joined several groups, added a diverse group of new contacts, and put dollars in my pocket to boot! It is clear these networks will grow in popularity and function, providing benefits to all of us ... even us old dogs! I hope for those who are members that you agree; I encourage the rest of you to join and participate in discussions. You will be surprised how many other entrepreneurial actuarial groups exist (I know I am). A few of my younger actuarial colleagues have assisted in showing me the ropes with LinkedIn. I'm not saying I'm ready for the other social networks, but I can see the benefits of joining LinkedIn. If you need help, just ask; we'll connect you to one of our LinkedIn experts. In the words of a former television commercial, "Try it, you'll like it"! Join today, communicate today.

And, just because it's summer, don't expect the EAS Council to take time off! Already in progress are plans for:

- Two more webinars scheduled later this year on project management.
- A speed networking event scheduled for early August in New York. EAS is cosponsoring this event with the Actuary of the Future Section and the Actuarial Society of New York. If successful, we plan to schedule these in other major metropolitan areas around the United States.
- Sessions for the SOA Annual Meeting in October, to include another social networking event.
- And, last but not least, the annual essay contest (already in progress). By the time you are enjoying this issue of the newsletter, the essay contest entry period will be coming to a close (submissions are due to the SOA by mid-August).

I welcome your input on these and other ideas for ways EAS can help you grow your business. Volunteer and get involved!

I was originally going to write this column about the many different hats we wear as business owners and entrepreneurs. Our jobs entail more than just "regular" actuarial endeavors. Seems Jay Jaffe beat me to this topic in his report from the IAA meeting in Cape Town, South Africa in March. This article appears later in this issue of *The Independent Consultant.* No matter where entrepreneurial actuaries are located, the functions we perform for our businesses don't seem to vary much. Be sure to read his article.

Don't forget SOA and section elections. Please vote!

Until next time, may all your experiences be profitable ones!

Larry N. Stern, FSA, MAAA, is president of Canterbury Consulting LLC. He may be reached at larry_stern@earthlink.net.

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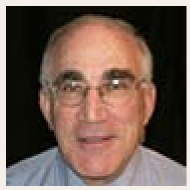

Consulting Actuaries: Professionals and Entrepreneurs

by Jay M. Jaffe

At the IAA Cape Town, South Africa meeting in March, 2010 the International Association of Consulting Actuaries (IACA) sponsored a panel entitled "Consulting Actuaries: Professionals and Entrepreneurs." The panelists included Barry Childs and Arthur Els from South Africa; Nick Dexter from the United Kingdom, and Jay Jaffe from the United States, as well as a contribution from Jacque Friedland of Canada.

Not only were the panelists from several different countries, but they represented multiple fields of consulting work (pensions, health, P&C and life), but they also represented one person, medium-sized and very large actuarial consulting practices.

This article is a compilation of their presentations and comments during the Q&A period. It is intended both as a very brief recap of the session, as well as a forum for helping consulting actuaries discuss some of the issues they face. It is probably comforting to know that consulting actuaries the world over have similar concerns and issues.

The panelists were all concerned that consulting actuaries wear two hats: professionals and entrepreneurs. In fact, it is typical that these two roles are part of every consulting actuary's employment, regardless of whether they are just providing consulting services or managing the entire firm.

The dilemma for many consulting actuaries is to find the right blend of being a business person and a professional. There is no single solution that fits every individual and every firm's needs, but it is vital for consulting actuaries to at least understand their dual roles if they are to successfully balance being both professionals and entrepreneurs.

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Following are some of the thoughts presented by the panel:

The Panel's Comments

Do the Right Thing

Consulting actuaries need to be conscious of "doing the right thing." In many instances doing the right thing is obvious, but in others it may be necessary to consult with peers or other professionals before making a decision.

One of the roles of senior consulting actuaries is to mentor others. Therefore, keeping the door open for conversation among consulting actuaries (whether within a firm or among firms) is extremely important.

Ethics and Reputation

In the long run, the only things that consulting actuaries have to sell are their ethics and reputation. Both of these attributes should be of paramount importance to any consulting actuary, whether considering the professional or entrepreneurial aspects of being a consulting actuary.

While much of the time situations can be black or white, there are going to be numerous times when this is not the case and value judgments will have to be made. Nowadays most consulting actuaries have guidance from the actuarial organizations to which we belong; but there will be occasions when it is necessary to make tough decisions even when there is no right or wrong answer. In these cases, first and foremost, a consulting actuary should do what he or she feels is correct even though there may be some "wiggle room."

