SOCIETY OF ACTUARIES

Social Insurance &
Public Finance Section

ISSUE 8 | JUNE 2013

IN THE PUBLIC INTEREST

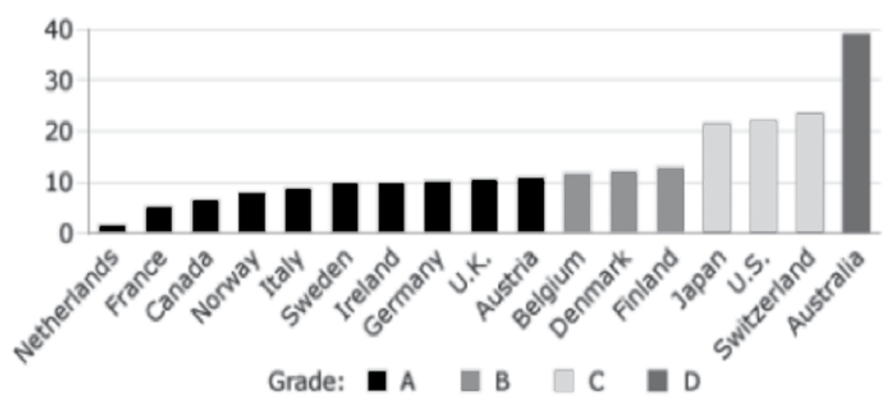
A COMMITMENT TO SUSTAINABILITY

Why I am optimistic about having access to the retirement security enjoyed by today's Canadian retirees.

By Joe De Dominicis

Growing up I was regularly reminded to respect my elders. Clearly many other Canadians received the same message, putting Canada in elite company as one of the best countries in the world to be a retiree. According to a recent report by the Conference Board of Canada, poverty among the elderly in Canada is at a low 6.7 percent. In fact we rank third amongst our Organization for Economic Co-Operation and Development (OECD) peers in this area as shown in the chart below from the Conference Board of Canada report.[i]

ELDERY PROVERTY RATE, LATE 2000S
(PER CENT)



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ISSUE 8 | JUNE 2013

IN THE PUBLIC INTEREST

Published by the Social Insurance & Public Finance Section Council of the Society of Actuaries

This newsletter is free to section members. Current issues are available on the SOA website (www.soa.org).

To join the section, SOA members and non-members can locate a membership form on the Social Insurance & Public Finance Section Web page at *http://www.soa.org/sipf/*.

LETTER FROM THE EDITOR

By Rachel W. Killian

Dear SI&PF Section Member,

As I reflect on this publication, the first thought that comes to mind is what a fantastic group of actuaries we have that contributed articles for this round. There is so much going on in the actuarial arena right now and many actuaries are working long hours. However, even with all of that work, we found a group of authors willing to contribute their valuable free time to volunteer by writing thought provoking articles for our newsletter. Due to work and personal commitments, it wasn't easy, but they have delivered. Kudos for their hard work!

The social insurance and public finance sector encompasses a large actuarial audience. Given that, we have attempted to include articles that touch on the many different areas that the SI&PF section covers. Not only does the section include members in the United States but also other countries. In tribute to our international members, we begin this publication with an article written by Joseph De Dominicis on the Social Security system in Canada. By looking at the social insurance programs in other countries, we can compare and contrast the issues faced in the U.S. programs. We can do just that as we read another article contributed by Sam Gutterman. Sam has written a larger article that can be found on the SOA website. Unfortunately, due to its length, we are unable to include his original paper in its entirety; however, we have included an abbreviated version that will be published in two parts. The paper includes a link to the full paper for those readers interested in the subject.

For many, the "hottest" topic at the moment is health care reform. Thanks to Bob Tate and Dwight Bartlett for two articles related to the subject. Many do not realize the links of health care reform to social insurance and so we hope these two articles broaden your thoughts on the subject. Often people also think that health care reform is just about commercial insurance. However, it also touches both Medicaid and Medicare. Thanks to Rebecca Owen for providing a look into the population of dual eligibles that cross over both of those programs.

In continuation of inclusion of articles regarding the work of our section, the Pension sub-committee has included a piece on the valuable research that they are undertaking. We'll keep you posted on the outcomes of that research.

Also included in this publication are three additional articles that I hope you enjoy as much as I did. Did you know our section is four years old? Thanks to Valerie Paganelli for sharing her thoughts on how the section started and what it has accomplished. Further, we accomplished our first spotlight article on an actuary working in the public interest. Thanks to Bruce Schobel for participating in an inspiring interview on his role working as an actuary in the public interest. Lucky for me, I had the opportunity to be "the fly on the wall" during this interview. I learned so much from Bruce in the interview that I felt I had lived a lifetime with him. The article can be found under the section of the newsletter, "Let's Talk."

Last but not least, we have our second round of our Actuarial Tips and Tricks Corner through Andy Large's inspiring piece of what we should all consider in addition to our certification into the ranks of fellows in the Society of Actuaries. It's a light-hearted piece but one that can provide much thought.

Again, thanks to all who contributed. We couldn't do this without you!

Sincerely,

Rachel W. Killian

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CHAIRPERSON'S CORNER

By Steve Schoonveld

Steven W. Schoonveld, FSA, MAAA, is head of Linked Benefit Product Solutions, Lincoln Financial Group, Hartford, Conn. He can be contacted at *steve.schoonveld@lfg.com*.

2013 is shaping up to be a year where "entitlements" continue to be a significant part of the public conversation. Throughout the year, debates and discussions will continue on the implementation of the Affordable Care Act, Social Security Reform options, proposals to free up the constraints on state Medicaid programs and Pension financing issues. This is indeed an opportune time for our unique section.

This section is indeed different from others in that we are a diverse group. When you consider the individual practice areas of actuaries, no single practice area represents a majority of SI&PF section members. We are predominantly from the Life, Health and Retirement practice areas but across an array of companies and organizations. There are less than five companies and organizations with double digit representation. This is a diverse section with an opportunity to reach many stakeholders.

This past October, the Society of Actuaries 2013–2016 Strategic Map (www.soa.org/Files/leadership-2013-strat-map.pdf) was approved by the Board. An added focus of the map is the addition of two new stakeholders; regulators and policymakers. These additions bring a greater sense of clarity to our section and our role. Our strategy as a section will incorporate activities that inform public policy development and public understanding (E6). In this way we serve a variety of stakeholders by developing intellectual capital that serves the public interest (S4). How do we accomplish this? As a section with such a diverse membership, we have the opportunity to collaborate with one another and in a robust way with external organizations.

At the date of this printing, the ballots for section council elections have been formed. I encourage you to review the slate of candidates for section council and to vote beginning in early August. While you may have missed the opportunity this year, many section members begin their interest in section representation by participating as a friend of the council. Representing your section is an important part of fulfilling the mission of the SOA and achieving the strategic goals. This is an excellent way to give back to the actuarial profession. You can participate as a friend during section calls and activities by contacting any one of the council members listed on page two.

We recently posted Sam Gutterman's paper titled, "The Nature of Social Insurance Programs and Their Funds," within the Articles of Interest link on our section website. You can view this point-counterpoint argument online by question or download the paper in its entirety. A webcast is scheduled for this summer on this topic which promises to be a timely and worthy debate with Sam Gutterman, Bruce Schobel and Rob Brown presenting.

Additionally, please look out for the release of section-sponsored research which focuses on communicating the financial health of public pension plans. The intent of this work is to provide an initial step toward influencing communications around these plans and improve the public's understanding and awareness. We anticipate a late summer release with a session scheduled to be given at the SOA Annual Meeting in San Diego in November.

As the second half of 2013 begins, the council will continue to focus on enabling the section to reach out beyond our traditional actuarial walls and fulfill our call to assist the public. We welcome any suggestions you may have and are grateful for your support.

Steve Schoonveld

The relatively low elderly poverty rate is a direct result of Canada's Social Security System, consisting of means tested floor benefits [OAS (Old Age Security)/GIS (Guaranteed Income Supplement) plus some provincial programs], plus an earnings related component [C/QPP (Canada/Quebec Pension Plan)]. Like social security systems around the world, the sustainability of the Canadian system has been strained in recent years by a confluence of factors including, the financial crisis, low fertility rates, aging baby boomers, longer life spans, and a decline in retirement coverage for many citizens, primarily due to lower coverage from private sector pension plans. In the face of these factors, and in comparison to the systems of peer nations, the Canadian system has proven rather resilient. While we are not immune to the risks now facing social security systems around the world, some prudent decisions have helped mitigate those risks, helping to ensure that the Canadian Social Security System will be available for future generations; these include:

1. Better Funding: Moving the CPP from a pay-as-you-go system to a partially funded system,

2. Better Governance: An increased focus on oversight, transparency and intergenerational equity, and

3. Plan Changes: Recent benefit changes providing incentives for Canadians to retire later.

BACKGROUND

The foundation, or floor, of Canada's Social Security System is the Old Age Security (OAS) program. The main components of the OAS program are the Old Age Security Pension and, for Canada's lowest income seniors, the additional Guaranteed Income Supplement (GIS) and Allowances. The OAS program is financed from general tax revenues of the Federal Government and provides a flat monthly benefit to most Canadian citizens, on or after age 65, based on their residency in Canada after age 18 and is provided regardless of their employment history. Both the OAS and GIS are means-tested. Higher income seniors have a portion of their OAS benefits "clawed back" after reaching a threshold annual retirement income and GIS benefits are not paid to pensioners above a certain low income threshold.

The second, income related, component to Canada's government administered retirement system, the Canada Pension Plan (CPP),[1] was established in 1966. CPP benefits are financed solely by contributions from working Canadians and their employers. The Quebec Pension Plan (QPP) is a sister program for residents in the province of Quebec. The CPP and QPP are almost identical.

