July 13, 2012 - Comment #10 - 2:27 p.m.

Re: ASOP No. 6 Revisions - *Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Plan Costs or Contributions*

Dear Actuarial Standards Board:

This letter responds to the community rating and implicit subsidy issues raised in the April 2012 Exposure Draft of ASOP 6.

I have run into several community rating examples where current guidance did not appear to provide a clear standard as to when an implicit subsidy should be measured and when it can be ignored. The ASOP 6 Exposure Draft provides a clear standard, but might yield impractical results by requiring implicit subsidy valuations for a great number of very small entities or for small community rated subsets of larger entities.

Background

Over the past several years I have prepared GASB 45 valuations for dozens of governmental employers in Oregon. Many of these entities are in statewide health insurance pools. My comments concentrate on this experience and illustrate several considerations by way of real-life examples. I believe the examples I address below could have counterparts in many other states, and possibly in the private sector as well.

Oregon state law requires that governmental employers offer their retirees access to group-priced health insurance from retirement until Medicare eligibility. The premiums paid by retirees are typically the same premiums charged for active employees. The result is that essentially every governmental employer in Oregon is potentially subject to the “classic” implicit subsidy.

Most governmental employers in Oregon participate in one of a few health insurance pools. (A significant number of larger governmental employers in Oregon have separately rated health insurance.) Separate pools of varying size exist for cities, counties, school districts, and special districts. Three agencies manage the four different pools, and each agency has different rating criteria. For example, all school districts are community rated, whereas cities and counties are generally community rated under 100 employees plus retirees, and partially or fully rated above 100 employees plus retirees.

Current and Proposed Guidance

I imagine that the primary impact of the ASB’s proposed changes to community rating considerations will be on accounting for governmental employers. Therefore, while I understand that GASB standards are outside your sphere of direct influence, I include GASB standards in this discussion, and I encourage the ASB to think about how the proposed ASOP 6 revisions can be both theoretically robust as well as yield practical results in conjunction with current and potential future GASB standards.

GASB 45 paragraph 13.a.(2) allows an "exemption" from measuring an implicit subsidy under certain conditions for employers participating in community-rated health insurance pools. The public sector health insurance pools in Oregon are community-rated for some or all participating governmental employers. The main remaining issue is whether an employer's active and retired members comprise a sufficiently small portion of the entire pool that an implicit subsidy is not required to be measured under GASB 45. It is here that GASB 45 points to the December 2001 version of ASOP for guidance.

GASB 45 Implementation Guide Q&A 66 further states that the community-rating exemption "is appropriate only on the condition that the actuary has determined, essentially, that the circumstances of the particular community-rated plan effectively insulate the employer from the effects of age on the cost of providing health care benefits for retirees that would otherwise be presumed to exist."

Health insurance pools for governmental employers are often comprised of many smaller employers, each of which is theoretically subject to an implicit subsidy measurement. It would seem inconsistent to consider entities as being "insulated" from the effects of retirees' higher claims costs when all entities in the pool must pay indirectly for the claims costs of all retirees in the pool. Put another way, it is difficult to state that implicit subsidies – which would exist for any individual entity if it were outside of a pool – no longer exist because the entity is inside a pool.

GASB 45 Implementation Guide Q&A 68 discusses the threshold at which the community rating exemption may apply, and implies by example that an employer comprising 1% of the pool's participants may be sufficiently small to qualify.

The current ASOP 6, section 3.4.5 indicates that the actuary may effectively skip the implicit subsidy measurement as follows: "For example, the actuary may use a single unadjusted premium rate applicable to both active employees and non-Medicare-eligible retirees if the actuary has determined that the insurer would offer the same premium rate if only non-Medicare-eligible retirees were covered."

The proposed ASOP 6 section 3.7.8 states in part that in pooled, community rated plans, "the actuary should reflect the full age-specific cost, including the implicit subsidy, regardless of the size of the group being valued."

Examples

In the following examples (except as otherwise noted), employers are governmental and are required under law to offer their retirees the right to continue health care insurance at group rates from retirement until age 65. The employers participate in health insurance pools established exclusively for similarly situated governmental employers. The employers do not pay directly for any portion of retirees' health insurance premiums. The relevant question is under what circumstances an actuary would be directed to perform an implicit subsidy valuation.

1) An employer has 30 employees. The health insurance pool covers 75,000 employees plus retirees.

Current Guidance: GASB 45 and ASOP 6 indicate that no implicit subsidy need be measured.

Proposed Guidance: ASOP 6 would recommend an actuarial valuation for this employer.

2) An employer has 30 employees. The health insurance pool covers 1,400 employees plus retirees.

   Current Guidance: GASB 45 and ASOP 6 suggest that an implicit subsidy should perhaps be measured. The "1%" GASB guidepost points to a possible valuation. ASOP 6 implies the actuary could assess whether the employer would be charged an identical rate if all its (former) employees were non-Medicare-eligible retirees. Clearly if the pool composition was changed to remove 30 younger employees and replace them with 30 non-Medicare-eligible retirees, the pool's premiums would increase. The question then becomes whether the increase is meaningful enough to commission a valuation. It might be useful for the ASB to assess how many actuaries are in practice recommending a valuation in such situations.

