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**PUBLIC RESPONSIBILITY OF THE ACTUARY FOR A
SELF-FUNDED GROUP INSURANCE PLAN**

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Panelists: STEPHEN D. BRINK, C. IAN DURRELL, RYAN R. LARSON

1. What is the actuary's responsibility?
2. Any difference if an actuary is employed by an insurer or directly as a consultant?
3. Specific case studies
 - a. Self-funded Multiple Employer Trust
 - b. Plan sponsor in trouble
 - c. Plan in trouble

MR. JOHN H. FLITTIE: This session will be presented in the form of a round table discussion with, hopefully, a rather free wheeling exchange of ideas. We will devote the last half to questions and answers and participation from the floor.

First of all, what we don't plan to do. We don't plan to discuss the pros and cons of self-funded plans, except as these pros and cons may bear on the actuary's responsibilities to the public. We do not plan to discuss qualified plans of any type. Rather, we will limit our discussion to what ERISA defines as welfare plans; primarily, medical, dental, disability and death benefit plans. Finally, we felt we needed a definition of what self-funded means for the purposes of this panel, and we decided that it means "Any plan in which the risk to the plan's sponsor in a particular fiscal period is greater than it would be on a traditionally experience rated group insurance plan." This would specifically include plans that use stop loss insurance and perhaps some types of minimum premium plans. First of all, let's examine (1) who are our "publics," (2) are these publics different for self-insured/self-funded plans as opposed to insured plans, and (3) what are the concerns of the publics in each of these circumstances.

MR. STEPHEN D. BRINK: Our "publics" consist of many different publics or groups of people having their own special interests. For self-funded plans, one of our publics is the plan sponsor who promises to pay the benefits. We have a responsibility to the insurance company who may assume some of the financial risks associated with the employee benefit program. Actuaries also have a responsibility to the participants who expect these promises to be kept and, in many cases, have made personal financial decisions based on the promises made by the plan sponsor. And finally, we as actuaries have responsibilities to the regulators who look after special interests; in this case, the interests of the participants. So I would view our "publics" as consisting of four separate publics, the plan sponsor, the insurance company, the participants, and the regulators.

MR. FLITTIE: What would you say the concerns of each of these publics are on self-funded plans?

MR. BRINK: The concerns are primarily that the plan sponsor promises to pay

the benefits; that is his concern; he wants to make sure that he can pay those benefits to his employees; the insurance company wants to make sure that they can also pay those benefits. I view the basic responsibility of the actuary as providing objective information to all of these parties. Their interests are in keeping the plan financially sound and in good operating condition.

MR. FLITTIE: I noticed that you didn't say "misinformation."

MR. BRINK: There is much misinformation involved with self-funded plans. There are brokers and consultants who are selling the self-insurance concept. In many cases these people have not provided the type of information that is necessary in order for the plan sponsor to make an appropriate determination of whether he should go under a self-funded plan or not.

The insurance industry in general has tended to over-exaggerate the risks that are associated with self-funded plans. On the other hand, some of these self-insured salesmen or consultants have minimized the risk aspects of the plan or have not discussed them at all. They have also misrepresented the need to recognize claim reserves and, hence, have misrepresented the savings that are associated with self-funded plans.

I have some quotes that illustrate the misinformation that is going on. I received a brochure from one so-called consultant which stated "The average savings of self-funded clients compared with their normal annual premium has been approximately 10 to 20%. This is after claims, insurance premiums, and our fee for complete claims and administrative services."

I received another brochure from the same organization at the same time and it is somewhat contradictory. They say that "the average saving for self-insured clients compared with their normal annual gross premium has been approximately 20-30%." They said 10-20% before. And they go on to say, "This is after claims, including claim reserves, reinsurance premiums and our fee for complete claims and administrative services."

One self-insurance salesman, who advertised in Time magazine, by the way, stated in his brochure, "During the first year, the cash flow advantage is incredible. You will save between 25 and 40% annual premiums alone in the first year." By using the term "alone," he suggests that the savings will be even more in the second year.

Even some insurers fail to recognize the need for claim reserves, as indicated by a quote from a large insurer regarding an Administrative Services Only (ASO) plan. Talking about reserves they state, "None are required. The main reason for reserves is to fund outstanding liability on the part of the insurer should the policy terminate. With an ASO contract there is no insurance policy and no use of insurance company funds. There is also no liability beyond issuance of drafts."

There is much misinformation on self-funded plans, especially as to the risk aspects and the potential savings that are involved with these plans. We, as actuaries, have failed to provide our publics with the appropriate tools so that they can evaluate the risk. This lack of information is a short-coming of the insurance industry and, particularly, the actuarial profession.

MR. C. IAN DURRELL: First of all, let me say that I concur with the earlier

remarks. I would just like to make a couple of general points. Perhaps, when one looks at our "publics," it is helpful to discern whether one is looking at a specific situation or from a broader perspective as a profession. In that respect, if one is looking at a specific self-funded plan, it is very easy to find one's publics as a more defined group of interests. On the other hand, when you look at it from a broader perspective, a professional point of view, the definition of publics can be much broader as well.