Conflicts of Interest

Consulting actuaries need to consider both actual and perceived conflicts of interest. Again, there may be situations that may or may not be clear cut. Each firm will have a different method for dealing with these situations. In larger firms, the process for identifying and resolving conflicts of interest is probably more formalized than in small firms.

Community Participation

Consulting actuaries will benefit from a sense of community involvement. All of the panelists have participated in community activities. Not only is participation in your community good citizenship, but it is also good business because you can make new contacts and have an influence in nonactuarial activities.

Some consulting firms sponsor community work, whereas in other firms the choice and level of community activity or volunteering is an individual responsibility.

Learn to Play Golf

Not every consulting actuary plays golf. One of the panelists offered the suggestion that learning to play golf or, at least, finding one or more similar networking activities, is important for consulting actuaries because it is a good way to meet new people and socialize in a less-structured atmosphere.

Innovation

Much of entrepreneurship is the result of innovation. Consulting actuaries are a goldmine of ideas. The trick is to turn these ideas into practical and profitable activities.

A great deal of innovation comes from contact with others. Having contact not only with other actuaries, but with people from other fields, definitely helps to keep the creative juices flowing. Applying game theory, operations research and other behavioral techniques to problems facing actuaries may produce better solutions to problems. Similarly, learning from the masters of other business subjects can also be a way to develop innovative solutions to actuarial and related business problems.

Tangential Extension

One of the more common approaches for developing entrepreneurial areas of activity for consulting actuaries is to extend their practices into areas that are tangential to their main areas of work. For example, doing retirement plan administration could be a logical extension of a pension practice. Another example is creating software in a field where a firm has expertise.

Even though tangential expansion is probably the more likely route for certain entrepreneurial activities, consulting actuaries should not ignore more expansive opportunities. However, when venturing into completely new fields, any business opportunity should consider all the implications and risks associated with this activity, including how to acquire the relevant skills and knowledge, capital needs, time to market, etc.

Management Skills

Regardless of what size firm in which a consulting actuary practices, there will be a need for management skills. Of course, the type of project will dictate the management skills needed, but the panelists all commented on the relationship between having this talent and success as a consulting actuary.

Sometimes the need is to manage a project team. At other times having the talent to communicate and manage clients is paramount. While in other situations, being able to work with other professionals (including opposing professionals) will make a large difference in a consulting actuary's ability to deliver a quality work product.

Communication Skills

It is axiomatic but worth mentioning that communication and presentation skills always will be an important factor in a consulting actuary's success. The ability to write and speak clearly and concisely continue to be major skills which should be at the top of the list of nontechnical skills honed by consulting actuaries.

Employee Dissatisfaction

As consulting actuaries build businesses, it is inevitable that there will be situations in which employees—particularly other professional employees or partners—express dissatisfaction with their positions. This is, in part, a natural consequence of success. As a consulting actuary, you are likely to have had multiple employers and you should expect many of your staff to have the same ambitions as you had. It may be that your employees with the most potential are the ones that turn out to be the most mobile and willing to express their feelings to you.

In a few cases, employee dissatisfaction may even deteriorate beyond cordial relationships. If a consulting practice is operational for an extended period of time, it is likely that sooner or later it will encounter this type of issue. While it is happening it will be an unpleasant situation, but be prepared for these events to occur and learn to deal with them as you would with any other business matter. Just remember that these problems will eventually be resolved and your business will return to normal.

And, Finally ...

Consulting actuaries are both professionals and entrepreneurs. These dual roles can be and are assumed by each of us who elects to venture into the world of consulting. In some cases we're self employed and work by ourselves, whereas other consulting actuaries are parts of very large firms. No matter our place of employment, we share the problems, opportunities and satisfactions which result from the variety of our work and the satisfaction of founding, operating or growing businesses. In some situations, we find that our interests become wider than the actuarial profession and we become both innovators and entrepreneurs.

But regardless of our specialties and interests, we act as both professionals and entrepreneurs. We have common concerns and problems. Hopefully, this short article will stimulate other actuarial programs to include forums for consulting actuaries to meet and converse about our environment.

Jay M. Jaffe, FSA, MAAA, is president of Actuarial Enterprises, Ltd. in Chicago. He may be reached at jay@actentltd.com.

