TRANSACTIONS OF SOCIETY OF ACTUARIES
1980 REPORTS VOL. 6 NO. 3

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

Moderator: STEVEN A. EISENBERG. Panelists: ROBERT G. MAULE, RONALD M. WOLF, CHARLES T. BELL

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. STEVEN A. EISENBERG: The responsibility of the actuary for group plans has not been specified or assigned by any government agency or any other profession. At one time that was true for casualty loss reserves and for pension funding. However, we now have directives and standards for both insurance reserves and pension valuations. Some day, group plans will have financial standards, and hopefully our profession will be the leader for setting those standards.

MR. ROBERT G. MAULE: The recent proliferation of self-insured plans and the growing interest in them raises important issues as to professional actuarial performance and conduct. These issues surface not only for arrangements involving complete self-insurance, but also for a number of alternative funding arrangements under which there is significant transfer of risk to a plan sponsor. In today's environment, there is a continuum of arrangements that span a range from traditional fully pooled insured contracts to full self-insurance.

The other members of this panel will discuss the subject at hand from the standpoint of an already established self-funded arrangement. I would like to discuss the responsibilities of the actuary as I perceive them, when he becomes involved in the decision-making process prior to establishment of a self-funded arrangement. I believe the issues that arise at this juncture will continue to be of significant concern to the actuary over the lifetime of a self-funded arrangement.

Although my background involves actuarial responsibility in both life insurance company and consulting environments, the perspective of my remarks today will be form a consulting viewpoint. However, I suspect that most of the issues are independent of an actuary's particular business connection.

The idea has been advanced that actuaries serve may publics and that we have varying specific responsibilities with respect to them. My remarks today will focus on the public which is represented by the ultimate risk bearer.

Before discussing our responsibilities under self-funded or alternatively funded arrangements, I believe it is important to address the environment from which these plans have emerged. A variety of factors have generated interest in evaluating self-funded arrangements. Over the years, costs associated with employee benefit plans have become significant from a budgetary standpoint. This has caused (especially among larger employers) an increasingly intense scrutiny of the cost factors associated with these plans and an increasing sophistication on the part of the plan sponsor in dealing with their technical and financial aspects. In some cases, there has been disenchantment, not always without cause, with the existing insurance carrier and with traditional financial structures. If the carrier has been unassertive in voluntarily proferring improvements to the financial design of the plan, with the result that the financial structure is no longer competitive or responsive to the current economic environment, then the sudden enlightenment of the employer to this fact can produce intense dissatisfaction. In today's environment, such "enlightenment" is likely to occur since there is active and aggressive promotion of self-funding concepts by many brokers and consultants. It is worth noting that some of this promotion has bordered on the fraudulent and some of it simply has been uninformed. Nonetheless, in today's economic environment, cost consciousness is a by-word and there is an almost universal need for the cash and capital. Thus, when the concept of self-funding is advanced, today's employers are likely to respond with true interest. These employers comprise all types of private and public institutions, both large and small.

If the interest in self-funding and alternative funding arrangements continues and expands, this may presage a fundamental change in the role of insurance companies with respect to these employee benefit plans. Some believe that the long-term result of this activity could be dismantling of traditional insuring mechanism for such benefits as medical care. In the long run, the insurance industry could be removed from its traditional role, and possibly the ultimate result could be that the funding responsibility for these benefits will pass entirely from the private sector. I do not mean to advance this view, but rather I mention it to

point up that the changes underway are fundamental in nature and have the potential of significantly changing the current role played by the insurance industry in group insurance programs.

The arrangements under consideration today are those which involve a significant transfer of risk from insurer to plan sponsor. Ironically, the insurance industry itself has not always fully understood the character of the risks it has traditionally assumed. This fact is borne out by the overall financial experience of carriers in the last decade under medical care, dental and disability plans. However, the industry itself has been financially strong enough to weather adverse experience. If the "experts" in this area have had great difficulty over extended periods of time, in generating satisfactory financial results, it is clear that in evaluating a prospective self-funding situation, there must be a thorough professional analysis of the risks.

Unfortunately, there is prevalent attitude, that even extends down to smaller groups, that the risks associated with self-funding are more or less minimal and that, in fact, current insurance financing vehicles in many cases rarely amount to more than cost plus arrangements. Therefore, I believe that complete disclosure of the nature of the risks to be assumed is at the core of the actuary's responsibility in this area.

Propensity for risk assumption varies according to the temperament and circumstances of the potential risk bearer. All other things being the same, a given level of risk in one situation will be perceived as unnacceptable, in another as acceptable. I believe that the actuary's posture should be neither that of promotor or adversary, but rather as the source of objective advice with respect to the risks to be undertaken. In order to provide such advice, it is necessary that these risks be characterized and quantified.

What are the basic categories of risk assumed by a plan sponsor under a fully self-funded arrangement? I believe such risks fall in the two broad categories of business risks and insurance risks.

In the event a plan sponsor takes full responsibility for all aspects of the plan, he commits himself to adequate performance for a variety of functions necessary to its successful operation. These functions involve legal, accounting, cash management (investment), public relations, actuarial, general administration and claims adjudication considerations. Risk associated with the assumption of these functions is not always small. For example, in the legal area, costs of litigation and the assumption of the financial risk associated with adverse outcomes such as punitive damage claims have been traditionally borne by the insurance industry. In an unsettled economic environment, striking a balance be-

tween maximum investment performance, safety, and day-to-day management of the cash flow is no easy taks. We can expect the asset management function to increasingly tax even experienced professionals within the insurance industry. In some cases, the removal of the traditional third party guarantees will strain the relationship between the plan sponsor and persons covered under the plan. In his role of evaluating the feasibility of a self-funded arrangement, I believe the actuary should give careful attention to these business aspects and that he should apprise his client of the effects that could result from inadequate performance or adverse circumstances.

It is essential that the actuary comprehend the character of the insurance risks to be transferred and that he be able to communicate these clearly to his client. In my experience, I have found it useful to divide insurance or financial risks into three categories:

1. Errors in judgement

2. Uncertainties arising from secular influences

3. Random (statistical) fluctuation

Under self-funding, the plan sponsor will be crucially concerned with the range of possible overall financial outcomes. In assessing these financial outcomes, a starting point is generally assessment of expected (mean) results. Even if the data available is comprehensive, there is significant risk that an actuary will fail to identify and assess the impact of some critical factor or fail to accurately assess the impact of known factors. There will always be some degree of uncertainty as to what base line financial results will be. In particular cases, this uncertainty can be significant.