At the present, at least, most self-funded plans appear to be implemented in the absence of any direct actuarial input. It appears to be the pattern, at least in Canada, that the consulting fraternity acting in these areas has an extreme lack of actuarial input in the process; i.e., the process of the consideration by the plan sponsor of the issue. It would only come indirectly through the role of the actuary from the insurance company who may be acting or requested to act for provision of stop loss or ASO.

In that regard, I would suggest that one of our "publics" should be the non-actuarial consultant who, through a lack of understanding, knowledge and information, is making the kind of statements that were noted earlier. Do we have a responsibility to address that particular public as a profession and insure that these people are better informed?

In the same scope, the regulatory authorities represent another very pronounced public that we should be addressing. Otherwise, we are going to find ourselves after-the-fact answering to, "Why hasn't the profession acted to insure that sound actuarial principles are applied to self-funded approaches?"

MR. FLITTIE: It is interesting that you suggest another public, namely, the non-actuarial consultant. How do you get his attention if he's not working in your firm?

MR. DURRELL: I submit that this is a role that the profession at large must play. It is difficult for an individual actuary to relate to the regulatory public. But, in terms of making sure that what is being done and the direction in which we are moving in this area is meeting the best interests of all the publics, we must act as a profession. We must put down some guidelines. Whether or not they are adhered to may be a difficult thing to police, but at least we are taking a stand. It will serve us well in the future.

Otherwise, disasters where the plans go essentially bankrupt are going to be inevitable, if the present practice continues. Particularly, take a look at the Long Term Disability (LTD) situation where many, many plans are being self-funded. Disabled pensioners are going to wake up some morning without a check in hand for the month.

MR. FLITTIE: Ryan Larson, before you discuss who are our publics, you might tell us how an insurance company actuary becomes involved in the self-funded group plan and the types of situations he finds himself in.

MR. RYAN R. LARSON: There are basically two situations in which an insurance actuary becomes involved in a self-funded group plan. One would be on an ASO basis. The insurance company provides certain services; primarily, claims-paying and also actuarial, underwriting and, possibly, legal services. Typically, there is no insurance risk. Actuaries' duties would

include assisting in claims cost projections, recommending funding levels to the client, and setting ASO fees.

The second area of involvement would be an insurance company writing stop loss or excess risk coverage. The insurance company bears a risk over a certain predetermined level with claims paid either by the insurance company on an ASO basis or by a third party administrator (TPA). The actuarial duties would include assisting in claims and cost projections, determining the level of the stop loss deductibles, and developing premiums for the insurance risk.

MR. FLITTIE: Under each of these insurance company arrangements, how do you view your public as a professional actuary?

MR. LARSON: Basically there are three publics. First, the employer or plan sponsor certainly is important. The plan is typically funded with employer dollars and he is the legal entity which the insurance company is involved with. He would be implicated if the plan got into financial difficulty. Second, the employees are certainly a public to be reckoned with. They are the ultimate recipients of benefits under the plan and are the most affected and most vulnerable should the plan go under. Third, the insurance company is an important public. Solvency is a basic responsibility, and a product as volatile or potentially volatile as stop-loss coverage is certainly no exception. Care must be taken to ensure the product is priced adequately and fairly.

MR. FLITTIE: You didn't mention the brokers, group representatives or self-insurance consultants that send you these cases as a "public." How do you feel about that?

MR. LARSON: They certainly should be included. It is the responsibility of the actuary, through the group representative, to the brokers or consultants, to make sure that the insurance company's ideas and intentions are presented accurately and that the risk is fairly portrayed and not exaggerated.

MR. FLITTIE: We have had quite a bit of discussion about communicating risk, and the risk elements of these plans. Perhaps we ought to define what we mean by risk and talk about how we communicate this risk to the various parties, including plan sponsors.

MR. DURRELL: Putting it in simplest terms, risk is the extent to which the actual outcome can deviate from the expected outcome. To give my comments some substance, I would like to talk in the context of an LTD plan. As actuaries, we tend to look at risk from the point of view of assessing the volatility. We look at the volatility in the actual cash payments, the stream of cash benefits flowing out in fiscal periods, as well as the volatility in the liability, the ongoing, outstanding reserve liability taken at fiscal year-ends over a given time horizon. This is the source of the risk in an LTD program.

However, I would like to point out that, if one focuses in on that kind of risk and then explains such risks in self-funded plans to a plan sponsor, and does not go beyond looking at risk defined as volatility, one could end up having a plan sponsor perhaps reach the wrong conclusions. In a program such as LTD, the cash disbursements relative to the fixed premiums are

rather nominal in the beginning of such a program. One has to, first of all, project out for a number of years. In a typical plan, our modeling processes have indicated that on a stable stationary population assumption, a stationary situation will not be achieved, from a financial point of view, on the plan until you reach about twenty to twenty-five years down the road. This would be further exacerbated if you factored in the real world; i.e., employees turning over, growth, etc.