For a Canadian who works a full career, the CPP and OAS are designed to replace roughly 40 percent of income, up to the national average wage ($51,100 in 2013).[ii] As of March 31, 2013, the maximum basic benefit a retiring Canadian could receive from CPP and OAS, combined, is $18,702.84. Many Canadians aspire to have retirement income in excess of that amount. However, CPP and OAS are only meant to provide a foundation on which working Canadians can build. At the same time they ensure that, at a minimum, most Canadian seniors retire above the poverty level.

Since the Canadian Social Security System was established, the programs have been amended on many occasions to reflect changing needs and to help preserve the sustainability of a system so many Canadians cherish. The Canadian system is certainly not immune to the risks now facing social security systems around the world, but some prudent plan changes and decisions have helped mitigate those risks and have made the Canadian system one of the most resilient.

THE SHIFT FROM PAY-AS-YOU-GO TO PARTIALLY FUNDED

The 1996/1997 review of the CPP revealed that, in its pay-as-you-go form, the plan was no lon-

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... the financing of the CPP was changed from a pay-as-you-go basis to a partially funded basis. ...

ger sustainable. For example, in 1996 the contributions collected were $11 billion, but $17 billion in benefits were paid out.[iii] It was clear that, given a rapidly aging population, the ratio of the number of workers contributing to the number of retirees drawing benefits would continue to decline, making the plan increasingly unmanageable—the chief actuary concluded that the plan's reserves would be completely exhausted by 2015.[iv]

In response to this imminent problem, federal and provincial finance ministers recommended and made a number of reforms to help ensure the long-term sustainability of the CPP. In addition to various benefit changes, the total level of contributions was increased gradually from the 1997 rate of 6 percent to 9.9 percent by 2003. And, most importantly, the financing of the CPP was changed from a pay-as-you-go basis to a partially funded basis called steady-state funding, where an asset reserve is accumulated with the goal of maintaining a stable asset/expenditure ratio.

The higher contributions were used to create the asset reserve to partially fund the CPP. In addition, the CPP Investment Board (CPPIB) was created to manage and invest the assets at arm's length from the government, for the sole purpose of maintaining the sustainability of the plan. As of Dec. 31, 2012, the CPPIB had $172.6 billion under management. The 25th Actuarial Report on the Canada Pension Plan as of Dec. 31, 2009, prepared by the Office of the Chief Actuary concluded that, under best estimate assumptions, the CPP is "expected to be able to meet its obligations throughout the projection period and remain financially stable over the long term." [v, 2, 3]

INCREASED FOCUS ON OVERSIGHT, TRANSPARENCY AND INTERGENERATIONAL EQUITY

In addition to moving from pay-as-you-go financing to a partially funded CPP, the 1997 reforms also increased the frequency for reviewing the CPP from once every five years to once every three years. In the event that a review reveals that legislated contribution rates are no longer sufficient to maintain the stability of the CPP, "self-sustaining" provisions have been implemented to allow certain benefits to be decreased if legislated contribution rates are not increased.

A full funding provision was also included to ensure that any future increases to CPP benefits are fully funded with contributions that are in addition to the regular, steady-state required contributions. This provision ensures that the costs of benefit improvements are not passed on to future generations.

The 1997 reforms were instrumental in helping to ensure the sustainability of programs. More recent changes continue to demonstrate a commitment to maintaining these programs.

RECENT CHANGES TO MITIGATE THE IMPACTS OF INCREASING LONGEVITY

Like most citizens in the developed world, Canadians are living longer and therefore drawing retirement benefits longer than in the past, and longer than was anticipated when our social security system was first designed.

In his speech to the World Economic Forum in January 2012, Canadian Prime Minister Stephen Harper verbalized his concerns about the coming demographic threat, "Our demographics also constitute a threat to the social programs and services that Canadians cherish. For this reason, we will be taking measures in the coming months … to secure the sustainability of our social programs … over the next generation."[vi] As part of the 2012 federal budget released later that year, the "Plan to Place OAS on a Sustainable Path" was announced and included reforms to increase the full eligibility age for OAS benefits from age 65 to 67, with the change to be phased in over the period from 2023 to 2029.

As the demographic crisis continues to unfold, additional changes may be required, but at the very least the current changes are a step in the right direction and demonstrate the flexibility of the Canadian system to adapt to challenges as they arise.

CONCLUSIONS

Social security systems around the world face immediate and significant challenges to their sustainability from the global headwinds of the economic crisis and rapidly shifting demographics. Certainly Canada is no exception. In comparison with other social security systems, recent and historical reforms have helped to improve the odds that the Canadian Social Security System will remain viable in some form, for future generations. There are no guarantees in life, and there will, no doubt, be future challenges in the short-, medium- and long-term that will continue to threaten the sustainability of our system. However, past decisions demonstrate, at the very least, the willingness of the stewards of our Canadian system to take action when needed to protect the retirement stability now enjoyed by most Canadian seniors. All of which increase the chances that future generations will have access to some form of government administered retirement income, even if it may not provide the level of retirement security now enjoyed by my parents and their peers.

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Social security systems around the world face immediate and significant challenges to their sustainability. …

Papers. CD Howe Institute (December 2012). Online.

8. Alexander Laurin, Kevin Milligan and Tammy Schirle. *Comparing Nest Eggs: How CPP Reforms Affect Retirement Choices*. Commentary #352. CD Howe Institute (May 2012). Online.

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10. Office of the Chief Actuary. *25th Actuarial Report of the Canada Pension Plan as at December 31, 2009*. OSFI (Nov. 3, 2010). Online.

FOOTNOTES

[1] The federal government, nine provinces and two territories participate in the CPP. The province of Quebec opted out of the CPP and instead instituted the Quebec Pension Plan (QPP). The history, benefits and contributions of the QPP are very similar to the CPP.

[2] By no means is the plan fully funded. Most of the annual benefit payments are made directly from contributions on a pay-as-you-go. However, the asset reserves held by the CPPIB are sufficient to cover benefit payments in excess of contributions for the foreseeable future assuming actual experience is in line with best estimate assumptions. The report also reviews the sensitivity of the long-term projected financial position of the plan to other sets of assumptions and provides an indication of the required increase (or decrease) in contributions under those scenarios.

[3] *The Actuarial Valuation of the CPP Report as of Dec. 31, 2012*, will be released later this year.

END NOTES

[i] Conference Board of Canada. "How Canada Performs, Details and Analysis, Society, Elderly Poverty." Canada CBoC, 2013. Online (Accessed April 9, 2013).

[ii] Morrneau Sobeco. *Morneau Sobeco Handbook of Canadian Pension and Benefit Plans 14th edition*. Canada: CCH Canada Limited, 2008. Print. Page 55.

[iii] Canada Pension Plan Investment Board (CPPIB). "CPPIB Our History." CPPIB, Canada, 2013. Online (Accessed April 9, 2013).

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[v] Office of the Chief Actuary. *25th Actuarial Report of the Canada Pension Plan as at Dec. 31, 2009*. OSFI (Nov. 3, 2010). Online.

[vi] Fred Vettese and Bill Morneau. *The Real Retirement: Why You Could Be Better Off Than You Think and How to Make That Happen*. Canada: John Wiley & Sons Canada, 2013. Amazon Online. Page 2.

PROFESSIONAL PASSION BEGETS PROFESSIONAL PASSION

By Valerie Paganelli

As an actuary, have you ever had an idea, interest or passion germinate professional cooperation or a shared interest group? Did pursuing the passion require starting from scratch or a blank slate and finding others who shared your vision? Did you find yourself relentlessly harnessing time and resources to pursue your idea and realize your desired success?

The Social Insurance and Public Finance (SI&PF) section of the Society of Actuaries (SOA) is just such a venture of professional passion. As the SOA's newest section (circa June 2009), the idea for the SI&PF section stemmed from the passion of a core group of actuaries and quickly broke early section participation thresholds by generating more than 600 section members. This strong early foothold came from SOA members who are professionally knee-deep in social insurance and public finance issues or who (similarly) have a personal passion in this domain. At its inception, the SI&PF innovators envisioned section membership and purview that could logically expand, asserting that the issues addressed by the section would pull together a myriad of actuarial disciplines. As the first SOA board member to serve as liaison to the SI&PF (2009-2012), I wholeheartedly agree. The SI&PF vision is both grand and extensive, which can bring with it some challenges. Yet, I have witnessed the early SI&PF section leaders strive to:

- clarify purpose and objectivity,
- identify strengths and weaknesses
- leverage available volunteer and SOA resources,
- bring (b)right resources to the forefront quickly,
- establish a sustainable structure to prove permanency,
- regularly (and rigorously) debate in which ventures to invest and which to defer

… all the while leveraging their passion, uncompromisingly.

The early SI&PF progress and successes have come through discipline; harnessing the passion to deliver:

1. Provocative member education (webcasts and newsletters),
2. Compelling research (conceived in 2011, funded in 2012, activity in 2013), and
3. Stimulating debates (annual meeting sessions).