Even assuming that the actuary experiences no difficulty in assessing expected levels of experience, there are a variety of secular influences, generally beyond the capacity of the actuary to predict, that can and do have profound influences on overall financial results. Among these are catastrophes, unexpected levels of inflation, changes in the economic climate, strikes and layoffs and changes in provider practices.

Finally, even if the actuary's assessment of the underlying costs is accurate, and secular factors create no unexpected results, there are significant risks associated with statistical fluctuation.

I believe it is the responsibility of the actuary to clearly present the nature of these insurance risks and, wherever possible, to quantify them in a manner that is clearly understood by the potential risk bearer. This calls for a special

effort to communicate the impacts of adverse circumstances and their related probabilities.

At this point it may be worthwhile to discuss specific examples. Our consulting activities have involved us in a wide variety of situations in which self-funding is under consideration. Clients range from small to large and coverages have included medical, dental, short-term disability, and long-term disability benefits.

Secular factors that influence aggregate claims under these coverages are well known. Economic downturn, strikes, and layoffs can have an adverse effect on all of these coverages. Medical dental costs are sensitive to inflationary trends and changes in provider practices. It is essential that the client be apprised of the historical variations that have occurred on account of these influences and what their impact could be upon his plan.

The assessment of statistical risk is difficult. It is often underestimated. Simple mathematical techniques, such as the priori assumption of an applicable claims distribution function will almost invariably understate the probabilities with which adverse results can occur. Even sophisticated models, such as Monte Carlo or convolution techniques can fail to provide appropriate measures. In our work we have employed both Monte Carlo and convolution techniques. However, we have made provision for factors in such a way that mathematical results are consistent with considerable amounts of actual experience. The point I want to emphasize is that casual assessments in this area are dangerous and will often result in inaccurate disclosure of the real statistical risks undertaken. In our work, we provide clients with a distribution of possible overall aggregate financial outcomes and the related probabilities for the points in this range.

With this information, the client is able to ascertain whether the risks assumed are acceptable. If they are deemed to be acceptable, the client can then measure the effects of increased risk assumption against the potential savings, if any, to be gained under a self-funding arrangement. Anticipated savings are generally measured by comparing the cost of the current program with expected cost under the self-funding arrangement. If, to make matters simple, cost under an insured program is defined as follows: Cost = benefit payments plus expenses plus risk charges less investment credits, then each item in this formula can be compared on a before and after basis to determine net savings. Under full self-funding, the expenses and risk charges inherent in the insurer's retention or premium loading would be eliminated, but these will be replaced with the anticipated costs of administering the program. Investment credits, to the extent that they existed under the insured plan can be compared to

expected investment earnings under the self-funding arrangement.

Although this approach is useful, it may not always provide the best understanding of the differences between the current insured program and the self-funded arrangement. In our work with both large employers and insurance companies (which are increasingly faced with the competitive threat of alternative funding arrangements), we have found that simulation techniques often provide a clearer understanding of the relative costs of alternative plans. To that end we employ a simulation program that permits the actual display of comparative financial results under various arrangements. This display indicates year by year results for an arbitrary number of years and for an arbitrary number of simulations.

Often a client who is considering self-funding is currently involved in a traditional insurance arrangement. The client generally requests comparison of his insured program with a self-funded arrangement. If this is the only evaluation made, the result is an appraisal of only two points on an entire spectrum of possible arrangements.

I believe it is the responsibility of the actuary to at least point out the existence of alternative arrangements if they have the capability of realizing many of the advantages perceived to exist under self-funding. Such alternatives often provide insurance protection consistent with the levels provided under traditional insured arrangements. Possible alternatives include minimum premium, deferred premium, retroactive premium, and stop-loss arrangements.

Self-funding and the circumstances that have given rise to it, presents important challenges to actuaries practicing in the area of employee benefit plans. These challenges call for an increased understanding of the nature of risk and the creation of the necessary technical tools to properly quantify risk.

I believe it is encumbent upon the actuary, from a professional and ethical standpoint, to give particular attention to complete and unbiased communication of the risk factors surrounding self-funding.

Mr. EISENBERG: Bob Maule spoke of the client who is considering self-funding and the actuary's responsibility for informing the client of the various risks and alternatives. On the other hand Mr. Wolf will assume the client already has a self-funded plan.

Mr. RONALD M. WOLF:

I. INTRODUCTION

Your panel this morning is to discuss the public responsibility of the actuary for a self funded group insurance plan. This topic contains several key phrases, in particular, the words "public responsibility", "self-funded", and "group insurance plan". Let's examine for a moment what is meant by these three key components.

A self funded group insurance plan is a plan where the risk for the contingency covered is clearly with the employer or some other non-insurance company entity, such as a non-insurance company multiple employer trust. There are a number of funding variations that commonly are regarded as self insurance, where the employer has most but not all of the risk. A minimum premium plan or a self funded plan with stop-loss excess insurance clearly is "self insurance" for our purposes this morning.

By "group insurance", I mean such benefits as health care benefits, including dental and vision care benefits and disability loss of time benefits, both short term and long term. Such other group insurance benefits as group pre-paid legal benefits and group auto insurance are beyond the scope of my experience. Perhaps some of the comments made this morning might apply to them in principle also.

The final key phrase is "public responsibility" of the actuary. This phrase does not necessarily connotate the actuary's duties or responsibilities that are immediately visible to the public at large or to the members of the group insurance plan. It includes but is not necessarily limited to the normal, professional duties that an actuary is expected to perform if for instance he was describing his duties to a committee on professional conduct of one of the actuaries organizations or to a team of auditors. In fulfilling these responsibilities, the actuary must be guided by the guides to professional conduct of the various actuarial organizations. His responsibilities then include both the normal tecnical work and non-technical ethical conduct, as seen by his peers, by regulatory authorities, by the group plan members, and by the public at large.

Your panel has been asked to comment on any difference in the actuary's public responsibility if he or she is employed by an insurer versus being employed directly as a consultant by the plan. My background is that of serving in the individual life department of an insurance company for several years, then followed by seven years of consulting experience in the health insurance area.

Hence, my background in self-funded group insurance plans and my subsequent comments will be drawn mainly from experience as a consultant.

II. WHAT IS THE ACTUARY'S RESPONSIBILITY

I see the actuary's responsibility for self-funded group insurance plans as comprising five major areas.

1. Benefits
2. Rates
3. Financial management and statistical analysis
4. Risk analysis
5. General public responsibilities

BENEFITS

The actuary may not have primary responsibilities in this area but he certainly should have an input. The benefits of the plan should be efficient and soundly designed, working together and not duplicating each other.

