

Helping to Keep Money in the Bank

CONSUMERS WHO DEAL WITH INSURANCE COMPANIES OR EMPLOYEE BENEFIT plans have two reasonable expectations. First, they want their claims handled fairly and quickly. Second, they expect money will be available to pay the claim. This second expectation goes to the heart of what the actuarial profession is all about.

Insurers and employee benefit plans are in the business of anticipating risks. They provide protection against future unknowns. The success of our economy is based, in great part, on the availability of insurance for business risks and health and pension coverage for its employees. Actuaries play a key role in monitoring and evaluating those risks.

Several years ago I worked for a state insurance department. A health plan administrator in the state got into financial trouble and eventually went insolvent. One day, without warning, the plan shut its doors and turned off the lights. There were pictures that evening on the nightly news of a long line of consumers trying to get in the front door of the health plan's building so they could find out what was going on. It was eerily reminiscent of those historical scenes from the Great Depression of people trying to access their bank accounts at failed financial institutions.

Today, bank deposits are protected by insurance. Customers of insurance companies or participants in employee benefit plans have no such protection. While there may be some form of a guaranty fund, patrons of a failed insurer or employee benefit plan are generally not entitled to any money in the event of an insolvency. They aren't protected from a failure in the case of bad management, fraud, or economic downturn.

It's up to the regulatory agencies and to company and plan management to make sure that insurers and benefit plans don't go out of business, except in very rare and unforeseen situations. And ultimately, it's actuaries who help ensure solvency in the face of risks—whether those risks result from normal day-to-day claims or from a catastrophic impact on the financial condition of the insurer or benefit plan.

Challenges to Solvency

There are a whole new set of risks facing insurers and

benefit plans. For example, a number of insurance policies and benefit plans are tied to the performance of derivative instruments or stock indices. With these new types of products, not only does the insurer or benefit plan have to be able to forecast future claim patterns, they also need to adequately safeguard the liquidity of the assets backing those liabilities.

The current trend toward financial services modernization also increases the pressure on the solvency of insurers and employee benefit plans. The regulatory barriers between insurance, banking, and securities are being removed, and the industry is undergoing consolidation.

Unfortunately, there are policy-makers and business managers unfamiliar with insurance risk who believe that underwriting an insurance policy or funding a benefit plan is just like any other financial line of business. They fail to recognize the long-term nature of the risks insurers or employee benefit plans face and the potential impact one catastrophic event may have on solvency.

Another effect on solvency is the globalization of the financial services industry. As insurers and benefit plan managers expand to new markets, they're finding additional risks along with those new opportunities.

The actuarial profession has taken the lead in dealing with risk management and solvency concerns. Actuaries helped develop risk-based-capital standards for insurance companies and continue to refine that formula as new issues arise. They're working on better accounting standards for reporting the financial condition of insurers and benefit plans to regulators and to the public. Actuaries are also working on models to analyze risks and risk patterns in a variety of situations, from the distribution of medical claims to



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the potential effects of hurricanes or other natural disasters.

Actuaries are also developing methods to include the analysis of insurance and employee benefit risks within the larger picture of what is sometimes termed “enterprise risk,” developing a holistic picture of the entire set of financial and economic pressures a company could face. Though actuaries for insurance companies and employee benefit plans typically deal with potential risks to the liability side of the balance sheet (e.g., insurance claims or benefit payments), they’re now coming to realize that asset risk, such as the sudden drop in the value of securities held by a company, can have a severe financial impact as well.

The American Academy of Actuaries has played an active role in the development of techniques to analyze risk. Academy volunteers worked with the National Association of Insurance Commissioners to establish the risk-based capital stan-

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dards. Academy work groups are analyzing the impact of new types of insurance products such as variable annuities, studying how insurers deal with liquidity risk, and working on a unified system of valuation for life insurers. The Academy is helping both national and international regulators understand how insurance risks are analyzed as part of our response to changes in the financial services industries.

In the end, it’s all about consumers.

They need to have confidence in the financial stability of insurers and employee benefit plans. Quite frankly, the public doesn’t spend a lot of time worrying about solvency or risks. People take for granted it’s been taken care of and that funds will be available if needed. It’s up to actuaries to make sure that risks are effectively managed and solvency is maintained; that the promises made by insurers and benefit plans will be kept. ●