I believe the robust actuarial skills set and the historically revered voice of the actuary is not always "right" … meaning we are not always in the right place at the right time with the right message at the right decibel level. The SI&PF section leadership is committed to building and exposing the "right" actuarial profile in relevant domains. Focused committees have emerged under the SI&PF section masthead for Social Security, health care and other ad hoc public finance issues in order to honor and encourage the highest level of actuarial involvement in areas of passionate concern for SI&PF members. The SI&PF section strives to bring forth education, research and

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next-generation ideas to equip us as actuaries to engage in compelling and competing issues: social insurance demands on our economy, balance across all stakeholders and political viewpoints, branding the actuarial profession as an active and trusted voice in the debates, etc. It is the mélange of SOA members and the experiences we each have that will help generate the "right" actuarial SI&PF perspective

Susan Pantely is now the SI&PF section board liaison and my new liaison assignment is with the Actuary of the Future (AoF) section. However, I remain a member of the SI&PF section and, certainly, a friend of the council. I stay connected to the passionate evolution of the SI&PF and invite opportunities to collaborate this passion with that of the AoF. SI&PF is still considered a "young" section, with innovation and volunteer involvement building momentum and membership sprawl yet to hit full stride. Its inventors stand proud, but also, actively vigilant. I encourage the broader group of SI&PF section members and non-members to engage in the SI&PF education, professional debates and far-reaching thought leadership … you and your expertise are important to the Social Insurance and Public Finance issues of our era!

Best Regards,

Valerie Paganelli
SOA Board Member Liaison to Social Insurance & Public Finance Section (2010-2012).

INTERVIEW WITH AN ACTUARY IN THE PUBLIC INTEREST

By Jeffery Mark Rykhus

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Bruce Schobel, FSA, FCA, MAAA, is retired. He can be contacted at *bdschobel@aol.com.*

I recently sat down with Bruce Schobel to talk about his experiences in the public sector, working with Social Security, the Greenspan Commission and advocating for the public throughout his career. Following are excerpts from our discussion:

What is your current professional role and how does it relate to the public?

I am semi-retired. I took early retirement from New York Life in April 2012. I speak on Social Security every now and then and still serve on some professional committees.

What is your educational background?

I grew up in Cleveland, Ohio, went to college at Massachusetts Institute of Technology, never failed an actuarial exam, and became a fellow in 1976, two years after college graduation.

What is your professional background?

I took my first job as an actuarial student in 1974. In 1975, I went to my first Society of Actuaries annual meeting, where I met Bob Myers. During my exam studies I had read more of his Social Security book than was required on the syllabus. I just couldn't put it down! Anyway, I told him I had read his whole book and loved it, but believed that I had discovered 12 errors. After Bob went through each "error" with me, about six turned out to be real errors. Bob really appreciated the thorough (though unsolicited) review and asked me to review every future edition for him.

In fact, Bob was one of my heroes. I really liked him a lot. I had been at Prudential, but in 1979, started working in the disability program at the Social Security Administration (SSA). I found a letter from Bob Myers in the files there and answered it. Bob was appreciative and that formed the basis for our friendship.

In March 1981, Bob was made Deputy Commissioner of Social Security, at age 68, and he came and found me to come work with him. We both worked on the Greenspan Commission. Afterward, I did other cool things in the government. At age 36, at the end of the Reagan administration, I left the government and went to Mercer to be their expert on Social Security. At Mercer I was in constant conflict with my bosses because I spent so much time answering internal questions from other Mercer consultants rather than billing clients. In 1990, I went to New York Life, and, with them, I was free to do Social Security consulting on the side. I was also appointed to the ACLI (American Council of Life Insurers) Social Security Committee and chaired it for a long time.

What prepared you most for your professional role?

I was lucky in lots of ways. Bob Myers was really, really cool, and we shared a lot of our personal lives together. You never know who you are helping. Answering Bob's letter back in 1979 led to a satisfying career for me, but I never took my friendship with him for granted. It's getting worse today. People are expecting some payoff for everything they do. I became an influential 29-year-old by virtue of Bob Myers bringing me in. I've left my fingerprints all over the Social Security Act. And I was able to accomplish all this just by being in the right place at the right time. I got lucky.

What are you most proud of?

The Greenspan Commission was reaching an end in 1982, but was having trouble concluding its work. They had agreed on many changes to Social Security, but needed some balancing items in their proposal to get them through 1983 (when the trust fund was about to reach zero). I was the one who came up with the idea. I said, "Why don't you refinance military service wage credits?" The idea was to force the military to pay taxes, with interest, into the trust fund, on this non-wage credit, all the way back to the beginning, for the military service wage credits. Because of this idea, $26 billion was credited immediately to the trust fund, the Treasury issued the bonds, and the 1983 problem was solved. No one in the general public had to pay a dime. It was nice to be able to show that actuaries can come up with policy ideas.

Are there any other actuaries that work directly in the public interest that you admire?

Dick Schreitmueller. He's about 80 right now. He worked in the Social Security Administration when I was there. He had a lot of impact designing the 1986 Federal Employees' Retirement System (FERS).

What are some of the ways that you have been able to stand up for the public interest?

In the late 1980s, increasing the number of years over which Social Security benefits are computed was very popular, with 40 years, rather than 35 years, a common proposal. The Moynihan proposal (using the high 38 earnings years to compute benefits) would have caused maybe 90 percent of the savings to come from women. Many women already had zeros in their earnings records. Senator Moynihan killed that proposal, after I made people aware of the unintended consequences of it.

In 1981, David Stockman proposed several things to change Social Security, and one was especially bad. He wanted to increase the early retirement reduction factors to 15 percent per year. This would have resulted in a 55 percent benefit, for three years early retirement, versus 80 percent, which is what it was at the time. This would have been a dramatic change in the short term. I hypothesized that the only people who would suffer would be poor people who had to take early retirement. It was a cruel way to cut benefits and benefit outgo. Rich people were inoculated against it because it was only the poor who couldn't delay retirement that would truly suffer. I was happy to be against that proposal, and it eventually died.

How have you dealt with difficult situations?

During George W. Bush's second term, starting with his second State of the Union address, he had pushed individual accounts for Social Security in a way that was intellectually dishonest. I tried to talk to people on the inside. That didn't work. Then I helped people on the outside to understand it better.

What was your most rewarding job?

There were two jobs I found most rewarding: staff actuary for the Greenspan Commission and senior policy advisor for the Commissioner of Social Security, Dorcas Hardy. The first job was a very challenging job, but I knew it was supposed to end in 1982, and it really did end in 1983. That's why it was a tie. I felt like every day I spent with the Greenspan Commission was a major contribution to public policy, but it was temporary. The other job lasted longer.

Where would you like to see changes made in Social Security so as to have a positive public impact?

That's really easy. The biggest danger is the loss of confidence in Social Security among younger people. We want to get a package of changes enacted into law. The only people who really believe in Social Security right now are age 55 and older. We might as well make the necessary changes now and get it over with.

Do you have any thoughts to share with current and future actuaries working in professional roles having a direct impact on the public?

Always be alert to opportunities to act in the public interest. We don't always think about what's right for the general public, because we become too involved with employers and clients and lose sight of the public.

Bruce D. Schobel is located in Sunrise, Fla. He can be reached at bdschobel@aol.com.

The only people who really believe in Social Security right now are age 55 and older.

LIVING to 100

SOCIETY OF ACTUARIES
INTERNATIONAL SYMPOSIUM

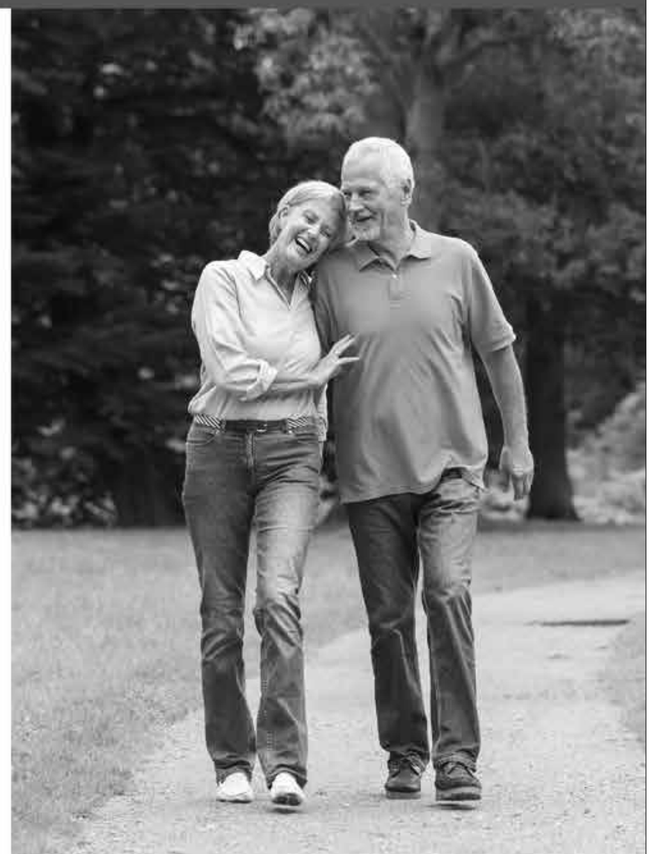
Living to 100 Symposium

The international Living to 100 Symposium will be held Jan. 8–10, 2014 in Orlando, FL. Thought leaders from around the world will once again gather to share ideas and knowledge on aging, changes in survival rates and their impact on society, and observed and projected increases in aging populations.

With the support of more than 50 organizations from around the world, past symposia brought together thought leaders from as many as 17 countries including a diverse range of professionals, scientists, academics, and practitioners. These professionals are expected at our prestigious 2014 event to discuss the latest scientific information.

The outcome of each Living to 100 Symposium is a lasting body of research to educate and aid professionals and policymakers in identifying, analyzing and managing the potential needs and services of future advanced-age populations. Questions may be directed Ronora Stryker, SOA research actuary, at ***rstryker@soa.org***.

Visit ***livingto100.soa.org*** to learn more.