A key point that should be put in front of employers, whether their group insurance plan is self funded or insured, is that the benefits of the plan should meet the employer's basic objectives. In this regard, it is useful at some point in time to sit down with the employer and lead him through a process of examining the objectives of his employee benefits, without considering current benefits. The employer may say that his objectives are to provide first dollar or first day coverage, or that the protection is essentially meant to be catastrophic with significant cost sharing features. The actuary then is in a position--and it is one of his responsibilities--to see that the plan benefits are in line with the employer's objectives. A part of the employer's team in setting these objectives might well be members of the employee group, and therefore the benefits might be designed with their objectives in mind also.

The actuary has at least partial responsibility that the plan's benefits be legal. With so many regulated or mandated benefits in recent years, such as the areas of maternity benefits and age discrimination, the actuary should be involved here. Often the mandated requirements are not clearly worded, and it is more than a legal matter to design a set of benefits that is in compliance. The actuary should be familiar with these legal requirements and should be able to put them into effect as plan benefits that are in compliance with regulations.

The mandated benefits may have alternatives in certain areas. The actuary should be in a position to advise the employer as to the relative costs and merits of such alternatives.

The words "cost containment" appear often in group benefit circles today. If presumably the employer's objectives are positive towards cost containment efforts, the actuary should assist in the design and maintenance of plan benefits so as to promote cost containment. In the health insurance area, such items as out-patient services, second surgical opinions, ambulatory surgical centers, etc. come to mind. HMO benefits are an alternative that the actuary should be able to explore with the employer.

Cost containment applies to disability benefits also. The plan benefits should be designed so that return to active employment is not inhibited. The actuary should be in a position to advise the employer if the proposed or existing benefits are too generous so as to promote malingering.

It is desirable that group insurance benefits be tax efficient. Although in most cases an actuary should not consider himself as an authoritative tax counsel, he should be familiar with the tax consequences of group insurance benefits.

Rates

All of us are familiar with a question that might be worded as "What factors should an actuary take into account when setting rates for an insurance plan?". This question was a favorite one on the old Part 7 and 9 exams. The answer of course was a famous list--adequate, equitable, consistent, competitive, etc. The answer is well-worn and seems simple, but is still appropriate and useful, even for self funded group insurance plans.

Of course the rates or contributions should be adequate to fund the benefits provided. In determining rates for a self funded plan, the actuary needs to consider such items as the prior plan experience, industry experience, volume or credibility of plan experience, and risk or contingency factors. the rates should be consistent with the funding level selected by the employer, such as pay-as-you-go or funding on a projected incurred cost basis. As the plan grows and develops its own experience, the rates should be based more and more on the plan's experience.

The rates should be equitable among the various rating classes. The actuary must decide what differential by rates should be made for such factors as age, sex, and dependents. This is enhanced by the actuary's ability to study and measure the plan's own experience.

The rates need to have a balance between being competitive--that is, being reasonably related to comparable insured rates--and not being overly conservative. A small margin for contingencies usually is necessary to provide a cushion.

Rates cannot be set properly without an analysis of expenses. The rates should take into account the actual expenses being charged by a third party administrator, or expense factors should be the result of an expense study undertaken by the actuary if claims are paid in-house.

FINANCIAL MEASUREMENT AND STATISTICAL ANALYSIS

A self funded group insurance plan cannot function efficiently for long without a system whereby the financial status of the plan can be measured on a timely basis. It is essential for the actuary and plan management to know the plan's financial condition and direction and to provide prompt responses to keep the plan on a sound course.

The actuary often is asked to provide advice for the establishment of a financial management information system. To form this judgement, the actuary should know what financial data is needed--and in what form. If management is not appreciative of the necessity of having these measurement tools, the actuary needs to stress to management that they are essential.

An important part of a financial reporting system is that claims be reported with a proper date of incurral. This date should be consistent with the legal liability of the plan and also should be consistent with recognized, published standards for such codings. The claims should be recorded separately by plan of benefits (if there is more than one) and also should be recorded separately for such cells as employees and dependents or family coverage.

Another important element of financial measurement is accurate loss reserves. A development or lag chart, showing claims by month or quarter of incurral and month or quarter of paymnt, is necessary, especially for medical benefits and short term disability benefits. The actuary's basic calculations should be based on recognized reserving methods. However, the actuary's sound judgement also is an important factor. He should take into account such items as plan growth, secular trend, benefit changes, and backlogs in the claims payment department.

With these tools, the actuary should look towards the development of historical unit claim costs. These can be used for future rate making and for trend development. In compiling trend factors, the actuary must take into account outside factors such as the Guidelines of the Council on Wage and Price Stability and published industry trends for such factors as hospital utilization.

Financial measurement and statistical analysis cannot be performed accurately without adequate statistics regarding premium units or certificates in force. It is not the actuary's responsibility to maintain such information. However, he should stress to management the importance of valid revenue and exposure to claims figures.

If these measurement tools are in place, the actuary should be able to use them to project into the immediate future the plan's financial results. Such aggregate projections are an effective tool to show to management where the plan is headed and also the expected outcome of proposed changes. Such projections should consider any investment income which will be earned by the plan.

RISK ANALYSIS

No matter how sound the actuary's judgement or how complete the financial measurement tools available, the plan's financial results will vary from that projected. A cushion or contingency fund is needed to protect the plan from unfavorable fluctuations.

Stop-loss reinsurance helps to limit the plan's risk. The actuary should be in a position to put into effect stop-loss reinsurance coverage that is in line with management objectives regarding risk limitation.

If a surplus or contingency fund is built up, its level of adequacy should be determined and it should not become excessive. By use of such methods as Monte Carlo computer simulations, the actuary can make a determination that a given level of surplus, plus a small provision in premiums for future surplus contributions, will provide something like 95% certainty that an unfavorable fluctuation in claims will not cause the plan to go into a deficit position.

GENERAL PUBLIC RESPONSIBILITIES

Of course the actuary is expected by the public at large, the plan participants, and his peers to perform sound, high level professional work that encompasses the items just discussed. But what specific things can actuaries do--or what specific things must we recognize--to ensure that our work is sound.

We need to keep in mind the professional requirements of the various actuarial bodies, such as the Society and Academy. One of these is that the actuary should not perform work when he is not qualified to do so. An actuary, just like anyone else, cannot be all things to all people. He should be able to recognize when his qualifications or lack thereof do not allow him to render a sound professional judgement.

Let's give some examples of this. If your self insured plan wishes to include a dental benefit or prepaid vision care benefit, then if you as actuary are not familiar with the actuarial aspects of these benefits, outside assistance should be sought. This may involve going to another department or another member of your company or firm. Another example is that if you as actuary are not familiar with how to perform a risk analysis of surplus levels, outside assistance can be sought.