   Proposed Guidance: ASOP 6 would recommend an actuarial valuation for this employer.

3) An employer has 1,000 employees plus retirees. The health insurance pool covers 200,000 employees.

   Current Guidance: GASB 45 and ASOP 6 suggest that an implicit subsidy may not be required. The "1%" GASB guidepost offers apparent guidance to argue against a valuation. (Although from a personal conversation with GASB staff, I understood that GASB may not have intended to provide so broad an exemption as to apply in this situation.) The ASOP 6 calculation described in the previous example may not result in a meaningful change in the pool's average premiums. It might be useful for the ASB to assess how many actuaries are in practice recommending a valuation in such situations.

   Proposed Guidance: ASOP 6 would recommend an actuarial valuation for this employer.

4) An employer has 100 employees plus retirees and is partially rated on its demographics. The health insurance pool covers 20,000 employees. The next year, the employer drops to 99 employees plus retirees, and becomes community rated.

   Current Guidance: For reasons discussed above, GASB 45 and ASOP 6 suggest that an implicit subsidy should no longer be measured. If in a future year the employer's covered population again exceeds 100, an implicit subsidy valuation should again be performed.

   Similar situations of an implicit subsidy turning "on" or "off" from one year to the next can occur for employers who enter or exit pools, or when pools change rating criteria. These short term fluctuations in whether an implicit subsidy is measured seem to be at odds with the decades-long horizon of an OPEB valuation. It is also not clear what practical result is served by producing on-again, off-again valuations.

Proposed Guidance: ASOP 6 would recommend an actuarial valuation for this employer in all years.

5) An employer has 200 employees plus retirees. 150 of these employees plus retirees are covered under health insurance rated on their demographics. The other 50 are union members covered under a community rated union-sponsored health insurance pool which covers 20,000 workers plus retirees around the region. Most of the covered members in the union health insurance pool work in the private sector.

   Current Guidance: For reasons discussed above, GASB 45 and ASOP 6 suggest that an implicit subsidy need not be measured for the 50 union members.

   Proposed Guidance: ASOP 6 would recommend an actuarial valuation for all employees plus retirees of this employer.

Conclusion

The purpose of this letter is to illustrate by example where *current guidance does not appear to provide a clear standard*, or where the *proposed guidance might yield an impractical result* with regards to the need for implicit subsidy valuations.

The ASB's ASOP 6 exposure draft removes much of the ambiguity of current guidance. However, it replaces that ambiguity with the prospect of a vast number of actuarial valuations (or Alternative Measurement Method calculations) for comparatively small governmental entities. It is not clear to me that such a result would be a good use of scarce public resources. While it would be correct to say that such considerations are more in the purview of GASB, because GASB has looked to ASB in developing its current standards, I believe the ASB should anticipate rather than react to the potential consequences of its promulgations.

I do not have definitive resolutions to all the issues raised in this letter. My best suggestion would be for ASOP 6 to deliberate further with the goal of establishing clear benchmarks or guideposts which actuaries can use to assess under what circumstances community rating "exemptions" to implicit subsidy valuation are appropriate. These benchmarks may include: a cost/benefit analysis of performing an implicit subsidy valuation; the absolute size of an employer; the size of the employer in relation to its health insurance pool; the existence or lack of implicit subsidies among other members in the pool (e.g. private sector union pools); and statewide small insurance restrictions which effectively limit the level of premiums which can be charged to small employers.

In writing actuarial standards, there is an understandable focus on theoretical issues. However, as a profession, we should recognize that a cost / benefit analysis of expensive actuarial work is a reasonable consideration in commissioning valuations. Actuarial valuations of theoretical implicit subsidies for small employers offering minimum benefits under law have proportionately high cost and relatively low value. I believe it would be reasonable to state in ASOP 6 that an assessment of the practicality, costs, and benefits of an implicit subsidy valuation is an appropriate consideration in determining whether such a valuation should be performed, particularly for small employers. Further, it may be worth noting that such an assessment may be made in consultation with relevant stakeholders, such as employers and auditors. This sort of approach might help to address the otherwise questionable requirements for an implicit subsidy valuation which the ASOP 6 Exposure Draft appears to require under examples 1, 2, and 5 above.

Finally, alternative approaches to individual employer valuations might include pools providing age-adjusted claims costs for valuation purposes to their members, or commissioning general implicit subsidy valuations for their pools, and using an approximate allocation of the liability to individual employers. These alternatives come with a host of logistical challenges, but they may ultimately be a better fit than a large number of small individual employer valuations. ASOP 6 might do well to at least open the door to alternative, simpler measurements for smaller employers.

With sincere thanks for your efforts, your time, and your consideration of these comments.

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