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However, information technology is a two-edged sword. It can seriously damage your business if you don't handle it properly.

IT Security

IT security awareness has been significantly improved over the last five years. However, most IT security strategies are still very primitive and only include installing anti-virus software and a firewall. Let me share a few stories with you to illustrate my point.

Too Many User Rights
A client asked me to investigate why the computers in his office were getting slower and slower. During my investigation, I noticed that the security software on some of the machines was disabled because the users wanted to speed up the machine. The question is, "How can security software protect the PC if you've turned it off"?

Data Encryption
Some employees work from a home office from time to time and need to access data with their office computer. They use laptops and USB drives. Unfortunately, most of these methods are not protected against accidental loss or computer theft. What would happen if your employees

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lost their laptops or USB drives? Some clients told me that all their laptops were password-protected and no one could access the data without a password. I proved otherwise in just a few minutes!

Remote Connection

If you allow your staff to access data in your office via remote desktop or other file sharing software, you open a door of uncertainty. Do you know what computers they are going to use? Are their home computers secured? Is your staff only using home computers? They may work on computers in a public library while they take their kids to swimming lessons. The bottom line is someone else may already have their user IDs and passwords if you allow them to remotely log in to office computers.

Security Patch

If you read the Symantec Global Internet Security Report, you would be surprised to see how many software security vulnerabilities exist. The good news is that software vendors are usually able to fix problems with a patch. Installation, however, is your responsibility. When was the last time you installed any security patch? How about your security software? How old is your virus and spyware definition file? There are new viruses and spyware programs being introduced every day. How can the security software protect your computers if you are still using a two-year old virus and spyware definition file?

Online Presence

Most marketing professionals suggest you should use social media sites to increase your visibility — LinkedIn, Facebook and Twitter among them. Certainly, social media sites can reach out to your client, improve your branding and collect market intelligence. Another positive result is you can expand your client data base. Before you relax and enjoy the rewards, please read David Airey's story. David is a brand designer and his website got hijacked. I heard similar stories about other social networks. If you don't keep your user ID and password safe, someone may take control of your account. The damage can be huge.

Servers

If you are hosting your own file server, Web server or e-mail server, the security issue can get much more complicated because all your critical business data is stored in the servers. Imagine if someone hacked into your e-mail server and sent inappropriate literature to your entire database? Smartphone

Do you know that your smartphone is actually a very powerful computer and it also contains some sensitive business information? How do you safeguard it? I did an informal survey at a networking event; over 70 percent of individuals in the group had smartphones, but less than 20 percent had them password protected or locked. I hope they never lose their phones!

A proper security strategy is not just about technology; it should include processes and people. You are naïve if you believe that only installing current security hardware and software is sufficient. I sincerely hope you change your mind after reading my article. And if I fail to convince you of the need for a properly planned and implemented security strategy, you may want to read about the recent cyber-attack on Google. Google has invested a lot of resources on IT security but all the hacker need is one single unpatched computer.

Business Continuity Planning (BCP)

I am an IT consultant, not an insurance broker, but if your office is hit by a natural disaster (e.g., fire, flood or tornadoes), would you not be happy that you were covered by insurance? However, insurance companies do not guarantee the continual operation of certain critical business processes. You have to have your own business continuity planning to cover the risks. Since most offices are heavily reliant on computers, IT should be a critical component in your business continuity planning.

What is Business Continuity Planning?
BCP is not disaster recovery planning (DRP). DRP recovers Information Technology (IT) assets after a disastrous interruption; it does not prohibit a stoppage in critical operations. BCP proactively ensures critical services to be continually delivered to clients.

BCP includes:

- Identification and prioritization of necessary resources to support continuity of critical business processes.
- Plans, implementations, control and tests to ensure the continuous delivery of critical services.

Why Do We Need Business Continuity Planning?
Every organization is at risk from potential disasters that are high impact but low probability. BCP can lower the cost of disruption and enhances an organization's image with your clients by demonstrating a proactive attitude. During the course of conducting BCP, we normally find additional benefits including a better understanding of business operations, improvement in overall organizational efficiency and identifying the key personnel, business partners and financial resources to critical services and deliverables.

How to Create a Business Continuity Planning
Every BCP is unique, but generally development involves six steps:

- Get management buy-in. You would be surprised how difficult this can be. Management understands the impact can be high, but most of them argue the probability is extremely low. Good luck to them!