All of the actuarial bodies have guidelines with regard to the preparation of formal actuarial reports. The major applicability of these to our topic this morning is in the area of loss reserves. If your plan is fully self insured then there is no specific requirement that an actuarial report or opinion be submitted to regulatory authorities. However, in my opinion, an actuary should have on hand in his files a written, signed formal statement that the plan's loss reserves have been computed by him and are actuarially sound, if for nothing more than documentation purposes. Perhaps this would be helpful if the plan is subject to an independent CPA audit. An easy way to do this is to write a statement of actuarial opinion similar to that filed for statutory annual statement purposes.

All of the actuary's work with regard to rate making and financial measurement should be well documented. If the plan's rates, as set by you or me as actuary, provie to be inadequate as the result of unforeseen circumstances, the quality of our professional work will be hard to substantiate if it was done on the back of an envelope.

It may be necessary at times for the actuary to qualify his formal opinion as to loss reserves and even to refuse to do the work assigned. This may happen in a situation where the plan's record keeping has been so poor that a professional opinion is not possible. In my opinion, the refusal to render an opinion or to provide some assistance is a last resort. My preference is to form whatever judgement I can with the facts and material available and to qualify such findings as necessary. If such qualification is felt to be necessary, the plan actuary should ask for the opinion of another consultant or actuary on an independent basis.

The American Academy of Actuaries Opinion A-6 regarding financial reporting recommendations and interpretations states that when an actuary's work relates to financial statements prepared in accordance with generally accepted accounting principles, the actuary should, as a minimum, provide an actuarial report to the company. The immediate context of this requirement is for the annual GAAP statements of stock life insurance companies. However, the idea of an annual actuarial report to management of a

self funded group insurance plan is a logical extension of this professional requirement. Such a report should contain a description of the scope of the actuary's work for the plan and a description of the actuarial assumptions and methods that he has used in his work. It further should contain the actuary's opinion as to the appropriateness of those assumptions and methods and a statement that all actuarial reserves and related statement items have been established.

Now I will admit that I do not have such a formal actuarial report prepared for the self insured group plans that I serve. However, in some cases there is summary file material which essentially constitutes such a report. In many cases the plan itself requires the actuary to make an annual review of the plan's actuarial performance and to write a report thereon. This requirement by management offers an excellent opportunity for the actuary to extend the Academy's requirements for a formal actuarial report into the self funded group insurance area.

III. ANY DIFFERENCE--THE COMPANY ACTUARY OR CONSULTANT

Although I am perhaps somewhat limited in offering views here because I have not served as a company actuary to group insurance plans, I see no major difference in the actuary's role as either an insurance company actuary or as a direct consultant to the plan. In both cases the actuary must be motivated by his need to fulfill professional requirements and to serve the needs of the client--or the plan.

If the actuary is serving as an insurance company actuary for a self funded plan, there may appear to be a conflict of interest with regard to the actuary's loyalty being to the plan or the insurance company. The actuary and his company might tend to be less interested in the financial or actuarial performance of the plan, because it was the plan's decision to go to a self insured basis in the first place. However, the success of the plan may affect the company also, in that if the plan is unable to meet its obligations the company may be left on the hook for any residual liability of claims after the plan's assets are gone.

The company actuary who is serving in connection with a large ASO case administered by his company may be limited as to the scope of work--both actuarial and other--that the plan has requested. I envision a situation where the plan is expecting the company to only pay the claims and has informed the company that it is using outside help to perform the functions of financial measurement and future rate setting. Regardless of this, in my opinion the actuary should at a minimum inform the plan of the recommended actuarial services which the plan should have. It

of course is up to the plan as to how these needs will be filled. If the actuary has in writing a recommendation as to needed services, then there cannot be a question of his fulfillment of professional responsibilities.

I have seen a number of cases where an insurance agent or broker will recommend that a group insurance plan to to a self funded basis, in order to prevent the broker's insurance company from losing the account altogether. In these cases the future actuarial functions are either ignored or are not well defined. If an actuary is part of his company's team in designing an ASO quote, the quote should be specific as to whether the company is expected to perform the necessary actuarial services or not. As part of this, again it is advisable that the company or its actuary inform the plan of the necessary services to keep the plan on a sound financial basis.

IV. CASE STUDIES

The outline asks your panel this morning to comment on case studies in the following specific areas--self funded MET, plan sponsor in trouble, and plan in trouble.

With regards to self insured MET's, my experience has been that problems arise most frequently when the record keeping and statistical measurement function has been ignored. This leads to problems of inadequate loss reserves and rate inadequacy. There have been a number of instances where poor record keeping just didn't allow the plan or its actuary to know where the plan was or where it was going on a timely basis. I see the actuary as having the same responsibilities whether he is serving as actuary to a self funded MET or as the direct consultant to a self funded employer plan. The actuary should always keep in mind his responsibilities to render advice only when qualified to do so and to qualify his advice or opinions where appropriate.

By "plan sponsor in trouble", I envision a situation where the normal actuarial work has been done on a sound basis but the plan sponsor is having problems in making the necessary premium contributions and is in poor financial shape itself. If cash flow is a problem, the actuary should be in a position to offer cash flow projections as to what the plan's requirements will be. He should be able to provide some advice regarding the cost of lower benefit alternatives on a going ahead basis. In setting his calculations and liabilities, the actuary should do them on a most likely assumptions basis, with no margins for conservatism. Regardless of the plan's ability to meet its obligations, it always needs to know clearly what those obligations are.

If the plan itself is in trouble, I envision a situation where the employer or sponsor has no problems but the plan has run into problems with regard to excessive claims or inadequate reserves. This may be a situation where a very large increase in contributions is necessary. If a large rate increase is necessary, perhaps it might be spread over something like a two year period in order to avoid excessive employee dissatisfaction and turnover, and antiselection.

One additional case study on which comment is offered is that of a Taft-Hartley Welfare Fund. We have seen that these funds or plans have pecular problems of their own. Such occurrences as a work stoppage or strike by the participants, the fact that the group is aging with few new entrants, and the factor that generous benefits are supplied to a growing number of retirees can make for some unique actuarial problems for such plans. I am not going to propose any solution to these perceived problems but will merely point out that the actuary to such a fund needs to be aware of them and to inform the fund's management, as accurately as he can, as to their actuarial impact.

V. SUMMARY

In spite of my previous comments, the public responsibilities of the actuary for self funded group insurance plans are not particularly well defined. The AICPA has proposed an audit guide that speaks to the subject of employee benefit plans. In conjuction with this proposed audit guide, the American Academy of Actuaries has formed an ERISA Health and Welfare Subcommittee Task Force. This Task Force, chaired by Mr. Bill Odell, currently is trying to respond to this proposed audit guide and to more clearly define its applicability to group insurance benefits and to relate these to the actuary's responsibilities. It would be most helpful if this Academy Task Force were to come up with some formal guidelines for all of us in this area. Until then, the self funded group insurance benefit area will continue to be one that tests not only our technical capabilities but also our ability to perform actuarial work that is sound and responsible when viewed by our peers, employers, employees, and the public at large.