When one looks at risk from a plan sponsor's point of view, one has to distill it down to the yardsticks that he is interested in, that are meaningful to him. One of the more important yardsticks is his contribution (cost) from year to year and how volatile that cost is going to be. Another important yardstick is the solvency of the plan and how volatile that solvency is going to be.

Let me define a few of these terms. If the plan sponsor looks at just the pay-as-you-go requirements as "cost," then cost is nothing more than the benefit projections. Therefore, one has to educate the client that pay-as-you-go is not his real cost. The only way one can do this is to apply the same principles one would apply in looking at "cost" under a pension plan. To do this, one must define a funding mechanism or strategy which will essentially transform the risks, the volatility that exists in the underlying risks, in the benefit payments and liabilities into a year-to-year contribution requirement. Then one must measure the risk or volatility on that contribution requirement. In doing so, one automatically picks up the solvency ratio. Whether or not the plan is funded, you still will be able to measure risk in such a fashion. You will be able to communicate to the plan sponsor that there are risks involved and that he has options as to the levels of volatility, i.e., deviation from the expected year-to-year contribution requirements and, alternatively, in the solvency position of the plan, he is prepared to accept. This may, in part, depend upon the amount of employee participation, if any, in the cost of the program.

Some employers may feel entirely comfortable waking up at the end of the plan year and finding that the accrued liabilities at that point in time are only covered by a factor of 50 cents on the dollar by the asset base. Other employers may find themselves totally uncomfortable. In that case, one must set up a framework to enable the employer to understand that there is a trade off between stability in solvency and stability in contributions.

MR. FLITTIE: Does the actuary have any responsibility toward communicating risk to plan participants? Should we be encouraging our clients in that direction? Should the actuary furnish a report that will be made available to plan participants? Let's use the LTD example again.

MR. DURRELL: That is a very tough question to answer in a conclusive way. Ideally, it is preferable to communicate the financial status of the plan, particularly if employee contributions are involved. However, the problem is that we are dealing with a complex area. No matter how carefully such a communication piece is structured, it may only aggravate the problem. That is the trade off; the employee may misunderstand what he is receiving.

We have the same problem in the pension sector. What is a funding ratio, for example? It depends on the funding methods one is employing. A plan could have a funding ratio of 50% but, in point of fact, the plan would be fully funded if it were wound up. Ideally, a communication piece would be

desirable, but it has to be designed very carefully.

MR. BRINK: I would like to expand on what Mr. Durrell has said. As actuaries, we pretty much agree what risk is; i.e., variation of actual experience from expected. However, our publics do not have a good idea of what risk really is. It is our responsibility to communicate that concept of risk.

A recent article in Business Insurance magazine illustrates the confusion of the public as to the definition of risk. They state, "In the insurance and risk management business few, if any, terms have standard, accepted definitions. Risk, like many other terms used in the industry in the profession, tends to mean whatever the speaker imputes to it." The article goes on to provide six different definitions of risk, but it did not select one as the best definition. It appears they just gave up.

One concern with self-funded plans is that, while risk is the variation of actual claims to expected claims, the self-funded plan may not even calculate its expected claims. With an insured plan, expected claims are measured by the premiums. If the premiums are inadequate, the insurer suffers a loss. That is very straightforward "risk." But, on a self-funded plan, if expected claims aren't calculated, then, theoretically, there is no way to measure what the risk is. If the expected claims are calculated in some manner, the method that is used to calculate expected claims is going to affect the "risk." For example, if expected claims were always set equal to the claims of the prior year, the variation of risk is going to be much higher than if expected trends were also taken into account. A simplistic projection or a non-actuarial projection of the expected cost will cause the "risk" to appear greater than is actually the case. We have found, in our risk analysis work that we have been doing over the last ten years, that the communication of "risk" and the concept of risk is extremely difficult. Ironically, communicating with the top management of insurance companies is equally difficult. Some of these people have as much trouble understanding risk and the concepts of risk as managers of self-funded plans. We found that it is difficult for these people to evaluate probability distributions.

One of the methods that we use to communicate the concept of risk is to ask the plan sponsor a couple of simple questions. How many years out of a hundred can you afford to be wrong? That gives us an idea of what the confidence level is. We ask, what is the crisis level for claims fluctuations? This enables us to find the point when they become concerned about the financial fluctuations. We ask, what is the prohibitive level of claim fluctuations? By prohibitive, we mean severe financial disturbances to the company.

Given this information, we can then assist the plan sponsor in evaluating the risk. A probability distribution is constructed recognizing their own plan of benefits and the demographic characteristics of the persons covered. We then determine whether the information that they have given us is compatible with the probability distribution. If it is not compatible, we show them why not and discuss some alternative financial arrangements. We show how the "crisis risk" can be minimized through the accumulation of contingency reserves and how the "prohibitive risk" can be transferred through the purchase of stop-loss insurance. Obviously, if the "prohibitive risk" is at a very low level, they have no business self-funding the plan. It should be on an insured arrangement.