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A BRIEF SURVEY OF DUAL ELIGIBLES AND THE ACA

By Rebecca A. Owen

In the world of social insurance in the United States, beneficiaries who qualify for both Medicare, due to age or disability, and Medicaid, due to low income, hold a special place. Known as dual eligibles, they are a vulnerable, highly needy population, who must navigate two systems that do not always work well together. These beneficiaries are more likely (than the general population) to have been disabled for much of their life, to have multiple chronic health conditions and to have difficulty in advocating for their own needs. A portion of the Affordable Care Act (ACA) is devoted to dual eligible coverage needs and to improving the coordination between the federal and state governments to deliver better, more cost efficient and more consistent care.

Dual eligibility means Medicare covers the bulk of a dual eligible's medical costs for physician and hospital services, while Medicaid coverage (which depends on the reason the beneficiary qualified) includes premiums and cost-sharing from the states. Usually, Medicaid also covers benefits, notably long-term care costs, not covered by Medicare.

Some statistics on dual eligibles are enlightening and highlight how distinctive this population is.

- In 2008 there were nine million dual eligible beneficiaries nationwide.
- Nearly one-third of the population is disabled and many have complex mental health issues.
- More than three-quarters of the costs of services are for members with five or more chronic conditions.
- Dual eligibles are more likely to be in long-term care and are much more likely to be functionally impaired.
- Nearly 20 percent of Medicare beneficiaries are dual eligible; in 2008, they accounted for 31 percent of Medicare spending.
- On average, dual eligibles comprise 15 percent of the Medicaid enrollment; in 2008, they accounted for 39 percent of the spending—there is considerable variation in the composition of the population from state to state.

As can be imagined with two payers so disparate as CMS and state Medicaid plans, the care that these beneficiaries receive is not well-coordinated. The care currently given is fragmented and there is poor communication between the states (Medicaid) and the federal government (Medicare). Not only can this be confusing to the beneficiary, but there can be conflicting incentives to the payers. For example, Medicare costs are, generally, reduced with fewer and shorter acute hospital stays, but Medicaid, which pays for long-term care, has increased costs when patients are returned to a lower acuity setting sooner.

There are other problems with the care that dual eligible beneficiaries receive. Uncoordinated care can arise when the variety of specialists, needed to treat multiple complex conditions, overlook care or duplicate care. It is possible for beneficiaries to fall through the cracks between acute and long-term care. There are often problems

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with access to care due to transport problems or the availability of practitioners. Beneficiaries may not be able to assess their own condition or to communicate their needs to their caregivers. They may have difficulty understanding how to navigate the system to receive the care they need, and they often rely on others to do this for them. This is a challenging population to serve, and the lack of communication between the two government payers makes it harder to find solutions.

Medicaid managed care plans and Medicare Special Needs Plans (SNPs) evolved to help improve the level of coordination, as well as to better manage complex conditions. In 2009, fewer than 30 percent of dual eligibles were enrolled in either a managed care plan or an SNP. These two kinds of plans do a good job of coordinating services within their coverage provisions, particularly for acute care. However, they have not been as effective in coordinating or contracting with long-term care providers, and this is an area of concern.

Long-term care (LTC) needs are an important component of the dual eligible population. More than three-quarters of the Medicaid spending on these beneficiaries is for LTC, either in an institutional or community setting. The demand for long-term care needs is expected to grow as the population ages. In addition, the prevalence of long-term chronic diseases such as diabetes, obesity and heart disease in an aging population means that beneficiaries may live longer, but are also likely to be infirm. Long-term care facilities and community support are already in short supply, and there are widespread problems with the quality of care. These health issues will be occurring at the same time as a lack of retirement income, coupled with much less provision for long-term care expenses. The result will be to push retirees into such dire financial straits and there will be an upward trend in those who will be eligible for both Medicaid and Medicare. The policy implications are considerable.

The Accountable Care Act (ACA) has some provisions that elevate this issue, bringing it to the attention of both policy makers and the public. The Federal Coordinated Health Care Office was established within CMS to improve coordination of care for dual eligible beneficiaries. The mandate for the office is clear; "Supporting state efforts to coordinate and align acute care and long-term care services for dual eligible individuals with other items and services furnished under the Medicare program."

CMS has funded demonstration projects in more than a dozen states to try to find a better way to serve this population. These projects will test either a modified fee-for-service or a capitation model. They will work on coordinating acute care, as well as long-term care, and on smoothing communication lines between the two funding sources.

Here are a few examples of demonstration projects:

- California has the Cal MediConnect Program, starting this year, which "aims to create a seamless service delivery experience for dual eligible beneficiaries, with the ultimate goals of improved care quality, better health and a more efficient delivery system."
- The Illinois version seeks "to provide Medicare-Medicaid enrollees with a better care experience by testing a person-centered, integrated care program that provides a more easily navigable and seamless path to all covered Medicare and Medicaid services."
- Ohio will use Integrated Care Delivery System (ICDS) plans, which will be paid a capitation to "coordinate the delivery of and be accountable for all covered Medicare and Medicaid services for participating Medicare-Medicaid enrollees."
- Washington will use a "managed-fee-for-service care model that will build upon its planned Medicaid Health Homes targeting Medicare-Medicaid enrollees with chronic health conditions."

While these demonstration projects have similar descriptions, the reader should note that there is wide geographic variation in the composition of the dual eligible population. State Medicaid plans differ broadly. The only generalization that can be made is that there is no single solution that can be applied to all the states. Solutions will emerge from the demonstration projects. However, solutions will take a while to develop, are likely to be localized in nature and, most likely, will require modification to be implemented in other locations.

The press has featured numerous articles on expansion of Medicaid and how each state will integrate Medicaid with the exchanges, but coordination of care for the dual eligible population has not been as popular a topic. Coordination poses a thorny problem, particularly in the area of long-term care. The impact is widespread and very large. There are several websites that will help the reader stay apprised of the emerging policy issues. The Kaiser Family Foundation site, http://www.statehealthfacts.org/, is an excellent source. The Medicaid.gov site, *http://www.cms.gov/Medicare-Medicaid-Coordination/Medicare-and-Medicaid-Coordination/Medicare-Medicaid-Coordination-Office/index.html,* gives the specifics of the provisions of the act as it relates to the dual eligible population. Further specifics on the Demonstration projects will be detailed in a Health Watch article to be published this summer by the Society of Actuaries Health Section.

There are several websites that will help the reader stay apprised of the emerging policy issues.

HEALTH CARE REFORM AND THE ACTUARIAL PROFESSION

By Dwight K. Bartlett

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The time has come for the actuarial profession to assert its views on significant policy steps which should be taken to rein in the cost of medical care in this country and state the impact of those steps on our federal and state budgets. While our profession provides much useful research in developing proposals for improving the health care system, the projected crisis is so severe that this is not enough. We should state our recommendations much more forcefully to policy makers and the public.

It is widely known that we spend close to 20 percent of our gross domestic product on health care, which is far greater than what is spent in most other economically rich countries. And we get far less for that expenditure than most other nations do, if life expectancies and infant mortality rates are used to measure the comparative effectiveness of health care systems. The United States ranks behind dozens of other nations in these statistics; see, for example, the ranking tables for these statistics in *Pocket World in Figures*, 2008 edition, published by *The Economist*. In my opinion, our present methods of providing and financing health care are dysfunctional.

It is, perhaps, easier to state what proposed solutions will be ineffective in making major progress in dealing with this crisis. Making reforms to Medicare may be part of the solution but will be insufficient by itself. For example, there is much talk about raising the minimum eligibility age for Medicare from 65 to 67 to be consistent with Social Security. The Congressional Budget Office (CBO) estimates that raising the age from 65 to 67 by two months per year will save $148 billion from 2012 to 2021. That is not chump change, but it would only have a minor impact on our total deficit spending of approximately $10 trillion in the period from 2013-2022.[1] Furthermore, much of that savings will be offset by increased costs within the Medicaid program, for the estimated (by CBO) 5.4 million people excluded from Medicare who would qualify for Medicaid.

Reducing Medicare reimbursement to providers is another nonstarter proposal. In every year since 2003 such legislated cuts to physicians have been rescinded by Congress. The fiscal cliff would have resulted in cuts in reimbursements to doctors of 27 percent. If these cuts had actually been realized, the percentage of doctors who refused to take Medicare patients may dramatically increase. Fortunately, for the time being, Congress has acted to postpone these cuts.

There are other tweaks to Medicare under consideration, but even if Medicare could be fixed to bring it into balance and improve the long-term federal deficit problem, it would not solve the larger issue of providing effective health care at an affordable cost to all Americans. Balancing Medicare long-term could, however, provide a model for broader reform.

What has contributed to our grossly expensive and dysfunctional health care system is multifaceted and will require a multifaceted approach to bring it under control. Following, in my view, are several components of an effective response.

First, we must reform medical malpractice insurance. This insurance annually costs many medical specialists premiums approaching six figures. Ten percent of the total cost of all medical services is linked to malpractice suits and the practice of defensive medicine, according to a 2006 report by Pricewaterhouse Coopers, LLP.

In 1972, California limited noneconomic medical liability damages to $250,000 by the Medical Injury Compensation Act. More recently, in 2003, Texas took a similar step. According to the Texas Insurance Department, those reforms have led to a 25 percent decrease in medical liability insurance rates for Texas physicians.[2]

But this is a problem that demands a national solution rather than a piecemeal state by state solution.

Another concern we must address is the overall shortage of general practitioners (GPs) relative to specialists. According to a recent *New York Times* (*NYT*) article,[3] the United States is projected to have a shortage of 50,000 GPs by the end of the decade. This shortage is, assuredly, aggravated by the recent development of concierge practices of GPs. What characterizes concierge practices is an annual patient fee of anywhere from $600 to $5000. For this fee, the patient client (supposedly) creates a special relationship with his GP. This includes enhanced access to the GP, a very comprehensive annual physical, and some additional premium services without additional charge. Many concierge practices will accept patients only on this basis. GPs who have adopted this style of practice have been able to reduce their patient load from 3,000 or 4,000 patients to a range of only 100 to 1,000 patients, while at the same time greatly increasing their income. Many such practices will not deal directly with any health insurance companies, including Medicare.