- Build a BCP Committee which is comprised of the sponsor, BCP coordinator, and key personnel from IT, operations, security, and finance.
- Identify risks, critical services and their dependencies; prioritize them; and identify internal and external impacts of disruptions.
- After the analysis, it is time to prepare detailed procedures and arrangements to ensure continuity. The pros and cons of each possible option for the plan should be considered, keeping cost, flexibility, minimum level of critical services and the probability of risks in mind. For each critical service, choose the most realistic and effective options when creating the overall plan.
- A lot of companies stop after planning. BCP is not just about planning; you have to implement it, train your staff what to do in the event of a disaster, and have frequent trainingsessions to achieve and maintain high levels of competence and readiness. How often do you have fire drills in your office?
- BCP is a living process and it will evolve with your business and its external environments; for example, a lot of companies in Toronto downtown are reviewing their BCP to prepare for the G20 meeting. Continuous appraisal of the BCP is essential to maintaining its effectiveness.

BCP is not free! However if critical services cannot be delivered, then consequences can be severe and the potential damage can be huge. We are all at risk and face potential disaster. A Business Continuity Plan is an insurance to make sure your business can continuously deliver critical services despite disruption.

IT Management

Management 101 – you either manage it or it would manage you. A lot of small business owners do not have any IT management so they let their IT take control; here are a few example of what the problems could be:

- *Desktop environment is not standardized*. I have noticed a lot of small business offices have machines from Acer, Asus, Dell, HP; and have a full spectrum of Microsoft Office, e.g. 2000, XP, 2003, 2007 and soon 2010. They purchased PCs from local computer store and the decision is normally driven by the price. It is just chaos and costly to support such IT infrastructure! By standardizing desktop hardware and software, organizations can ultimately save money and advance toward a more flexible, agile and optimized infrastructure.

- *They don't manage the users*. Their users can install anything they want, configure whatever they feel fit (including disabling antivirus software), or even download illegal movies/ music. I did a software inventory audit for one of my clients and I found over 500 software titles installed on three different machines that I randomly selected. You may also want to find out how much Internet usage is used for downloading music or watching YouTube.
- *No training is provided*. Most users are still using very basic functions; e.g., they have all their e-mail in their inboxex because they don't know how to create new folders or use a macro to automatically filter the e-mail. Proper training can definitely increase the productivity in your office; however, it is very difficult to train your employees if they are using different versions of Excel.

Conclusion

What I described here in this article is only the tip of iceberg! If you ask an IT consultant to do an audit on your IT infrastructure, processes and usage, you may find out how lucky you are that you don't have any major issues. IT is a very powerful tool and you may be enjoying the benefits that it offers but if you don't manage it carefully and professionally, then it can bite you badly soon or later. Use IT wisely!

Andrew Chan, ASA, is an IT solutions consultant for ALG, Inc. He may be reached at chan_a@algconsultings.com.

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by Jim Mooradian and Bryan Lambert


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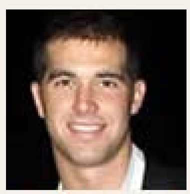
Bryan Lambert

One size does not fit all when it comes to some insurance solutions. Whether you are planning for your own insurance needs or a client is seeking your advice about insurance plans, it may be useful for you to recognize that employers and employees often misunderstand the types of coverage they own, why this or that particular insurance solution is right (or wrong) for them, and whether a particular insurance "solution" has real value for them and/or their firm. You and your clients should know that *customizing* insurance solutions—focusing on the needs of specific groups within employee populations—is the pragmatic way to go, since needs and solutions are rarely the same for everyone.

When assessing employee benefits, for example, an effective plan design typically starts with employer-paid group insurance at some level. Because these plans are subject to ERISA and nondiscrimination rules, these plan designs are more limiting from a customization perspective. Such plans are meant to give coverage across an entire employee population, with one plan design formula giving all employees some coverage. This is typically the baseline for employee benefit plans and is otherwise known as part of a core *benefit* offering.

Some employers look to supplement their core benefit offerings with voluntary programs, which can include many different types of products, from auto and home insurance, to disability, dental, prepaid legal and even pet insurance. Because voluntary benefits programs are employee-paid—typically with after-tax payroll deductions—there are usually accompanied with enrollment and communication strategies. There is

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also some scope for customization, depending on the enrollment communication strategy. These voluntary programs are becoming increasingly more popular in the marketplace because they give employers the ability to offer more products to their employees on a competitive and streamlined basis, typically at no cost to the employer. Because these programs are supplemental, they are not subject to the nondiscrimination rules that apply to the core group employee benefits.