MR. CHARLES T. BELL: I must confess that my first reaction to discussing the subject of this concurrent session was not one of the most enthusiastic moments in my actuarial career. On the surface, the subject initially seemed quite limited in scope and depth. However, as I began to turn the subject over in my mind and to discuss it with some of my associates, I began to appreciate the opportunity to reflect on the potential for actuaries to impact the image of both the profession and the insurance industry in general in dealings

with self-insured plans. In particular, the contrast between someone working for a commercial carrier, like myself, and someone employed directly as a consultant offers some interesting points of comparison.

At the basic level, the responsibility of the actuary to any plan involves the application of disciplined analysis to the development of future cost projections and evaluation of current liabilities. However, the group actuary employed by an insurance company is accustomed to approaching these considerations from a "book of business" standpoint, with little or no public visibility. It is the insurance company rather than the plan which is at risk, and the plan continues to have access to the competitive market. The consultant, on the other hand, is employed directly by the plan with the express purpose of evaluating costs and liabilities for that specific plan. The consulting actuary is directly visible to the plan as opposed to the insurance company actuary who is merely a part of an overall service package.

It would be quite easy for the staff actuary of a large insurance company to conclude that nothing has changed just because a small part of his "book of business" has converted to a non-insured or service only basis. At the other extreme, the company staff actuary could easily conclude that, since his company is no longer at risk, he has no impact or responsibility with respect to the services rendered.

Upon more critical analysis however, a case could be made that the insurance company's staff actuary has a very broad professional responsibility to the self-funded group insurance market because of his unique position in being able to influence a large number of plans rather than just a specific plan. Consider, for example, some of the functions frequently performed under the management or supervision of a staff actuary in a large insurance company.

The most obvious and direct function is the basic risk selection function. Each group insurance underwriter must reach the basic decision of whether or not to endorse self-funded group insurance plans by agreeing to offer administrative services only type contracts. If offered, the company must then wrestle with the more difficult question of the size threshhold it believes to be appropriate and the level of administrative sophistication and financial commitment it will require. While competitve considerations are and will continue to be a very strong influence in the decision-making process, each company's posture with respect to the level at which it will endorse self-funding by offering service only contracts constitutes, at least in part, a public statement on behalf of that company's actuarial staff regarding viability of the self-funded plans.

Thus, the staff actuary of an insurance company has a responsibility to the self-funded group plan by assisting his company to determine a sound level at which the company will add its name and endorsement to the self-funded concept and under what qualifying conditions.

Another area of broad public responsibility which is frequently the responsibility of staff actuaries is the area of benefit design and interpretation. Company actuaries take into consideration a number of very broad implications when determining the types of benefits and plan designs which the company should endorse and the specific claim interpretations that will be applied with respect to those benefits. Among these considerations are contractual liability, the impact of change on future cost patterns, social desirability and influence on or from government programs.

The responsibility for carefully evaluating the broad impact of changes in benefit design or claim interpretation does not change significantly when applied to an administrative services only contract. While it is true that the insurance company is no longer at risk, it is also true that the benefit expectations and insurance company image developed by employees, providers and government officials are influenced by the conduct of the insurer's overall business. To the extent that sound underwriting judgements and contractual interpretations are undermined by inconsistant interpretation in non-insured programs, the basis for insured programs will ultimately deteriorate.

The staff actuary, therefore, has a responsibility to the self-funded plan for providing sound advice with regard to future implications of benefit design and interpretation questions through his overall responsibility in determining the benefits and claim practices which his company will endorse as sound and appropriate.

A third area in which the staff actuary may become involved is the area of contractual liability. In many companies, staff actuaries are responsible for the development of contract language and the resultant language which is displayed to covered individuals through booklets and/or certificates. It is this language which defines the providing contract development and employee announcement services under a service contract represents, in effect, that the language will limit liability of the plan to the levels anticipated. The staff actuary in charge of contract development has a responsibility to assure that any language recommended to a self-funded plan will be consistent with the level of liability desired and anticipated by the insurer based upon its insured business.

As a sidelight to this particular function, the staff actuary also has a responsibility to his employer, and to the industry generally, to evaluate the risk connected with a self-funded plan which fails to meet its benefit obligations. To what extent will endorsement of the self-funded plan by an insurer, through a services only contract, be interpreted by courts as an obligation on the part of that insurer to fulfill benefit obligations not met by the employer? This might be of particular concern if the bankrupt employer had followed fully all of the recommendations of the carrier with respecto to funding, contracts and claim interpretation. This is a particularly sensitive issue in a coverage like long term disability but could be an issue for short term coverages as well, especially under adverse economic conditions.

Similarly, what is the risk to the insurance industry if beneficiaries under a self-funded plan administered by an insurer are denied benefit because of employer financial failure?

The final, and perhaps most visible, area of the staff actuary's involvement (and responsibility) with respect to self-funded plans is with respect to financial projections. From an actuarial standpoint, the self-funded plan administered by the insurer is suddenly removed from "book of business" considerations and must be evaluated on its own merits. To what extent is it necessary to modify trend factors, reserving formulas, and information systems which are adequate for a large "book of business"? Is it necessary (or possible) to adopt special accounting techniques, special reserve margins or other financial adjustments in preparing periodic financial reports for self-funded plans?

For example, trend factors used in projecting health benefit costs are currently restricted for insured plans by formulas established by the Council on Wage and Price Stability. Is it appropriate for these factors to be used in preparing cost illustrations for self-funded plans, or does the company actuary have a responbility to develop more "realistic" estimates?

In general, it would appear that the staff actuary of an insurer which also engages in administrative service only business has a responsibility to separately evaluate the formulas, information systems and procedures applicable to his insured business in order to determine their appropriateness for self-funded clients. The quality of insurance company information provided to administrative service only clients will have an effect on the image of the insurance industry in general and, at least indirectly, on the actuarial profession as it relates to the insurance industry.

Mr. BOLCHICK*: You mentioned the fact that once you make a decision to go self-insured as far as a corporation is concerned, you've got to make a decision as far as the level of self-insurance. What do you really mean by that comment?

Mr. BELL: I'm talking about the individual contractholder. Would you as an insurance organization be willing to write an ASO contract for a 100 life group or would you only be willing to go down to 1000 lives?

Mr. RANSBY: Charlie, in interpreting your contracts as far as administering claims, do you find that your interpretation of claims are modified by the employer? Do you find that happens very often?