It is estimated that there are 1,000 to 5,000 concierge-style practices today. That amount may not be a major factor in the GP shortage right now, but the development of this style of practice is growing rapidly. At some point it will create a tipping point, where access to GPs will be significantly affected. Thus, effectively, a two-tier health care system is being created. Those who can afford the concierge practice enrollment fee will get very effective care, and those who can't will suffer the consequences of limited access to care by GPs.

Another factor contributing to the shortage of GPs is the high cost of medical school education and the resulting heavy student loan burden on medical school graduates. A recent *NYT* article[4] stated that the median loan level of medical school graduates is $160,000 and one-third of graduates' loan balances exceed $200,000. Doctors choosing residencies and contemplating how they are going to cope with their heavy loan burdens are, undoubtedly, influenced by their high loans to choose a higher income specialty rather than a lower income GP practice, apart from the concierge-style GP practices.

Whether government can afford to intervene or medical schools, themselves, will intervene to reduce this burden requires more research. However, the issue is so severe it demands a fix.

Finally, the reform that would be the most dramatic in "bending the curve," i.e., reducing the rate of increase in the cost of health care, is moving away from the fee-for-service (FFS) method of reimbursing providers, or principally paying hospitals and doctors for each service they give. That providers respond to the incentives of FFS by providing more expensive forms of health care, more frequently, is strongly suggested by direct and indirect evidence. Examples of this evidence are cited by Shannon Brownlee in her book, *Overtreated, Why Too Much Medicine Is Making Us Sicker and Poorer*.[5] She notes, for example, Medicare annual claims costs per enrollee averaged $8,414 in Miami and $3,341 in Minneapolis in 1996. Yet there is no reason to believe Medicare enrollees were any sicker in Miami than Minneapolis.[6]

Another example cited by Brownlee was the differing rates of tonsillectomies in two Vermont communities in a study in the early 1970s. In Stowe, 7 percent of children under age 16 had their tonsils removed, while the rate was an astonishing 70 percent in nearby Morrisville. These two communities were very homogeneous in their socio-economic and ethnic makeup.

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The increasing availability of high tech equipment, access to specialists, and access to hospital beds also drives up costs without necessarily resulting in more effective care. Ms. Brownlee notes the differing costs incurred by Medicare enrollees during the last two years of their lives. In two different hospitals in California, one group had costs of $104,000 and the other group had costs of $37,000. Not surprisingly, the more expensive hospital had many more specialists on staff and many more hospital beds per thousand Medicare patients served.[7]

Ms. Brownlee goes on to cite the lower cost of systems that currently operate on other-than-a-FFS basis. She cites, in particular, the Veteran's Health Administration (VHA), which in 2002 had claim costs of $2,910 per enrollee, versus $4,576 for the general population.[8]

These examples, while subject to criticism as anecdotal and outdated, are just a few of those cited in Brownlee's book, which is well worth reading.

Another, more recent (12/26/12), article in the *Baltimore Sun* titled, "Over Treatment Common, Study Finds," quoted a source as saying, "one component of the high health care costs is the overuse and misuse of therapies and interventions." It cited, in particular, prostate screening for older men and screening for older women for breast cancer. It did not attribute this overuse to FFS financing of health care, but the implication is clear.

There is clearly a growing consensus that FFS financing of health care is a major factor in driving the cost of health care upwards at rates which can sometimes be multiples of the general rate of inflation in our country. See, for example, an article which appeared in the Oct. 10, 2009, issue of the *Christian Science Monitor,* which gives a good summary of the case against FFS-financed health care.

The Affordable Care Act does take some timid steps away from FFS financing of health care. Most importantly, perhaps, it provides for the creation of Accountable Care Organizations (ACO). Made up of integrated hospitals and doctors, an ACO serves a substantial population. Although ACOs may charge patients for care on an FFS basis, their overall reimbursement will be modified each year by modest positive or negative adjustments, computed as a function of statistics measuring the effectiveness and cost of the health care provided. Whether these adjustments will be large enough to substantially modify the behavior of the providers in the ACO remains to be seen.

I have cited only three reforms to the financing and providing of health care, all of which I believe the actuarial profession should be more assertively advocating. In summary, these reforms are, (1) reform medical malpractice insurance and liability, (2) address the shortage of General Practioners, and (3) move away from FFS reimbursement of providers. Other reforms might be added to the list, such as moving away from employer-financed health insurance, which is currently the main form of health insurance for those not enrolled in Medicare or Medicaid. Employer-financed health insurance, arguably, removes the incentive for the covered person to make more thoughtful decisions about the cost and effectiveness of the health care he/she is receiving. As you can imagine, there are many combined efforts that could help solve the health care cost problem that we face today.

If you have read this article in full, I hope you will understand why the actuarial profession needs to assume a more assertive leadership role in the public interest. We must pursue these and similar reforms to our health care system, where problems are reaching a crisis level.

END NOTES

1. "Hopes dim as lawmakers return to make a final push for deal," Washington Post, 12/26/12.
2. Medical Malpractice, *Wikipedia,* 12/16/12.
3. "Tackling the Problem of Medical Student Debt," Pauline Chen, *NY Times*, 12/13/12.
4. Ibid.
5. *Overtreated, Why Too Much Medicine Is Making Us Sicker and Poorer,* Shannon Brownlee, Bloomsbury USA, New York, 2007.
6. Ibid, p. 35.
7. Ibid, p. 116.
8. Ibid, p. 270.
9. Accountable Care Organizations, *Wikipedia*, 12/28/12.

SOCIAL INSURANCE IN THE WAKE OF THE AFFORDABLE CARE ACT

By Bob Tate

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As we enter 2013, the sixth year since the beginning of the Great Recession in December 2007, it seems that the political culture of Washington is permanently changed. No political issue gets talked about more than deficit reduction, and our elected leaders lurch from the debt ceiling to the government shutdown to the fiscal cliff to the sequester and back to the government shutdown, with no meaningful deficit reduction plan resulting from any of these crises.

One constant in the discussions surrounding all of these crises is the need to "reform entitlement spending. As the baby boom generation retires, politicians from both political parties acknowledge that Social Security and Medicare benefits will inexorably consume a larger and larger portion of the nation's Gross Domestic Product (GDP). As a result, the current tax structures supporting Social Security and Medicare will not be able to provide the promised benefits at some point in the future.

As actuaries, we might know entitlement spending by another name—social insurance.

As actuaries, we might know entitlement spending by another name—social insurance. These programs, starting with Social Security in the 1930s and expanding with Medicare and Medicaid in the 1960s, were enacted to provide, on a national basis, statutorily defined benefits to those who qualify based on age, disability or low income.

We might also recognize that passage of the Affordable Care Act in 2010 introduced another social insurance program. The federal goverment will now provide private medical insurance premium and cost sharing subsidies for Americans with incomes lower than 400 percent of the Federal Poverty Level (FPL). Medicaid, in many states, will also be significantly expanded by replacing a patchwork of state Medicaid eligibility rules with a national income test of 133 percent (or, in some states, lower) of FPL.

HOW BAD IS THE ENTITLEMENT SPENDING PROBLEM?

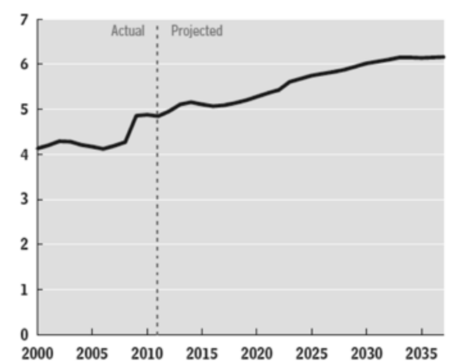
With this addition to our social insurance infrastructure about to go into effect in 2014, now is a good time for actuaries to remind themselves of the overall magnitude of spending on these programs. When politicians in search of sound bites start throwing around loaded terms like "bankruptcy" actuaries can provide a balanced view. We can provide mathematically sound projections that show the magnitude of the impact of proposed policy changes.

Fortunately, we can look to projections from the Congressional Budget Office (CBO) to see the magnitude of these social insurance programs. The graphs below show figures for the next 25 years, until 2037, from the CBO's 2012 Long-Term Budget Outlook.

Figure 4-1.

Spending for Social Security Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

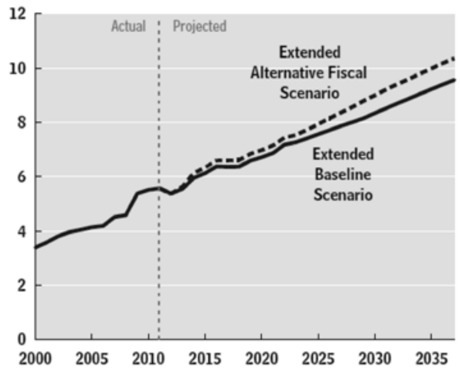
Note: Projected spending for Social Security is identical under CBO's two long-term budget scenarios—the extended baseline scenario and the extended alternative fiscal scenario. (For details of the scenarios, see Table 1-1 on page 8.)

Figure 4-1 shows that Social Security, because of the aging of the population, is projected to gradually increase from 5.0 percent of GDP to 6.2 percent. So over these 25 years, Social Security is projected to grow to take up 24 percent more of our economy than it does today.

Figure 3-3.