MR. FLITTIE: You have talked about the ideal situation where there is a client that is interested, willing to be informed, and willing to take the time to become informed. That probably exists in the Fortune 1000 group, but, as one moves a little below that level, it is not the case. Yet there is a lot of interest in self-insurance at that level.

We have found one of the toughest challenges in the consulting business is the client who says, "Don't give me this distribution stuff and this crisis stuff and all those alternatives, just tell me what to do or, better than that, do it and go away." How do you handle a situation like that? It seems there is a basic lack of communication in that circumstance.

MR. BRINK: Any time there is a lack of communication, it is very difficult for the actuary to fill his role responsibly. An actuary has to do one of two things. Either press the client and make them understand that there are risks; or just simply decline to work with them, because in that situation the actuary cannot function responsibly. If problems do develop, the actuary may be held responsible.

MR. FLITTIE: Mr. Larson, we have discussed the question of the actuary's responsibility and of communication. In an insurance company there are probably some real communication problems with the various publics, too. Would you elaborate on that?

MR. LARSON: The main communication problem would be communicating through the group representative to the broker or non-actuarial consultant. We must point out the risks to the potential self-funded group. The group representative isn't too interested in pointing out all the risks; certainly, his job depends on making a sale. He is more likely and the broker is more likely to point out the benefits. We as insurance actuaries have to be conscious of this. Certainly, with respect to the sales literature that is produced and the sales presentations that are made, we must make sure that potential risks are pointed out.

MR. FLITTIE: Let's turn to the matter of the transmittal of actuarial projections. Mr. Larson, although your company probably is not involved in that, let's think generally how you would reconcile that situation with the Society's requirement that any actuarial report be directly transmitted to the client or that the actuary be available. Surely there are situations where it is translated a little loosely by the consultant.

MR. LARSON: That would be more common in the ASO arrangement where a vague (or possibly no) description of the expected cost would be presented. In stop-loss arrangements, the client would have to have some idea of the expected cost because the aggregate attachment point factors are related to him.

MR. FLITTIE: It seems that in this area of communications with the plan sponsor, there may be a problem in communicating the information to the appropriate person. One may be dealing only with the employee benefit officer or the personnel officer whose interests are benefit related, whereas the chief financial officer, or at least the financial section of the plan sponsor, should be getting involved and should be understanding the financial aspects and the risks. Have you found this to be a problem in practice, Mr. Durrell?

MR. DURRELL: In practice the financial segment in the corporate environment is much better equipped to address the question of risk. This relates to Mr. Brink's remarks about communicating risk. When one deals with "risk," the difficulty is that there is not a unique answer. In any given situation with a given employer, one has to "factor in" management's attitudes towards risk in the process.

So, apart from the actuary's ability to measure risk, there is a second step. That step is to control the risk if there is too much risk. Mr. Brink addressed this issue. One can adjust the funding mechanisms slightly, or add such things as claim fluctuation reserves, or go out and lay off part of the risk by stop-loss insurance or other arrangements.

While one can control the risk, it implies that one must have a methodology which the plan sponsor can relate to and by which one can optimize the financial arrangements within the risk constraints of that particular organization. That dictates the need to be able to go through the process that Mr. Brink mentioned. One must set up a set of multiple constraints using ruin theory and other techniques. In that process, there is no question that the financial people are the people that can relate to that. In most major corporations today, the people that you would deal with on the financial side have been exposed to these things. This is not something that is new. One should recognize that. What may be difficult for the practicing actuary is that the way the financial people have used the tools of risk may be slightly different. It is important for the actuary to have an understanding of how they have been using the same tools in their day-to-day business. This will enable one who has the difficult job of communicating risk to relate to those tools in the way that they are commonly used in the general financial community.

In that respect, it is important to recognize that many of these people have been through business schools. The kind of tools that are required to address, measure, and control risk are tools that are in common use in business. While they may not have a detailed understanding of the distributions, they know what the purpose of the tools is. The secret is to get to the financial people who are going to have much better success in communicating the problem, and providing a general understanding of the problem, and getting the risk constraints quantified so that one can do a proper job.

MR. FLITTIE: One of the more controversial areas is the Multiple Employer Trust (MET), particularly the uninsured MET or self-funded MET. Mr. Brink, have you had any experience there you would like to share with us?

MR. BRINK: We have worked with a number of self-funded METs. Actuaries have three primary difficulties in working with a MET that is self-funded. These difficulties affect the actuary's ability to function responsibly. The first one is the very definite lack of a plan sponsor. The trust is a legal entity, perhaps organized by a sales organization. Participating employers then join the trust for the purpose of obtaining insurance. Unless there is an insurance company involved to assume the financial risks of the program, there tends to be a lack of genuine interest on the part of the sales-oriented management of the self-funded MET to operate the plan on a solid actuarial basis.