The fact that voluntary benefits programs are not subject to nondiscrimination rules makes them easier to customize. That said, most enrollment firms still don't provide much customization with voluntary benefits due to the costs associated with the additional employee communication and education that must happen with customized programs. However, depending on your employee population and their needs, you can provide effective and meaningful customization by offering a combination of core and voluntary benefits.

As an example of a situation where one solution does not fit an entire employee population, let's use a college offering a supplemental disability program. Colleges have a wide variety of employees from a job and income perspective. The higher earners at a college are faculty members and some administrative employees. A disability solution for this segment of the college employee population might be more income replacement, above and beyond the standard 60 percent ratio used in group employee benefits. Many times, a supplemental program will allow an income replacement ratio of up to 75 percent of an employee's salary.

However, colleges also have many lower-paid employees who work in such departments as landscaping, building maintenance and food services. More income replacement for this employee population might not be relevant, depending on the underlying plan design of the college's group long-term and short-term disability programs. Instead, their customized solution might look more like a simple and affordable product, such as accident or critical illness insurance benefit that has a premium of approximately $3 to $4 per week.

As an example from the for-profit sphere, we put together a customized plan for a very large fitness company that operates multiple sites in multiple states. The largest proportion of the employee population is on the lower end of the pay scale and works in the fitness clubs. A smaller number of the employees work in the corporate offices and make higher salaries. All employees had a minimal amount of short-term disability coverage, with a low weekly benefit. Because of this, there was a large appetite for additional disability protection. The higher-paid corporate employees were looking for long-term disability insurance, so we offered them a voluntary disability program. In addition, we offered a variety of voluntary benefits—including additional short-term disability coverage—to the entire employee population, targeting the people who worked in the fitness clubs.

With this level of customization, we had to create several different messages to communicate with and educate the different employee groups. This took a bigger enrollment commitment (e.g., labor, expenses, enrollment costs) from the brokerage firm and carrier than communicating with employees about a one-size-fits-all plan. However, the effort paid off, in the form of a 50 percent enrollment rate, which is a very good participation rate in any industry.

Targeted Offerings Increase Participation

Unfortunately, as we mentioned earlier, very few enrollment firms or carriers offer customized plan designs, even in the voluntary benefits area. The reasons have to do with the widespread perception that one size fits all makes for greater efficiencies and reduced costs related to enrollment and communication. As a plan design gets more "outside the box," the communications strategy necessarily gets more complex and has added costs in the form of additional education sessions and more brochures and other materials targeted to the different employee populations. However, as explained above, we've seen participation rates go up because the customized benefits *actually meant something* to the employees to whom they were being offered.

Ultimately, the success of any voluntary benefits program is predicated on your education strategy for your employee population. A more customized solution that is targeted to specific employee segments based on compensation, underlying plan design, etc., will be more meaningful to employees in each particular group. Because the voluntary offering is more targeted to their needs, the overall success of, and participation in, the program will go up. This creates a win for the employer, the employees (due to increased education about and understanding of their benefits), and ultimately, the carrier or enrollment firm executing the program. We think this is the only truly effective way to offer voluntary programs that are meaningful for all parties.

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The Potential Impact of President Obama's Financial Regulatory Reform on Start-Up Companies

by Michael Baker

Editor's note: *In 2009 the Entrepreneurial Actuaries Section sponsored an essay contest and this was one of those entries. It was written in 2009. In July 2010, Congress approved the Financial Reform Bill.*

The Securities and Exchange Commission disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. This paper expresses the author's views, and does not necessarily reflect those of the Commission, the Commissioners or other members of the staff.

Executive Summary

President Obama released his plans for financial regulatory reform on June 17, 2009.[1] While the proposals are not entirely surprising given the state of the economy, they do reflect a potential fundamental shift in the regulation in our capital markets. Of particular interest for a start-up company is the proposal to extend the existing Investment Advisers Act registration requirement[2] to advisers of hedge funds, and, by extension, venture capital funds.[3] I believe that the proposed requirement has the potential to significantly increase the financial burden on an early-stage firm through increased scrutiny and record-keeping. This paper outlines the extent of the issues facing a start-up company due to the Administration's proposals, and offers solutions to the problems facing these entrepreneurs.