Federal Spending on Major Health Care Programs Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: The extended baseline scenario generally adheres closely to current law, following CBO's 10-year baseline budget projections through 2022 and then extending the baseline concept for the rest of the long-term projection period. The extended alternative fiscal scenario incorporates the assumptions that certain policies that have been in place for a number of years will be continued and that some provisions of law that might be difficult to sustain for a long period will be modified. (For details, see Table 1-1 on page 8.)

Figure 3-3 paints an even more ominous picture for Medicare and the newly expanded Medicaid, CHIP, and Exchange programs. Under the alternative scenario, combined government spending is projected to grow from 5.4 percent of GDP today to 10.4 percent of GDP in 2037. That is a 93 percent increase in the portion of the economy taken up by federal government health care spending.

CONTRIBUTION OF THE AFFORDABLE CARE ACT

These social insurance spending increases would obviously be smaller without the new social insurance benefits added just three years ago with the Affordable Care Act. However, subsidies and Medicaid expansion did not add a huge amount to our social insurance burden. Subtracting the current spending for Medicaid, CHIP and Exchanges (1.8 percent of GDP) from the projected 2016 spending (after all ACA changes will have had time to phase in—2.6 percent of GDP), you can see that the new spending under the ACA only added at most 0.8 percent of GDP to total social insurance costs. This is less than 10 percent of total social insurance spending in 2016.

COMBINED IMPACT OF INCREASED SPENDING

Individually, the increasing cost of any given social insurance program is concerning, but when you add them all together, the figures start to take on real significance. According to Figures 4-1 and 3-3, the combined social insurance programs' current costs are 10.4 percent of GDP. After 25 years, they are projected to increase to 16.6 percent of GDP. These social insurance payments will take up 60 percent more of our economy than they do today.

That increased share of GDP is probably enough to be concerning on its own. But when you compare this total spending to the CBO's Long-Term Budget Outlook for tax revenues, you can see why politicians will be talking about entitlements for a long time. In the CBO's alternative (i.e., more realistic) scenario, tax revenues are projected to be 18.5 percent of GDP in the long run. Federal government interest payments are projected to be 2.5 percent to 3.0 percent of GDP.

That means that social insurance plus interest spending is projected to be 19.1 percent to 19.6 percent of GDP while tax revenues will only be 18.5 percent! To have something close to a balanced budget, that leaves no room for any other federal government spending for defense or anything else. Today that other spending accounts for about 10 percent of GDP. So you can see why, aside from political posturing, our political leaders talk so much about entitlement spending and why they will continue to do so for the foreseeable future.

IS THERE ANY HOPE?

With distressing budget projections like the ones above, is there any hope for the federal govern-

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... social insurance payments will take up 60 percent more of our economy than they do today.

ment's fiscal situation, or should a wise actuary just move to Norway?

Actually, it is important for actuaries and others familiar with long-term projections to provide reasonable and measured input to politicians as they assess potential changes to social insurance programs. Long-range projections can provide valuable insights into the future of these programs. They also can demonstrate how seemingly small changes can greatly influence the magnitude of perceived problems.

For example, it takes less than a 1 percent reduction in the annual growth rate of Social Security to erase all of the excess growth projected in that program over the next 25 years. Shaving 2 percent off the annual growth rate of medical costs removes about half the excess growth in those programs. Changes of that magnitude certainly won't be easy, but perhaps careful and wise actuaries can help guide our politicians to reasonable changes that are not too painful for the public.

THE NATURE OF SOCIAL INSURANCE PROGRAMS AND THEIR FUNDS (PART 1 OF 2)

By Sam Gutterman

This article consists of a point-counterpoint dialogue addressing important aspects of social insurance programs. It discusses the desirability and advantages of these programs that provide financial assistance to those who are retired, disabled, ill or unemployed. The second part of this article that will be included in the next issue of *In the Public Interest* will address whether pre-funding of a social insurance program can occur and contribute to the financial security of the participants.

Further, it discusses whether these programs are Ponzi schemes or whether their social contract can form a sustainable basis for generational equity. Fundamental differences of opinion exist regarding these programs, not only due to different personal and political values, but also as a result of the viewpoint from which it is evaluated (for example, the program in isolation, the sponsoring government's financial situation or the overall national economy).

Together this and the subsequent article summarize a longer paper that can be downloaded from the website of the Social Insurance and Public Finance Section at http://www.soa.org/professional-interests/social-ins/default.aspx. Note that the author does not agree with all the views described. A single best answer may not exist for each issue, with different points of view being legitimately held.

BACKGROUND

A social insurance program is designed to protect individuals against the adverse financial effects of demographic-based hazards (such as greater-than-expected longevity after retirement, disability, expensive medical treatment and unemployment) by sharing these costs across population segments and generations. Its benefits are payable when designated events occur and indicated criteria are met. It normally disregards the individual's income or assets, although contributions or benefits can be tilted to favor a population segment more in need.

Government can make participation compulsory or heavily enough subsidize it so that most of those eligible choose to participate, resulting in coverage of a large part of the population. These programs are often financed by contributions from employers and employees, as well as in some cases from general government revenue and related investment income. Law or regulation defines their features, including eligibility requirements, benefits, and financing. They contrast with social assistance (welfare) programs that provide benefits only for those in need.

In many cases there is at least some pre-funding from contributions in excess of benefits because of higher cost per participant as they age or the program matures. In some cases pre-funding is not used, in which case the program operates strictly on a pay-as-you-go (PAYGO) basis in which current contributions pay for today's benefits.

Two views are presented, expressing opposing perspectives that have been taken by various stakeholders and commentators on social insurance programs. One perspective Supports (S) the long-term nature of these programs and a mechanism to provide for pre-funding of benefits, while the other presents the Alternative (A) view that argues that either (1) program benefits are badly targeted or inappropriate and can have adverse consequences or (2) funds generated under these programs are illusory. These views have often been taken by different political camps, with those supporting greater collective societal responsibility tending to support S, while those in the A camp tending to support more individual responsibility for personal financial planning. Concerns over the sustainability of a population financial system to support adverse financial effects of individual's risks are contrasted with those more concerned with the well-being of the economy as a whole.

POINT-COUNTERPOINT

Is social insurance insurance?

S — Social insurance is similar to other insurance programs that incorporate pooling of risks.

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A social insurance program that provides benefits after retirement can be viewed as a large defined-benefit pension or health plan. ...

Its benefits, determined by formula, are payable to designated beneficiaries. It protects participants financially from current and future changes in their condition, including their longevity and health status. Social insurance is not intended to provide for first class benefits, but it is intended to be sufficient for most participants to cover the types of risks that might be provided by private insurance.

A — It has little in common with a private insurance plan other than the pooling concept, although it does deal with some of the same risks commonly covered by private insurance. In contrast, it also pools demographic and financial risks across generations and various population segments. Other differences include an emphasis on social adequacy at the expense of private equity, mandatory or heavily subsidized rates to ensure close to universal participation, legal/regulatory rights (thus, changeable if the law/regulation changes) rather than contractual rights, and use of partly pre-funded or PAYGO financing rather than full funding. From the government's perspective, it is not very different from other public programs, although there may be a hint of an implicit guarantee because of its long-term nature, but that is similar to other functions as defense and education.

Don't most social insurance programs operate just like private retirement plans?

S — A social insurance program that provides benefits after retirement can be viewed as a large defined-benefit pension or health plan, with contribution rates and benefits enacted by law. In many social insurance programs, contributions or benefits favor those who need public support more. It is developed to provide for the systematic payment of determinable benefits after retirement—just like a private defined-benefit pension plan. The more a participant contributes, the greater his or her benefits are. Social insurance programs also anticipate a continuous flow of new entrants (e.g., births and new entrants to the labor force), just like newly hired workers in a private pension plan. Thus, although social insurance cross-generational issues are somewhat unique, as long as the employer remains a going concern, there is no difference.

A — Social insurance at most shares the form and certainly not the substance of a private retirement program. Although it also protects against longevity risk, the amount of these benefits normally does not provide by itself a standard of living most participants would be happy with. It normally involves some form of wealth transfer between generations, as those who contribute to the program (employers and employees) don't have to pre-fund all of their benefits, nor are contributions necessarily determined in a direct actuarial relationship to their benefits.

How is social insurance different from a welfare program?

S — In contrast to a government-sponsored welfare program that incorporates a needs-conditioned set of criteria for eligibility, the financial condition of beneficiaries normally does not directly affect benefits of a social insurance program, but it can provide a minimum level of benefits to their participants. Social adequacy, a key characteristic of social insurance, provides what society considers a minimum level of benefits for all participants. It is a program for the middle class, the vast majority of the population. In contrast, welfare benefits, being means-tested, only focus on social adequacy. Social insurance can redistribute income to those who have not been able to prepare financially for an adverse event or condition, but do so independent of consideration of the beneficiaries' current financial history or current financial status. It also provides some benefit to or increased peace of mind for all participants.

A — There is no need for the government to provide such a benefit to those who don't need it. The wealthy should be embarrassed by accepting a public pension while others live in near-poverty conditions. The middle class shouldn't come to expect what may be an unaffordable level of benefits—they need to better provide for their own future. The purpose of a government safety net is to help keep people out of extreme poverty or to redistribute income, either between population segments or generations, although recently it has provided benefits to the middle class who have lived beyond their means. Society cannot afford to provide benefits forever to those who can and should provide for themselves. Our aging societies cannot support all of these extravagant benefit programs, as there will also be other demands for society's limited resources.

There are at least two possible views of social insurance—as a stand-alone program and as part of the overall economy. Do higher earlier contributions really constitute pre-funding? Why pre-fund at all?