Mr. BELL: It varies by the company, Ken. In general as a corporate position on our part we do not accept the final determination responsibility. If there is a disputed claim it is up to the employer to settle that claim. We require that it be done so that it is non-discriminatory, and at least we define the contract from that point forward to be in accordance with non-discriminatory rules. Ultimately, the decision on how to dispose of problem claims is up to the employer in a self-funded situation. We do not accept that as our responsibility, so there is a distinction here.

Mr. RANSBY: When the employer becomes involved in that type of situation, is that really different from the very large experience related situation where many claims are perhaps not strictly covered in a contract and therefore not recognized or paid?

Mr. BELL: In a very large situation in either case, whether it be in a insurance contract or a self-insured contract, there obviously are many special situations. We recognize these but they are more individual than book of business type of decisions.

Mr. RANSBY: What about the overall area of financial experience? You said that although you are contractually not on the risk you might be held by the courts to be on the risk. Has that happened to you?

Mr. BELL: It has not as yet. I can't say that it won't, but certainly the possibility exists under a plan that is administered on that basis by an insurance company that the company would be found to be liable.

Mr. RANSBY: Is that really much different than the pension situation where you provide investment only services?

*Mr. Bolchick, not a member of the Society, is associated with the Blue Cross/Blue Shield Association.

Mr. BELL: Yes. I think so because in the pension situation you are not combining that with the benefit implemenation promise.

Mr. RANSBY: Agreed. But your name is still on a contract associated with the plan.

Mr. BELL: I could be wrong here but in general I think that if you are providing investment services to a pension plan, you are not in a position of distributing that fact to every employee. That's just a contract between the employer and the insurance company as part of the employee's overall investment program. Whereas, if you have a health benefit plan, you have something in the hands of all the employees that says this plan is being administered for you by XYZ Life Insurance Company; and in most instances the name of the insurance company is actually going to be somewhere on that benefit draft.

Mr. BEIN: I would like to ask the panel a question on self insured LTD claims. Do you see the role of the actuary in his responsibility as being different if there is an employee payall plan as opposed to an employer payall plan, particularly in the area of setting the appropriate rates, the appropriate contribution levels, etc. Should there be a higher margin of conservatism, for an employee payall plan?

Mr. WOLF: My initial reaction is no. I don't think I would treat it any differently. I think I would like to assess the risks on their own merits.

Mr. BEIN: I think that for LTD you have to proceed with extreme caution in evaluating self-insurance. We've had a great deal of interest expressed in self insuring long term disability benefits even with employers as small as 250 lives because the cash flow advantages are perceived to be so attractive. We lay out the risk as carefully as we can to the employer.

Mr. HARDIN: I am curious to know what you gentlemen feel your responsibility is? If you have an employer who wants to be self-insured with a 200 life LTD plan, do you feel it is your responsibility to act. How does the consultant or the insurance company actually deal with that issue even after having the risks fully explained to them?

Mr. MAULE: Bob, when we incur situations like that, we would simply say that our advice is that you don't consider that alternative.

Mr. HARDIN: Would you continue to work for them if they wanted your services but did not consider your advice?

Mr. MAULE: I have not been put into that situation yet and I do not know that I can respond to it. Generally, we like to provide advice if we can in a situation and do not like to back away. Incidentally, we have backed away from self-insured multiple employer trusts since this area is found to be unmanageable. In our own experience, the absence of plan sponsors and the absence of people controlling the plan who have financial responsibility make the situation intangible for us. So, I don't know if we backed away from that situation but we would certainly make a very strong recommendation that this would be an inappropriate vehicle and that they should not consider it.

Mr. WOLF: In that situation I would make it very clear, in a formal communication to the company that perhaps the client should not go self-insured. If they became self-insured I would continue to serve them and give them the advice that they would need for the plan.

Mr. EISENBERG: Your company is administrator for a self-funded plan but does not have actuarial responsibility under the ASO arrangement. Assume the sponsor of the plan either (1) has no qualified actuary making periodic reports and designing a statistical system or (2) has an actuary whose judgment appears to be faulty. What must your company do? From my limited experience I find much resistence by plan sponsors for having actuaries become involved with these arrangements. Many times there is a benefit consultant or a broker who has pulled the plan out of the insurance company. Or, possibly, there is a third party contract administrator who may be very capable as an administrator and sees no need for an actuary when the administrator can calculate their own loss ratios and recommend necessary rate increases or alternative benefits.

In other words, there effectively is no qualified actuary and the plan only has an ASO contract with the insurance company. What is your responsibility as the actuary with the insurance carrier?

Mr. BELL: In effect that's what we are referring to as a claims service only contract. Where it is entered into with just a third party administrator, all we are contracting for is actual claim service and none of the support service. How you react to that from a company standpoint is a multi-level decision. First you need to decide whether you would even offer that type of contract which in my experience is very rare in the marketplace. In those few instances where I have seen it offered, it has been primarily by the very large carriers where consultants provide the support service, but I am not aware that it generally has been offered through brokers. I have not been placed in a position where I would consciously know that service is not being provided on a reasonable basis. I think that becomes an underwriting

judgment on the part of the carrier and my predisposition would be that this would not be an acceptable contract to offer if you are not working through a consultant that you felt was working properly on behalf of the client.

Mr. BEIN: It sounds like you are trying to protect the employer from himself. Doesn't it go beyond the actuary's responsibility to try to protect the employer if the employer made the decision that he wants to use pay as you go with the self-insured plans and there is no actuarial advice as to appropriate levels of reserves and projected cash flow? Isn't that his decision?

Mr. BELL: That's his decision as to whether or not to follow the advice that he gets and in many instances I think corporate employers particularly do not follow the advice they get from a qualified actuary. My disposition here is that I would like to know that that advice is being given.

Mr. EISENBERG: There are now pension funding requirements; you cannot have a pay as you go qualified defined benefit pension plan. There are also loss reserve requirements in the casualty field. The pension, casualty, and life insurance reserve requirements all seem to be for the purpose of protecting the employee, the participant in the plan, or the insured. Maybe other people will disagree, but there is no doubt in my mind that standards will be set to protect the employee. I think if we do not set them ourselves then the government will set them for us and we will have a group enrolled actuary, or some type of designation like that applicable to pension plans, to ensure that benefit promises will be met.

Mr. BILISOLY: We've been hearing for years that there are going to be requirements with respect to 501 C-9 trusts in the funding of benefits that are provided by the trust. We heard a rumor several weeks ago from a law firm in Chicago. This law firm has been trying to hire an attorney who is now with the IRS and purportedly has just finished drafting a set of proposed regulations that will govern the funding of such trusts. Have you heard anything about this?