Business Problem

Currently, section 206 of the Investment Advisers Act of 1940 ("Advisers Act") is applicable to hedge fund managers. This section generally

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prohibits investment adviser fraud.[4] If the Administration's proposals are enacted, other substantive provisions of the Advisers Act may become applicable to hedge fund managers and managers of venture capital funds thereby changing the landscape for seed capital for a start-up business. These provisions could include requiring registered advisers to keep certain records and, more importantly, subjecting the managers to examinations by the Securities and Exchange Commission staff.[5]

The entrepreneur has a strong interest in this proposed legislation. The potential registration, bookkeeping and examination requirements could increase the administrative burden on managers of venture capital funds, and, consequently, could create an additional compliance burden on the start-up company. Further, the managers of the venture capital may be subject to additional requirements which would ensure minimum investment quality and could subject start-up companies to additional scrutiny to meet this objective, though this possibility has not been included in the Administration's proposal. Although no one can be certain regarding the extent of the new regulations on the hedge fund and venture capital industry at this time, I believe that it seems relatively certain that change will come to the financial industry.

The problem for a start-up business is two-fold: 1) the strain on cash-flow for whatever the eventual additional requirements happen to be; and 2) the uncertain form of this additional strain. Given its financial capital constraints, these two issues create enterprise risk for a start-up firm.

Business Impact

Start-up companies seeking additional rounds of financing subsequent to angel investors' or the founder's seed money may be subject to additional scrutiny by potential investors. Venture capital managers may request assurances from the business and may require audited financial statements from even nascent firms. The cost of an audited financial statement varies, but it is not insignificant. Start-ups typically hire outside auditors who scrutinize the financials of the company to ensure that the accounting for the firm is sufficient.

To make matters worse, many entrepreneurs with a great business idea are not versed in financial and accounting standards. The individual or small staff working at the start-up may not have the expertise to keep complicated financial records. The start-up company would not only be required to factor the outside auditor cost into the company's budget, but would also need to spend its valuable time ensuring that the financials for the audit are up to par.

Unregistered investment advisers may also lose interest in providing financing to entrepreneurs. Additional burdens on advisers mean that the relative attractiveness of providing start-up money may decrease, as the formerly unregulated niche becomes regulated. The registration requirement may cause the adviser to divert his funds elsewhere.

If the above needs can be met, however, entrepreneurs now faced with completing audited financial statements will have some opportunities available to them that may have been precluded in an unregulated industry. Often, start-up companies desire to eventually become public companies. While the Securities Act and the Securities Exchange Act impose many requirements on public companies, a company required to keep audited financial statements may find it easier to meet the financial information reporting requirements in quarterly 10-Qs and annual 10-Ks. Thus, the mandatory audited financial statements could actually make it easier for the start-up company to transition into a public company.

Potential Solutions

Securing Alternate Financing

I believe that under the proposal, venture capital funds may be compelled to saddle start-up companies with additional burdens. Depending on the size and the cash-flow of the firm, these burdens could constrain cash-flow and jeopardize the existence of the firm. A start-up company can avoid this problem by simply employing other types of financing arrangements. Angel investors may become more important in this environment, because they could avoid the registration requirements of the Advisers Act, provided that the angel investor's structure does not fall within the scope of the new laws. Albeit a much more direct type of financing, the angel investor not required to register would be able to continue operating in much the same way that he did prior to any hedge fund adviser registration requirement that may be enacted.

A start-up company could also benefit from employing an acquisition as an exit strategy. As previously mentioned, many companies desire to become public, and use venture capital money as a bridge to take a start-up company from its inception to public company status. An acquisition strategy would mean abandoning hopes of public company status, but would relieve the potentially daunting burden that may be imposed by venture capital funds.

Overall, a company employing this strategy needs to ensure that it has proper connections to angel investors and managers of companies that might be interested in eventually acquiring the start-up company.

Planning for Audited Financials

I believe that if the legislation is enacted, a start-up company planning on securing venture capital financing could be required to complete audited financial statements. Venture capital firms may require this, and the start-up company should factor the audited financial statement cost into early-rounds of budgets and financing. The firm would be prudent to assume that the financials are a condition of subsequent venture capital financing.