S — Pre-funding is desirable for many social insurance programs where increasing costs are expected, for example, due to an aging population. Pre-funding reduces somewhat the burden on future generations and tends to reduce intergenerational inequities. Further, to operate independently and avoid periodic borrowing, a small contingency fund is useful to smooth out short-term fluctuations in contributions or benefits. As a result, segregated social insurance funds are generated as an accumulation of historical revenues, reduced by benefits and administrative costs. Perfect PAYGO financing assumes that subsequent generations will always be willing to pay for their parents and grandparents. A fund can focus attention by producing clearer measures regarding future funding risks compared with PAYGO financing information that defers cost pressure.

A — Partial pre-funding of most social insurance programs costs less than if provided through a fully funded private insurance or pension plan, due in part to its potentially huge size (in some countries the resulting fund might be greater than the size of the entire economy) and the understandable unwillingness to accumulate a huge public fund that would constitute a significant drag on the economy and would likely prove politically unsustainable. In essence, since money is fungible, the program's funds are in effect commingled with general government accounts. Arguments in favor of even partial pre-funding are at best theoretical, with the so-called funds just a large suspense account. That is, any pre-funding of assets held as government bonds are economically equivalent to using a pure PAYGO funding method, with accumulated funds representing a combination of money already spent and a gross-up of calculations that result in bonds both owed and invested in different parts of the government. A change in a fund balance doesn't create sudden attention and action. Even if the current generation remains committed to the program or if an identifiable fund

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has been accumulated, it is a wealth transfer scheme dependent on future governments to pay currently promised benefits after the current working population retires. Since benefits and contributions can be changed, whether the program is said to be pre-funded is not relevant. At best, the pre-funding slightly increases the likelihood that benefits will not be decreased and contributions won't increase—but if taxpayers/workers pay the interest, what is the real difference?

Some claim that social insurance is no more than a Ponzi scheme. At best, social insurance redistributes income earned during participants' working years, that would otherwise be used for consumption that could drive economic growth, to the old, who tend to hoard it; at worst, current workers pay for benefits for current retirees with no guarantee of receiving benefits when they need it. Is this accurate?

S — A key characteristic of a Ponzi scheme is an intent to defraud, by taking advantage of and cheating participants by promising extraordinary returns on their investments, often needing an ever-increasing number of participants to continue. There is no evil intent underlying the design of a social insurance program, as those in government responsible for these benefit programs receive no financial reward from the program. It is not a scheme to obtain immediate profit and its finances are transparent. Although later generations may end up bearing a significant share of the program's cost, it is the most practical and efficient approach available to address the huge social needs that it can meet.

A — Whatever the intention, the result is the same. New money pays for old obligations, and old money was used when contributed for other purposes. Fulfilling the program's promises represents a significant cost or drag to current and future taxpayers. This Ponzi-equivalent scheme is one in which participants are "forced" to join, with early joiners profiting most. Its funding depends on the willingness and ability of subsequent generations to contribute. Considering the long time before they receive benefits, what happens if current or future contributors simply say "enough is enough"? The current and next generation would be out of luck, especially if economic difficulties arise or overly generous promises are given. Many young people are worried that Social Security will not be there for them—should we expect that politicians will always act in the public's long-term best interest? An apparent Ponzi scheme can be just as bad as a real one. Whatever the intent, ultimate cost pressures may lead to cutbacks, possibly turning it into a non-guaranteed welfare scheme with significant financial harm to those who have relied on what they thought were guarantees. With no binding promises exchanged, a social insurance program is just a set of voluntary gifts from one generation to another, while the current generation hopes that the next will be equally charitable. That is as close to a Ponzi scheme as one can find in a public program. It is a massive cookie jar filled with IOUs and promises to pay by possibly an overly indebted country.

If not a Ponzi scheme, then at least aren't huge intergenerational subsidies involved?

A — In part because of differences in perspective of those in the generations involved, the definition of intergenerational equity or fairness is impossible to agree upon, let alone achieve. Nevertheless, perceived inequity is inevitable because of population dynamics and the impracticality in obtaining agreement as to what are fair contribution and benefit levels. Although a large percent of young American adults think Social Security is important, only one-third think the program will benefit them. In looking ahead to their future financial security, uncertainty and skepticism regarding this program exist. These young people ask their parents why today's rich society will not provide the benefits the previous generations received. Not only do many view social insurance as sacrosanct entitlements, but companies are now less willing to assume longevity or investment risks associated with defined-benefit pension plans. This is in part because the rules that the baby boom generation introduced to ensure their own entitlements cannot be fulfilled. It is hard enough for most people to provide for current needs, let alone to set aside enough funds for future needs.

S — Fairness has several meanings, depending on who you are. Social insurance programs can be viewed as being fair to the extent they adhere to the principles of social adequacy and individual equity. Reflecting voters' views, current and future politicians will stand up to the pressure to avoid future raids on program funds to radically cut back benefits for use in populist programs, expansion of benefits or public debt reduction. Intergenerational equity is an overused but still important concept. Almost all parents want to provide opportunities to their children to become better than what they had. But if each person/generation acts as if they are the only ones deserving of financial rewards, then perverse action will result. The bonds between generations are far stronger than what they are made out to be. A true social contract implemented through a social insurance program can exist if future generations agree to honor the financial obligations created by the past generation, in the expectation that the following generations will do likewise.

Now that we have discussed what you think social insurance is and is not, why do you believe that these programs are a desirable way to create financial security?

S — Social insurance is unique, emphasizing protection for the lower- and middle-income classes while at the same time providing benefits to all participants. It addresses human needs in an effective and cost-efficient manner, with a focus on the financial security risks that people face who either do not or cannot adequately prepare themselves financially. It combines social adequacy and individual equity characteristics. Its scope and breadth of participation results in a broad pooling of risks, provided in a more humanistic and fair manner than other approaches. By reducing dependency on welfare, it does not create a second class citizenry that would reduce social solidarity and harmony. The promotion of social support for those in need benefits society as a whole, as well as providing personal financial security in a period of austerity and cutbacks in private defined-benefit pension plans.

A — Although the objectives of social insurance sound worthwhile, they can be better achieved by other means, through a combination of private insurance/savings and welfare benefits. These can also be designed to meet the financial needs of particular population segments as they arise in a dynamic and more affordable manner, avoiding a one-size-fits-all approach to meeting needs that cannot all be the same. In addition, the very existence of a social insurance safety net reduces personal incentives and responsibility, as well as reducing participants' personal options and liberties. Society cannot continue to take on seemingly unlimited financial obligations to certain population segments without considering the financial effect on society and the economy as a whole. Required and formulaic pre-funding in periods in which such pre-funding is not financially affordable is inadvisable at best.

Social insurance is unique, emphasizing protection for the lower- and middle-income classes while at the same time providing benefits to all participants.

SOCIAL INSURANCE AND PUBLIC FINANCE PENSION RESEARCH PROJECT SYNOPSIS

By Social Insurance and Public Finance Pension Sub-committee

Public pension plans are mentioned frequently in the media and it is no secret that a number of high profile plans are significantly underfunded. Further, it is difficult to make an assessment of the nature and degree of the situation given the available information. For these reasons, the pension sub-committee of the Social Insurance and Public Finance (SI&PF) section has undertaken a research project to design a prototype public pension report. This report will focus on ensuring that relevant information about the financial health of all plans is readily available and accessible to all interested parties, including sponsors, participants and state and local officials. The sub-committee's main aim in undertaking this research is to design a prototype report that is transparent, understandable and informative to those with an interest in public pension plans.

In designing the prototype report, the structure of an actuarial control cycle will be used as a guide. As with other actuarial applications (e.g., valuation of insurance organizations or books of business, establishment of insurance liabilities, etc.), an actuarial control cycle can serve as a continuous feedback loop on the financial health of public pension plans. Among other items, information that could be communicated (as the final result of this project) is as follows:

- Financial results and implications produced from the use of current assumptions and methods.
- A different set of results, with different implications, produced from the use of alternative assumptions and methods.
- The impact on results if experience emerges differently than assumed.
- The impact on results of different governance decisions.
- Those assumptions with the most significant impact on the financial condition of the plans.

The sub-committee recognizes that its prototype report will set an ambitious benchmark, but hopes to encourage dialogue and action within the actuarial community that will lead to its general adoption (after an appropriate revision thereof) as an example of best practice over time.

In completing its research the sub-committee will prepare a number of sample prototype reports of public pension plans with both strong and weak financial positions, using public data, thereby illustrating what information generally is available today, the gaps to be filled in order to meet the aspirational report content, the activities the actuarial profession can undertake, and the influence it can exert to reach the "best practice" report format. These reports will have a common format, but will allow for some variation due to differences in available information and the relative priority of issues that plans confront. By improving the communication regarding the financial health of public pension plans, we are improving the ability of all to enter this dialogue, on how best to improve the financial condition of public pension plans.

The sub-committee will present the initial results of its research at the SOA's Annual Meeting in

October 2013. The session content will include the following:

- A presentation of the draft prototype report.
- A discussion focused on the key gaps observed between information that is generally available today and that which could be considered in best practice.
- The development of the next steps to encourage the general adoption of a best practice prototype report for public pension plans.

SO WHAT?

By Andy Large

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There have certainly been more than three times that I have had my name announced as I walked across a stage, but, without question, the most recent three were also the most memorable and meaningful: June 2000, at Dobyns-Bennett High School in Kingsport, Tenn.; May 2005, at the University of Tennessee in Knoxville; and June 15, 2012, at the Landsdowne Resort, 20 minutes outside Washington, D.C. Graduating from high school, graduating from college, and successfully earning my fellowship in the Society of Actuaries (FSA) were three milestone events that I will never forget; each one filled both me and my loved ones with pride and excitement, and each one was tied, inextricably, to its own defining question.