The second area of difficulty for actuaries is that there is a lack of

adequate regulation of these METs. The regulatory status is unclear at the present time. It appears that there is a trend towards regulation at the state insurance department level rather than through the Department of Labor, although there really have not been any definitive rulings in this regard. The lack of regulation is especially critical when coupled with the lack of a financially responsible plan sponsor. While the presence or absence of regulation does not have a direct impact on the role of the actuary, the lack of any regulation puts a much heavier burden on the actuary. He may have to be the "conscience" for one of these self-funded METs.

The third difficulty is the area of unsatisfactory operating experience. Despite assurances by trust management that the trust is going to be operated, or is operated, on a sound actuarial basis, this is not always the case. In some cases, an initial actuarial review may indicate severe deficiencies. Following the disclosure of these deficiencies the plan management sometimes is unwilling to take any corrective action.

MR. FLITTIE: Mr. Brink, you have raised an interesting question about the actuary's responsibility to plan participants. Perhaps before one recommends a self-funded plan, one must take a hard look at the financial stability and soundness of the employer. Is this a practical solution?

MR. BRINK: It is difficult to review the financial soundness of the employer. Generally, the sponsor is a corporation. As actuaries, we are not able to adequately assess the financial condition of a corporation. It is more an accounting matter than an actuarial matter. Nevertheless, this is an area that we have to be concerned about. We should also be looking at the financial solvency of some insurance companies, for example, where the plan sponsor obtains stop-loss coverage or another insurance contract. In some cases, these insurance companies may not have the capacity to provide that type of coverage. Similarly with HMOs, one must look at the financial solvency of the HMOs. This has been a very difficult area over the last several years. Several HMOs have gone bankrupt.

MR. FLITTIE: Are you suggesting that, if the consultant is pressed for a recommendation as to whether or not a plan should go self-funded, he may have to qualify that recommendation on the basis that the company is a sound, ongoing entity?

MR. BRINK: We have a responsibility to point out that the success of the self-funded plan is, of course, tied to the financial soundness of the employer. Our responsibility is more of raising the issue rather than putting any qualifiers on our recommendations.

MR. FLITTIE: Many of these plans involve third party administrators, particularly in the MET area. Mr. Larson, is there a responsibility of the actuary of the insurance company in regard to entering into arrangements with these third parties?

MR. LARSON: Yes, there is a responsibility. There are third party administrators, it seems, falling out of trees these days. Everybody is hanging up a shingle and calling themselves a TPA. It is the responsibility of the actuary to all of his publics (the employer, the employees, and the insurance company) to make sure that the TPA in question is ethical and qualified. There are horror stories of fraud and misuse of funds with plans having consequent financial difficulty. So there is a need for audit standards and

approval standards by insurance companies of TPAs.

MR. FLITTIE: Let us suppose one has a self-funded plan and one has gone through all of the initial process, adequately explaining, communicating, etc. A few years down the road it becomes fairly obvious that the advantages of self-funding are not as great as they once were, or perhaps there have been new developments in the insurance market (for example, the price of stop-loss has come down from twenty times the net to two times the net). What is the actuary's responsibility -- to go back in there and raise the questions, "Does this arrangement still make sense? Is there any trimming around the edges we should do?"

MR. BRINK: The characteristics or the risk aspects of a self-funded plan do change over time. An actuary may initially be asked to review various financial arrangements and present his analysis of the risk. The risk isn't static; it changes in time. For example, a good number of employees from self-funded plans are now going into HMOs, where HMOs are available. While one may start out with a certain size group and present one's analysis for the risks, suddenly 10%, 20% or more of that group may join an HMO. Then one has a much different population base, which changes the nature of the risk. In such a situation, there is a definite responsibility for the actuary to come back in and point out what aspects are changing.

At the outset, the actuaries should specifically state that the analysis is of the risk at the present time and point out that it could be changed by various factors. The actuary should list those factors. That list provides a plan sponsor with a trigger so that, when those things happen, he may ask for another review of the risk.

MR. FLITTIE: That is only going to be feasible if one is engaged on an ongoing basis. Perhaps in the cases where that ongoing review should be done and a recommendation should be made to go back to being insured, the actuary is no longer involved.

MR. BRINK: Maybe the original actuary is no longer involved, but perhaps someone else is. The purpose in giving plan sponsors an analysis of the factors that could change the risk ahead of time, is so they have some idea of the variables and could take some form of action, even if the original actuary is not around.

MR. DURRELL: In my personal experience, one does tend to have an ongoing involvement. Things do change. Plans get amended, which can substantially change the risk. Our clients have always opted to put into place some form of reinsurance, whether it be stop-loss or some other type, to control the risk. In point of fact, the strategy has been to "walk before you run." The reason behind this is that often one goes into a case and does not obtain a good data base for that particular employee group. As a result, we discuss the pros and cons of self-funding and of the degree of conservatism which one wants to employ. Employers, while they are certainly prepared to assume risk, are somewhat more conservative than I would have anticipated. They are conservative not in the decision to go self-funded, but in their decision as to the amount of control they want to have over the risk through implementing side reinsurance arrangements. In practice, what has happened is that as experience has unfolded and we have gotten a better handle on the nature of the employer's particular risk, the controls tend to be relaxed. Thus, we have gone in with a fairly conservative strategy and then, as the experience

unfolded, it tended to become more liberal.