Mr. BEIN: Well, we really should keep a sense of perspective here. I think the IRS came out initially with a proposed set of regulations on 501 C-9 trusts back in either 1966 or 1969. They withdrew them and these are the regulations that they are supposedly coming out with. So you know it might be 1986 before they finally come out.

Mr. ETHINGTON: We had an ASO customer that recently went into bankruptcy. This is a Chapter XI filing where we hope to continue our involvement so that all the benefits will be paid to plan participants.

Mr. HARDIN: What is the coverage?

Mr. ETHINGTON: This is medical care. There were many different coverages but the medical care coverage was the primary one. No one has suggested that the insurance carrier is in any way liable for those claims. It becomes confusing as you might guess; employers sent money to us (the insurance company); however, we could not accept any funds after bankruptcy was filed. Claims could not be paid even though the employer wanted to continue to pay them. If the plan had been insured, it would have been much easier for the plan participants, and the employer would also have been better off. As it turned out, the employer had recently gone to the self-insured approach to save money.

In my experience I have only seen one employee pay all non-insured long-term disability plan and for that plan the employer guaranteed the benefits even though the employer had no intentions of having to disburse any money. The employer was well aware of the fact that the rates were not adequate to provide benefits and that he had a problem, but I felt that the material that had been provided to the employer and the disclosure of the plan documents were adequate to protect the plan participants.

Mr. EISENBERG: How does one advise an employer that his purported cash flow savings in an initial year is really due to a transfer of liability and that this does disappear in the ensuing years? Then, as an adjunct to this question, how does one further tell the employer that he might be locked into self-funding due to the future "double whammy" of paying the run out of claims and also funding future claims. That is if he desires to return to the traditional insurance coverage he may have a possible cash flow disaster!

Mr. MAULE: In the course of my previous example of self-insurance no valid experience studies were made so that when the plan went insured again the potential insurer had no record of what the experience was and consequently he established a 20% margin in his rates which just added a little bit more injury to the whole situation. I believe that when you have marketing courses that promote or talk about self-insured arrangements the cash flow effect is one of the things that needs to be disclosed. If you get into this situation, the plan may have some initial cash savings but things could go badly in the future. If things do go badly and if you decide that you want to switch back to an insured plan, then here is what you can expect to happen. Probably part and parcel of that discussion is going to be a talk about what incurred claims are and that is difficult. It is difficult to explain to non-insurance people what these claims liabilities are and what we mean by incurred claims, but it is essential to make the effort to do that. If the employer decides to go to an individual excess and aggregate

stop loss type of contract, one of the things that might bring an employer to this position is his irritation with trend rates, and I've seen this in practice. For instance, Blue Cross may give a 35% increase after requiring other increases and so on and so forth and the employer is mad. He then takes a look at a self-insured arrangement say up to an aggregate 125% attachment point but also insuring individual excess claims-capping the losses on any individual claim of up to $10,000, $25,000 or whatever it is. One of the things that ought to be disclosed is that if he did not like the trend rates on the total coverage he is going to hate the trend rates on the individual excess coverage. If 10% is the base trend rate for comprehensive coverage then at the $25,000 individual excess level we are talking about a 25% to 30% trend rate.

Mr. BELL: The question of discussing with an employer this magical, marvelous cash flow release that comes in the first year of a self-insured plan is one that comes up frequently. One technique that might be considered would be to discuss self-insured arrangements with the employer in the framework of an investment decision rather than as an insurance decision. Ask him what he is going to do with that money and what are the various alternatives in which that money can be used. Right now, you could construct for him the theory that he has a certain amount of money invested with an insurer to provide for a liability which is yielding a certain return on that money. Well, first of all, if he receives that money back what are the tax consequences? Is it immediately taxed at 50% and then what is he going to do with the money? Is he going to invest it? What rate of return will he invest it, or is he going to pay it out to his shareholders? What rate of return will he realize on that net investment after taxes and how does that compare with the current insured arrangement? How long would it take for the net funds to be invested in that way to build up to the full principle that he has invested now with the insurer at the current rate of interest? Try to get them to think about this as an investment decision and consciously think about how they are going to use that money. Most times when I have seen an employer really pressed he does not know what is going to happen to that money. The whole reason for making the decision is glitter and not substance. They have not thought through what the benefits or the final ramifications would be regardless of what the risk considerationis would be from a sound investment viewpoint. Sometimes it is sound and sometimes it is not but it is necessary to do something from your standpoint as an actuary to help the employer understand and reach an intelligent decision rather than just buying the sizzle and not the steak.

Mr. EISENBERG: Bob (Maule), you mentioned before that you can prepare illustrations or simulations of the alternatives which show what is going to happen under an insured plan with

alternative sets of assumptions. For instance, what is going to happen under a self-funded plan taking into account fluctuations and various other risks? Also could you discuss the simulation techniques that could be applied in this situation?

Mr. MAULE: We just completed a great deal of research and study on claim distributions for individuals and also for groups in the aggregate for all types of coverages and size groups. In the process we have developed some sophisticated mathematical techniques to do that and which also tie into realty. Now let's suppose we are looking at a group of 1,000 lives and we start out with an aggregate claims distribution that we have predetermined for some particular coverage. Take medical coverage for an example which has an aggregate claims distribution where we expect about 8 million dollars of claims with a probability of 2%, $9,500,000 of claims with a probability of 1/2% and so forth. There is an entire distribution of possibilities all of which add up to one. What we can do is sample the distribution on a Monte Carlo basis and determine the cost of claims for any year. What were your claims in year 2, then year 3 and so forth throughout a 10-year period. Once we have the claims, we can look at various proposals that have been made by brokers; one of them is a pure ASO, one of them is minimum premium, one of them is a fancy retrospective experience refunding arrangement, one of them is a retroactive premium and so forth. The program has a facility to look at various types of plan arrangements that exist today and we can see what happens under that plan. We actually go through the financial results and show the employer's costs under those arrangements; that's one simulation. The number of additional simulations you run in order to obtain the full range of financial results will depend on the size of the group. You summarize those results and show it to the employer. At this point you can discuss what he likes best on the basis of the results. The advantage here is that the employer does not see some quaint estimate that only represents a single expected value for each proposed arrangement. He sees the types of things that can happen, and the frequency with which they happen. He can then say that he is satisfied with the current situation or that he will adopt any one of the other arrangements proposed.

Mr. EISENBERG: Are the statistics that are published annually in the transactions on LTD probabilities adequate or suitable for setting rates for self-funding?