Start-up firms should ensure that financial information required for the statements is maintained in an orderly and accessible way. A start-up business seeking venture capital financing may want to consider employing an experienced accountant to maintain these records, especially if the founders do not have sufficient experience to execute this role effectively.

Hiring a Knowledgeable CCO

To navigate the complicated world of the federal securities laws, a start-up company may need to consider hiring a knowledgeable Chief Compliance Officer ("CCO") early in its lifecycle. The CCO would ensure conformity with applicable securities laws, and would hopefully be a great resource for other legal issues that arise in the beginning stages of a firm.

Conclusion

With the Administration's proposals, I believe that the financing landscape for start-up companies will be changing. The extent of this change remains uncertain. Entrepreneurs and start-up companies must be mindful of any forthcoming changes in laws governing hedge funds, as well as any other laws that have the potential to impact their source of financing. Entrepreneurs should keep abreast of the changing environment to give themselves and their companies the best opportunity for success.

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[1] Financial Regulatory Reform, a New Foundation: Rebuilding Financial Supervision and Regulation, Department of the Treasury, June 17, 2009.

[2] 15 U.S.C. 80b-3 (1940).

[3] "All advisers to hedge funds (and other private pools of capital, including private equity funds and venture capital funds) whose assets under management exceed some modest threshold should be required to register with the SEC under the Investment Advisers Act. The advisers should be required to report information on the funds they manage that is sufficient to assess whether any fund poses a threat to financial stability." Financial Regulatory Reform, a New Foundation: Rebuilding Financial Supervision and Regulation, Department of the Treasury, 13 (June 17, 2009).

[4] 15 U.S.C. 80b-6 (1940).

[5] "We further propose that all investment funds advised by an SEC-registered investment adviser should be subject to recordkeeping requirements; requirements with respect to disclosures to investors, creditors, and counterparties; and regulatory reporting requirements. The SEC should conduct regular, periodic examinations of such funds to monitor compliance with these requirements." Financial Regulatory Reform, a New Foundation: Rebuilding Financial Supervision and Regulation, Department of the Treasury, 37 (June 17, 2009).

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ERM Executive Compensation

by Nian-Chih Yang

Executive Summary

Enterprise Risk Management (ERM) enhances a company's long-term stock growth. Executives' buy-in is essential for the success of ERM. The proposed Stock Performance Protection Plan (SPPP), with the inducement of stock performance floor protection, encourages the executives to fully participate in ERM. The insurance companies have a long history of partnership with their clients to manage the various risks their clients face. The SPPP can be the vehicle for the insurance companies to help their clients to control risks and attain long-term growth.

Problems

The disconnect of executives' compensation and employers' stock performance is considered a cause of the current financial crisis. The short-term view promoted by some compensation formulas hurts a company's long-term stock performance/growth. There are calls to only reward the executives for risk-adjusted performance and to make the executives share both sides of the stock performance. Awarding restricted stock to executives aligns a company's financial growth with the executive's personal interests, which brings about greater long-term growth (higher stock price).

The current crisis also casts ERM under an unfavorable light, with some doubting its usefulness. ERM is a mechanism that could have reduced the hardships many companies are facing. However, it can work only with the full support of the executives.

Many executives only pay lip service to ERM or other similar instruments. Executives want to see the proof of the benefit of ERM before providing their whole-hearted support, but this often turns into a

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chicken and egg situation. If they cannot see the immediate payoff of ERM, without other inducement, they would rather have free reign without consideration of ERM.

Solution

Insurance companies have great sway in molding public conducts. Insurance companies acting as partners with the entities they insured have improved safety records and lowered claims from accidents with initiatives such as regular review of company operating processes, setting up safety standards, and conducting regular safety inspections. Through benefit designs, underwriting requirements (e.g., preferred risk ratings), and claim processing standards, life insurance companies have also changed insureds' behavior (e.g., quitting smoking, exercising).

Through the SPPP's ERM effectiveness ratings (ERMer) mechanism, the insurer hopes to attain the executive's buy-in and effective execution of ERM. Aligning key executives' self interest with the employer's can increase the likelihood of reaching the employer's financial goals.

The SPPP provides a minimum floor for the performance of the restricted stocks. The protection only applies to a portion of the stocks awarded to the executive to ensure there are insurable interests involved, so the executive has as much incentive as the insurance company to see the employer's stock perform well.