MR. FLITTIE: Mr. Larson, any comment from the insurance company standpoint?

MR. LARSON: The insurance industry is guilty of conservative entrance into the field, also. As time progresses, it leans toward a more liberal approach rather than more conservative.

MR. FLITTIE: Let us head into one of the real "gut" issues that an actuary has to face in practice, whether he works for a consulting firm or an insurance company. Suppose one has a self-funded situation and the actuary does not like the way things are going; i.e., the client consistently refuses his recommendations, tends toward what he feels is unsound funding; the plan is headed for trouble. What is the actuary's responsibility? Does he "pick up his bat and ball and go home," or does he say, "Our publics are probably better served if I stay involved, because at least then they know what an actuary will be involved?"

MR. BRINK: I think "going home" is the last resort. When one gets into a difficult situation where there is some financial difficulty, the actuary has the responsibility to inform the plan sponsor of the situation immediately -- that goes without saying. Secondly, one has to raise some very important policy questions such as, how can the sponsor guarantee that the present participant obligations are going to be met? Can the plan continue to operate in its current financial condition? Will it be allowed to operate? Assuming that the plan is going to continue its operations, one must ask what actions can be taken to best remedy the situation?

Assuming that the plan is going to continue, the actuary may get involved in defining a possible recovery plan that could be implemented. Some of the elements of a recovery plan would include: 1) inform the plan participants of the financial condition of the plan; 2) review the current conditions with all possible regulatory bodies. Even though the regulatory situation is not clear, review the situation with the possible regulators; 3) develop a combination of benefit reductions or contribution increases, and perhaps expense reductions, that are needed to maintain the plan on an actuarially sound basis; and 4) seek an insurance company or another plan sponsor to bail out the program.

Often the actuary faces a real dilemma when he is working a deficient plan. The plan sponsor may offer a recovery plan which involves continuing the program on a short term basis even though new participants or the existing participants will have their benefits jeopardized. Should the actuary permit this type of situation to develop? That is an open question.

When one has a situation like this, one does not want to "go home." When one does "go home," what are his responsibilities then? Does one go to the regulators? Does one send a letter to all the plan participants unilaterally? That is a very difficult question; when does one's responsibility end?

MR. FLITTIE: The practicalities of communicating with plan participants and communicating with the regulators (if you can figure out who those are) are immense. The summary annual reports that are put out on ERISA-subject plans are remarkably uninformative as to what the real financial situation of an LTD plan or even a self-insured hospital/medical plan is.

MR. DURRELL: One of the recurring issues that comes up in an LTD plan (which is the bulk of our experience, since we don't have major medical coverage in Canada to the extent you have it down here) is what does one do when he gets an assignment from a plan sponsor to assess and address the merits of self-insurance. After one lays it all out for him, he comes back and says, "This is a great idea, but I can see there's no reason why I should set up a separate trust and maintain segregated assets. Why don't I just go on a pay-as-you-go basis?" This is certainly his right to do under statute, at least on the Canadian scene. In that type of situation, in Canada at least, there really isn't a regulatory authority that one could report to. The people primarily concerned are the beneficiaries and the plan members.

There is, however, another vested group or interest, the financial shareholders of the company. If there is a public company, one must address himself to what the auditors are going to say about this. Does one have a responsibility to disclose to that professional body the fact that the tack the employer has taken is, in fact, not recognizing the liabilities that he has created?

Our approach on this, at least as has been stated in our operations in Montreal, has been that if an employer elects to go that route, we recognize that as his prerogative and we withdraw. We do not feel it is within our mandate or responsibility to report our feelings about the issue to any third party individuals, be they the auditors or whomever.

MR. FLITTIE: What communications must be made to any successor actuary that may be hired to replace you?

MR. DURRELL: Generally speaking, in those kinds of circumstances, no successor actuary gets appointed.

MR. BRINK: If I may interject here, I disagree with Mr. Durrell in that I do not think it is always necessary for a plan sponsor to separately fund for his liabilities. I believe that the plan sponsor should have an accurate determination of the liability and should recognize that liability on his balance sheet. However, here in the United States, few employers or accountants currently recognize the need to set up these liabilities on the corporate balance sheet. Therefore, they are not recognizing this liability.

MR. DURRELL: I agree with you there, but it is not a question of whether or not you maintain a segregated fund in hard core assets or a trust fund. The question is about recognizing the liability. One can book it on the balance sheet. It should be expensed through the P&L. Otherwise, the P&L statements could be distorted, depending on the magnitude of the expense item.

This is where the non-actuarial group consultant comes in. Report after report that comes across my desk defines "savings" as a lack of holding a reserve. They say, "If you don't hold reserves, then you have saved all these dollars." That is not a savings. It is just a question of timing or recognition of cost. But for the non-financial people in an organization, it is difficult for them to discern the differences between those two terms.