Mr. WOLF: I generally believe they are. There is more or less a spread of experience in there by industry or by occupation. I do not think you can take your raw claim frequencies or claim continuance out of the reports and immediately assume they are applicable to any one group. I think you need to take into account, as best you can the

particular characteristics of your group and possibly modify the reported data as some other tables in the report generally indicate. My response is that the TSA data is a good place to start.

Mr. MAULE: I would like to speak to that question in terms of an example. We were employed by a large public group with about 12,000 employees where we did a study to develop contingency or stabilization reserves for all of the insurance programs and LTD is one of the significant coverages. First, we wanted to determine the expected costs so we modeled the plan and broke it down into age, sex, salary level and so forth. We estimated the appropriate rate of disability for this plan based on the industry and the different classifications of state employees and termination rates. With respect to the termination rates I do not think that the full evidence is in any of the TSA reports yet, however, you might be led to assume that you can use rates of disability that grade into CDT termination rates after a few years. The fact is that you ought not do it. The termination rates are less than CDT rates for many, many years after disability not just two or three or four years and we made modifications in this particular situation.

Another thing I wanted to comment about was that in considering self-insurance for LTD again you want to look at the range of possible aggregate results since you get a number of very significant statistical factors with LTD. One of them that we observed is the possible offset from our benefits provided under government programs. We made assumptions in pricing and getting the mean expected costs that involved a certain percentage of those who will also qualify for social security benefits resulting in an offset of the long-term disability program costs. Now the point here is that these offsets are rather random types of occurrences and they introduce a great deal of additional variability into the overall claim cost. I just can't emphasize too much that you have to look at all the different factors that can create variations because they can create far wider variations than you might suspect if you take a simplistic look at them.

Mr. HOUGHTON: I would like to make a comment about LTD. I think to some extent your assumptions depend on the sponsor's attitude with regard to how concerned he might be if your assumptions for the first couple of years do not turn out to be accurate. You could obtain his reaction to a situation where say after a year or two the premium has been $8 million and the claims have been $9.5 million, although that is very unlikely to happen. You need to explain what will happen in that situation with premium if you have a $6 million claim liability, but only $4.5 million in assets and the sponsor is short by $1.5 million. You will then have to raise the rates not only so they will be self-supporting in the future, but enough to make up the other $1.5 million deficit. You can

probably give your best guess on rates as long as that sponsor is not going to have a cash flow problem. Why give a rate that may be 20% or 25% higher than you really believe to be necessary just so that two years from now a decrease in rates is possible? As long as the sponsor understands what you are doing, by assuming your best estimate including all the variables and offsets. Sometimes you don't even have very accurate data. Maybe there are 50,000 employees and you end up with information on 29,000 or 35,000 of them. I think to some extent it is like a pension fund where the contributions year by year never exactly match the accrued benefits. But it is essential the sponsor understands what it is you are doing for them so they don't react unfavorably when the contribution rates go up to provide for incurred claims which have been more than previously anticipated in the rates.

Mr. MAULE: Let me add one comment to that. In long-term disability we have seen situations where secular influences can increase the rate of disability so as to double it. Now, that does not necessarily double the claims reserve. Fortunately there can be an increase in termination rates and consequently you do not double the reserves and you do not double the total cost. But you can get a very significant increase in short-term cost just because of these nonstatistical factors. If in a particular industry it is observed that expected LTD cost was $8 million and actual cost was $14 million, a plan sponsor is going to want to know if that kind of thing can happen in his industry too. I'll mention dental coverage here in that respect too as a secular type of influence and a practical example that comes to mind is Boeing which suffered with the last recession. The union people were aware of the pending substantial layoffs well before they occurred and you would not believe the amount of loss incurred by the dental plan prior to the year end. The dentist must have been busy 24 hours a day for 2 months.

Mr. EISENBERG: Has the question concerning the best method of showing an employer the possibility and extent of secular socioeconomic risk factors under a self-funded plan been answered?

Mr. BILISOLY: You mentioned the three kinds of risks, one being the secular risk. You spoke very well of the method by which you would show an employer the statistical risk associated with self-insured funds, but how do you show the secular risk? Do you use historical examples?

Mr. MAULE: That's about all we have and they can provide some interesting information, if you go back and look at how rates of disability have changed over economic periods and if you look at the experience of certain industries in that area as well. The layoff situation, the strike situation or the high turnover situation for dentals produce some results that are known and you could apply factors to the expected claims. We have done this trying to arrive at overall stabilization

reserves and for this one client I was talking about we classified him by the secular risk and by the statistical type and we assigned a number to the secular risk that was going to be part of the stabilization reserve for all the different types of coverage.

Mr. EISENBERG: Is anyone aware of the accounting standards set forth by the AICPA or FASB for establishing liabilities for self-funded plans?

Mr. HOUGHTON: Well, the accountants are now working on this question as to proper treatment of liabilities and to what extent they would use other professionals including actuaries. There are also questions relating to income tax deductions as to whether you can even take a deduction on your income tax return, but that aside I would think it is necessary to establish liabilities for claims that have already occurred.

Mr. ETHINGTON: I don't know what the economy will be like but my observation for a number of companies has been that they operate their insurance claims on a cash basis. Purely and simply they do not make entries for anticipated experience refunds during the year and they do not make any adjustments for known large payments they have to make to an insurance company. In fact, they just report on a cash basis.

Mr. EISENBERG: The accounting profession, as Mr. Houghton mentioned, is taking a good look at the accounting treatment for corporate benefit plans. I would hope that current practices are going to change.

I would like to ask Anthony Houghton a question. I understand that there is an actuarial task force, of which you are a member, working with the accountants on the accounting treatment of employee benefit plans. Could you tell us something about what this task force is doing and what its objectives may be in the future as far as professionalism goes and other related matters which we are discussing?

Mr. HOUGHTON: Well, first the auditors are putting together an audit guide for examining the self-insured health and welfare benefits and by that they not only mean pension benefits, they would mean medical plans, LTD and soon they would even go beyond that and include areas like the auto industry unemployment funds where the companies pay additional contractual amounts for unemployment compensation. Someone may be holding those funds and there may be a number of things like vacation allowance days that different employers will allow employees to accumulate and so forth. The auditors are reviewing these matters and telling their profession how they ought to account for these items, what information they ought to obtain from the employer and under what circumstances they ought to use other professionals where you are not in a position to simply inventory these

items. The subcommittee working on behalf of the American Academy is trying to discuss with the accountants certain technical matters relating to all the types of benefits which are involved, areas of discussion covered, how benefits are funded and different arrangements such as the cost plus, the stop-loss and traditional retrospective refunds with companies and unfunded plans which are handled on a fully cash basis. The discussions tend to indicate where professionals are to be involved and where it might be required to recognize a future liability. All this is in the discussion stage now and the task force is just working back in the previous drafts.