For the readers who have never experienced any one of these three events, I say to you, "This is a newsletter for actuaries; it's only going to get more boring from here." For the rest of you, I'm sure you vividly remember (subject, perhaps, to the vagaries of time) some variation of the same questions I kept hearing during these three periods of my life: (1) "What are you going to study in school?" (2) "Do you have a job lined up?" And, of course, the ever-present (3) "Now, what exactly is an actuary?"

These questions, burning in the hearts and minds of those closest to me, were asked out of love, curiosity, concern, and genuine interest in my future. To be quite honest, they were questions that I had spent a lot of time asking myself. Except for the last one (which I filed away, next to "Is that like an accountant?" and "Can you tell me when I'm going to die?"), these questions were answered only gradually, with a multitude of false starts along the way.

Engineering, accounting, and finance are not actuarial science; working as an insurance salesman (about which I am always very careful not to characterize myself as having "sold insurance"), an asset liability management specialist, and a bank Information Technology professional are not being an actuary. These all were, however, stops along the way for me—answers to many internal questions that I had to fill in with pencil until I found a pen. Looking back now, I realize that, whoever you are at any point along the early stretch of your professional journey, the questions you find and answer are about much more than what will go on your business card, above and below your name, one day. Instead, finding the answers to each of them, especially the most important question that goes along with attaining fellowship, was simply about becoming better. It was (and is) about bettering yourself, broadening your knowledge base, improving your chance to succeed as a professional—putting yourself in a position to contribute, to the best of your ability, to the work environment to which you will return after the Fellowship Admission Course (FAC). It's already been a lot of work getting to this point, but the heavy lifting is only about to begin—and it starts when you ask yourself the question, which of course is not "What exactly is an actuary?" but instead "What are you going to do with the fact that you are one?" In other words, "So what?"

It was an inspirational moment for me, with more than 200 of us sitting in the ballroom that day, to hear (immediate past SOA president) Brad Smith tell us that nobody is going to care that we received our FSA. To be sure, that was startling to hear, but take a moment to think about it: it's not that nobody cares, present tense—it's that nobody will care. All right, so maybe highlighting that distinction doesn't make a huge connotative difference, but it's true. When I went back to work on Monday, I was no more or less an FSA than the chief actuary of my (large) company; I was actually more credentialed because he wasn't also a Chartered Enterprise Risk Analyst (CERA), as I was. There isn't a "superfellow" of the Society of Actuaries, only a fellow. And, once you get it, there are also no more exams, no more modules, and, perhaps most importantly (and unfortunately, as it can no longer be used as a watertight excuse for not having to do dishes, wash the car, or have company over whom you have absolutely no interest in entertaining), no more study time to define your life. You have your diploma, and you have successfully attained the highest professional designation available in your field. Now it's time to ask yourself, "So what?"

"So what?" I was proud to receive it, but my high school diploma is only proof that I didn't have too many absences, and that I took a handful of classes the state thinks constitute a well-rounded education. I have a college diploma still in its tube that will tell anyone who looks at it that I took a lot of finance credits and, most likely, a few other classes that weren't tennis or bowling. These things at one point were the "be-all-and-end-all" summary of my life's achievements, the top line on my resume. Looking back, it's obvious now that each of them only marked the beginning of something bigger.

Graduating from high school meant you had what it took to begin college, and finishing college told prospective employers that you could enter a profession. Most likely, you passed at least one exam before securing your first actuarial job, or, at least, this was a good way to show a Human Resources professional that you could handle the work. These are three huge accomplishments, and yet they only, ultimately, serve as starting points for three completely new levels—is attaining fellowship really any different? Well, yes and no.

Yes—being an FSA is a big deal, and one that only other people who have done the same can truly appreciate. Having those letters after your name opens up a world of possibilities—you can, will, and absolutely should strive to find a place where your experience and contributions are respected and appreciated. You have proven that you have the aptitude to handle a variety of complex problems and situations and that you are ready to begin your career.

The FSA is yet another beginning, where what you've done up to this point only serves to prove that you're ready to take the next step. It might be frustrating to think about, but the fact that your FSA only opens another door also means that there are endless possible doors ahead. Obviously, the first thing a newly-minted FSA will ask him- or herself is, "What do I do with all that extra free time?" Certainly, golf, television, travel, and family are all valid options; I know that, for me, having gotten married one month before my last exam sitting made my choice pretty easy. Whatever your situation, I highly recommend taking time to ease yourself back into the normal (for an actuary), exam-free, life.

Eventually, though, you'll need to remind yourself (because Brad Smith won't always be there to do it for you) that nobody is going to care. Having finished all the FSA requirements is no time to rest on your laurels, and no reason to be complacent with how far you've come. Instead, it's the best possible time to look at where you have the opportunity to go and what you have the ability to do.

Work on projects you have no idea how to begin. Read articles and listen to webcasts that, six months ago, you had no interest in whatsoever. You have the chance now to learn new concepts and techniques because they are going to better your practice, rather than because you had to learn them to pass an exam. Collaborate with colleagues and professionals who wouldn't otherwise know your name, and, no matter what your level of expertise, make sure that they learn it (preferably due to your enthusiasm and willingness to contribute, rather than ineptitude). Even if you have, literally, no idea what you're doing, the letters after your name tell those around you that you have the ability to learn.

Five years from now, if not sooner, the fact that you have your FSA will be a given. It will be known, assumed, or, perhaps, even expected of you, depending on where you find yourself. The key is, though, that this fact, by itself, will reveal nothing about the caliber of actuary that you have become, other than "one that passed a lot of exams." Be known for a project that you led, a training session that you conducted, an exam question that you wrote, an external conference at which you spoke, an emergent area in which you took the time to become more expert than anyone else in your company.

Brad Smith is right—those same five years from now, nobody will care about the fact that you received one more diploma on a stage in front of colleagues in a nice hotel. Nobody will care how many exams you passed, and (thankfully) nobody will care how many exams you failed. Simply put, nobody will even give a second thought to those letters after your name; it's never too early, though, to begin shaping the opinion they have of the name before the letters.

2013 SOCIAL SECURITY TRUSTEES REPORT

By Bruce Schobel

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On May 31, Social Security's Board of Trustees issued the *2013 Annual Report* on the financial status of the Social Security (Old-Age, Survivors and Disability Insurance, or OASDI) program. The 2013 report looks remarkably similar to the 2012 report. The long-range, 75-year actuarial deficit grew slightly from 2.67 percent of taxable payroll to 2.72 percent of taxable payroll. (The effect of moving the 75-year valuation period forward one year, by itself, would have been 0.06 percent of taxable payroll, so all of the other effects netted almost to zero.) The projected year of trust-fund exhaustion remained unchanged at 2033. After the trust fund is exhausted, annual income is projected to be sufficient to cover roughly three-fourths of projected annual outgo.

Social Security's Board of Trustees has six members: the Secretary of the Treasury (who chairs the Board), the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two members of the public (one Republican and one Democrat) appointed to 4-year terms. Between 2012 and 2013, three of the six Trustees left and were replaced: The Secretary of the Treasury is newly appointed, and two officials are "acting" in the positions of Secretary of Labor and Commissioner of Social Security. The two acting officials have not been nominated to fill their positions and thus may themselves be replaced before too long. These changes in the make-up of the Board led to the late issuance of the 2013 report, which by law was due on or before April 1. But interestingly, the changes did *not* result in any significant changes to the long-range actuarial assumptions from 2012 to 2013. That's important to note.

There were, however, some changes to the actuarial assumptions. In the short range, starting values were updated to reflect the latest data, and transitions to the ultimate, long-range assumptions were necessarily adjusted. In both the short- and long-range, immigration assumptions were modified slightly. The legislation permanently lowering marginal tax rates for many taxpayers resulted in lower projected income from the taxation of Social Security benefits. (Much of that tax revenue is transferred into the Social Security trust funds.) All of these changes, taken together, increased the long-range actuarial deficit by 0.34 percent of taxable payroll. But they were slightly more than offset by methodological changes that reduced the long-range actuarial deficit by 0.35 percent of taxable payroll. The most significant methodological change (with an effect of +0.09 percent of taxable payroll) improved the projections of fully-insured population—those eligible for retired-worker benefits, in other words—as a percentage of total population. Other methodological changes are even more esoteric.

Other than the relatively minor changes noted above, the 2013 report and the financial projections contained therein look remarkably similar to the 2012 report. Social Security is a gigantic program that is critically important to the financial well-being of 57 million beneficiaries as of year-end 2012. About 163 million people (and their employers) are expected to pay Social Security payroll taxes in 2013, and all of them do so with a reasonable expectation of ultimately receiving benefits one day. The amount of those future benefits will depend on what Congress does to restore Social Security's long-range financial status. Under present law, the latest projections again show that timely benefits cannot be paid in full starting in 2033. As the 2013 report states so well:

"The Trustees recommend that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes and give workers and beneficiaries time to adjust to them. Implementing changes soon would allow more generations to share in the needed revenue increases or reductions in scheduled benefits. Social Security will play a critical role in the lives of 58 million beneficiaries and 163 million covered workers and their families in 2013. With informed discussion, creative thinking, and timely legislative action, Social Security can continue to protect future generations."

Acting sooner rather than later is critically important to finding a responsible solution to these financial problems, which are not going to go away by themselves. We can only hope that Congress gets the message.

You can find the entire 2013 Social Security Trustees Report at the following link:

http://www.ssa.gov/OACT/TR/2013/tr2013.pdf

SOCIETY OF ACTUARIES Social Insurance & Public Finance Section

IN THE PUBLIC INTEREST

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