MR. FLITTIE: We have discussed the situation of the plan getting in trouble. What about the situation where the plan seems to be fairly healthy, although it is a long term commitment (like post-retirement life insurance or LTD), but the employer may be in some difficulty? Can the actuary just assume that

the plan participants understand the implications of this? Let us take the worst situation of an employee-pay-all LTD plan where, perhaps, there (as in any case of LTD disabled life reserves) is some question about the long term adequacy.

MR. BRINK: This is an extremely difficult situation. The responsibility of the actuary, when he sees a plan sponsor getting into financial difficulties, is to make sure that the liabilities are recognized, to bring it up to the forefront, and to set the stage for the worst scenario. Perhaps the employer or plan sponsor could take some actions to fund for his liabilities, which is unlikely because he probably needs the cash, or find some other way to bail out the program.

MR. DURRELL: One might add that the question of the advisability of self-funding an employee-pay-all program from the beginning, such as an LTD, is a very hard question.

MR. FLITTIE: We have spent a fair amount of time this morning talking about what the role of the actuary is, or perhaps what it should be, or perhaps what we would like it to be. There is a broad question here of the responsibility of the actuarial profession in total, as opposed to the individual practitioners. First of all, unlike pension plans, we do not have legislated funding standards in this area. Secondly, unlike pension plans, we do not have opinions as to professional conduct, such as opinion S-4, "Actuarial Principles and Practices in Connection with Pension Plans." Nor do we have actuarial principles and practices as we do in connection with life insurance statements.

It would appear that there are no real professional standards in this area except those formed by individual actuaries or individual firms. Perhaps this creates a vacuum and, at least in the U.S., the federal government usually moves into such a vacuum. When the government does intervene, we, as a profession, do not like what they do. Would each of the panel comment on this before we turn it open to the floor?

MR. DURRELL: It is a very serious concern. It is a greater concern for programs such as LTD where the accountability for the costs extends beyond the current fiscal period. On the Canadian scene, we are starting to see some interest shown by the regulatory authorities even though we do not have the proliferation of self-funded LTD plans, for example, as exists here in the U.S. It is a very growing thing. It is certainly desirable for the profession to take a public stand; otherwise, after the fact, one will ultimately be put in a defensive position. Having said that, I doubt very much that the profession would ever do it.

MR. BRINK: In my opinion, the actuarial standards are fairly clear; the same standards that apply to a life insurance company should also apply to a self-funded plan. There are the same liabilities. The actuary has the same responsibility to project costs and estimate liabilities. Those standards are clear. The problem is communicating them. The Society or we, as members of the Society, have not properly communicated what the actuarial function is. This is particularly true in the area of self-funded plans. It is more of a communication problem than anything else.

MR. LARSON: I agree with Mr. Brink in that these standards are fairly clear, but I also agree with Mr. Durrell in that I am somewhat pessimistic that they

are being followed. I expect that sometime in the next decade we are going to see a major corporation go under and, as a result, its benefit plans go under as well. I also expect to see a PBGC-type of arrangement set up by the government.

MR. FLITTIE: We would now be happy to address any questions, comments, or discussion from the floor.

MR. SAMUEL E. SHAW, II: Have the members of the panel found unions to be interested in the degree of self-funding for a formerly insured welfare plan? Is the plan sponsor's decision to go towards self-funding usually negotiable or is it something that can be done unilaterally? In the experience of the panel, where a union negotiated plan has moved toward self-funding, have they had to liberalize benefits at the same time?

MR. BRINK: It has been our experience that, in a union situation, one bargains for the right to have a self-funded plan. Sometimes there is a named carrier in the collective bargaining agreement. The collective bargaining agreement can be a barrier towards any form of self-funding. We have found, in some situations, unions have been opposed to self-funded plans because they feel that there is a loss of the insurance company guarantees. But, by and large, that really has not been the case. In most situations, the union is not interested in how the plan is funded; they are interested in the benefits that are being provided. We have not seen any situations where an employer would have to trade higher benefits for a self-funded plan.

MR. LARSON: We have written stop-loss coverage on several union plans and, to my knowledge, all decisions have been unilateral; no benefit liberalization has resulted.

MR. DURRELL: My experience has been that unions have been a deterrent in the decision to go self-funded. For example, in one case, even though there was a third party administrator (an insurance company), management felt that they were losing some degree of objectivity by the self-funded approach, and that they would be better off with an insured program because of the impact their loss of objectivity might have on employee-employer relationships as they related to union negotiations. Another concern is whether there is a loss of objectivity as to the cost of the program. This loss of objectivity enables the union to say, "You are controlling the funding mode and the contributions, so how do we know that the costs have gone up 10% or 15%?" There have been decisions made, for that reason and that reason alone, not to go to the self-funded mode in a union-type plan.