The variables in the SPPP are restricted stock vesting period, strike price, employer matching percentage, employer matching dollar amount limit, floor protection designs, and ERMer table scores.

The floor protections are similar to the secondary guarantees used in equity index products. Instead of linking the protection to the performance of equity indexes, SPPP only links the protection to performance of single company stock.

The SPPP premium is paid jointly by the insured company (employer) and its executive. To encourage the executive's participation in ERM, the company matches, up to a maximum, the executive's self-selected SPPP premium contribution.

Design of the ERMer Table

Similar to a life ratings table, which is used to determine a life insurance premium, the ERMer table consists of credit and debit factors.

The unit premium for SPPP is lower for a better ERMer table score. The lower the premium, the more coverage the executive's contribution can buy. The executive has incentive to work with the insurer to perform effective ERM and achieve high ERMer score.

The ERMer table is designed to produce high scores for effective ERM practice and ensuing lower projected stock volatility s. The Black Scholes formula produces a lower option price with the lower volatility. The insurer can expect a lower claim cost of the protection than what the company would have to pay for the options from outside, because these options are derived based on the higher volatility assumption.

Similar to considerations for life underwriting table, level of details and preparation costs of the ERMer need to balance against the benefit of differentiation provided. The ratings table is not meant to be a set of static factors. All the factors need to be considered for their interrelationship.

Gross Premium Determination

The stock performance protections are basically stock put options. The insurance companies can purchase these options from the open market. There are counterparty risks involved (default risk of the issuer of options). The pure premiums (expected claim costs) for these options can be determined using the Black Scholes formula and also verified/confirmed by asking prices from the open exchanges for options. If all the other factors stay the same, lower volatility (reduced s through ERM) produces a lower option price.

Starting with the pure premiums, the gross premium is adjusted based on the company's scores of the ERMer table.

Instead of acquiring put options for the floor protections from external sources, the insurance company can choose to keep the risks (fully or partially) in-house if it has the capital to support them. The insurance company can also seek support from re-insurers. The re-insurers can participate/assist in the designing of the ERMer table among other support mechanisms and provide favorable reinsurance rates.

Benefit/ Risks/Opportunities

The SPPP generates benefits to all the participants of the contract. The employer attains long-term stock performance growth through effective ERM. The executive is rewarded for the stock growth with a floor guarantee. He/she also receives insurance company's advice/confirmation on executing ERM. The insurance company and its re-insurers can control the SPPP claim cost.

The board of directors in most companies determines the executive compensation formula. The board members on the compensation committee neither can be impartial nor have the knowledge to judge the executive's risk avoidance performance. The insurer plays the role of referee of executive's performance on executing ERM. The insurer has to do this evaluation accurately, since these ratings are used to estimate the expected claim cost.

Collapsed company stocks in employee stock ownership plans have caused much heartache in the current financial crisis. SPPP can be expanded to cover stock ownership plans for employees in general. It may breed new lives to this important retirement security instrument.

The current equity index products' viability rests on standardized design, low margins, and economy of size. The proposed SPPP provides performance protection for a single stock and may not have the premium volume to spread the fix expenses.

Since coverage involves company stocks, safeguards are needed to avoid treading on "insider trading" issues.

With sufficiently accumulated experience on SPPPs, studies can be performed to determine the correlation between effective ERM and employers' long-term growth. There have been talks of auditing company's ERM processes. The SPPP does one better with the insurer's candid evaluation of the employer's ERM effectiveness and endorsing it with a favorable premium for stock performance protection.

Staffs of insurance companies (e.g., actuaries, underwriters) are well trained to understand risks, manage risks and evaluate the execution of ERM. The hedging techniques are matured. As long as the insurers faithfully staying within their risk tolerance level, the risks they faced are limited. If the intellectual property rights for SPPP are established, competition from imitators can be limited.

Even though the SPPP is a specialty product, with the huge volume of stocks holding in both employee stock ownership plans and restricted stock plans, the potential premium for this product is substantial.

My Plan

I recently received a provisional patent for this product design. My goal is to make ERMer a well-known moniker and the ERMer score an important measurement of an executive's management capability. May one day executives will proudly list their "Super Preferred ERMer" in their resumes.

I will promote SPPP by presenting it at professional conferences and submitting articles to industry journals. Entering the EAS's contest will also gain some needed exposure.

Every month I will seek out the Marketing VP of a different insurer to implore his/her interest or advice on SPPP.

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