MR. BRINK: When there is a Taft-Hartley situation, the actuary has additional responsibilities to examine other risks. For instance, extended benefits or continuation of benefits may require that there be a much larger contingency reserve than would normally be the case. Of course, under this situation liabilities are going to have to be fully funded. Benefits cannot be provided on a cash basis.

One situation in which we were involved illustrates the actuary's responsibility in this situation. We were involved with a large group of employees of a single employer that had their medical, disability, and life insurance benefits provided through a joint trust agreement. It was actually organized as a fraternal insurance company; the employer and employees both made contributions towards the cost of the coverage. The plan got into financial

trouble for a number of different reasons. By the time we became involved, the plan had a serious deficiency but the cash flow was still positive. Employee contributions had been raised, but employer contributions were fixed. The unique aspect of this situation was that, as a fraternal, the plan had the right to assess its members in order to maintain solvency. After exploring many different alternatives and looking at different recovery plans, the only solution that could continue the current plan of benefits and which was in the best interest of the plan participants was to provide an assessment, even though the maximum assessment would have been just under one thousand dollars per employee!

The story has a happy ending because, after the employees threatened to go out on strike, the employer contributed a large lump sum to fully fund the liabilities. From that time forward, the medical coverage was provided through a group insurance contract.

MR. ALEXANDER D. BRUNINI: Along those lines, I have a question about the responsibility of the actuary with respect to funding--strictly defined as setting aside assets which are related to some sort of liability. I was a little confused about what Mr. Brink said at scattered points in the discussion. I thought that, at the very end, you said that, in essence, the soundness of the plan should not be affected by whether it is self-funded or whether it is insured. Yet, earlier, I thought both you and Ian had nodded your heads that you insist that they recognize the outstanding liabilities as a matter of accounting. But it seems that it is not the norm for any sort of segregated assets to be set up to offset those liabilities. Is that correct?

MR. BRINK: Yes. I perceive the actuary's basic responsibility to be to provide independent, objective information so that all parties involved can make sure that those benefit promises can be met. They have to recognize these liabilities on their financial statements, assuming there are assets on the other side to back up those liabilities.

MR. BRUNINI: Do you not see some loss of soundness, in the sense that a segregated diversified investment, whether it be through an insurance company or through a separate fund, is a little bit different than simply holding retained earnings in the corporation?

MR. BRINK: No question that it is different. Segregated assets are probably more sound than the retained earnings of the corporation. The problem that we have as actuaries is determining what is actuarially sound. Is the Social Security program actuarially sound? Are pension plans that have accrued liabilities which are not fully funded but that have a rational funding method to accumulate assets actuarially sound? It is a tough question to decide whether one of these should be used exclusively; i.e., whether a plan should always have funded assets.

MR. BRUNINI: This is one of those situations in our business where the responsibility falls directly on the actuary as opposed to insurance companies which are regulated and qualified plans which have minimum funding standards. And, as Mr. Durrell pointed out, there are no guidelines, there is only the actuary talking to his client.

MR. DURRELL: I do not see that an actuary or the actuarial profession has the mandate to say that a plan must have a segregated fund. I do not see

that as my role. What I do see as my role is that, whether one has a segregated fund or one is "booking" it, the expense or contribution which is assessed in a given fiscal period is determined on the basis of sound actuarial principles. This means that some funding method has to be devised which is systematic. I cannot see how an actuary can justify his position by sitting down at the end of the year and looking at the historical experience and just saying, "Well, I think maybe we ought to increase it by 10%." If he is going to play a role he should say to the employer, "Here is the method I recommend you follow," in advance. Thus, the method, which may be subject to change just as funding methods on pension plans are from time to time, determines the contribution or expense, reflecting the actual experience that occurs.

Especially in the absence of regulations, if one leaves it up to the plan sponsor by saying, "Well, just do whatever you want," one will subject himself to tremendous pressures from his clients. When they ask you, "How much should we put in this year?" and one replies, "I think we should expense this amount," they may well respond, "But we had a terrible year, why should we expense that much?" If one has not cleared the expense in advance, one may get himself in a bind. It becomes the employer's opinion against the actuary's opinion. A large client may be able to apply all sorts of pressure, because this one particular plan may be a small piece of the pie you are dealing with the client on. He can put a lot of pressure on you.

MR. THEODORE W. GARRISON: Mr. Brink, wasn't there a recent Revenue Ruling to the effect that the employer cannot simply take a liability on his own books for the purpose of calculating the employer's income tax? It seems to me the employer almost has to put the money into segregated assets, set aside in a 501(c)(9) trust, in order to be able to claim the deduction for his own tax purposes?

MR. BRINK: From the Service's point of view, they will allow a full tax deduction only if one actually funds the reserves through a qualified trust. While that is true, that does not negate the plan sponsor's responsibility to fully recognize the liability. There may have to be two sets of financial statements: one for tax purposes, and one for the corporate financial books. Interestingly, one large plan sponsor that we have been dealing with has taken a deferred federal income tax credit for future tax deductions. They have recognized the difference on their corporate financial books so that they are consistent.