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ASOP No. 6 Revision
Actuarial Standards Board
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Washington, DC 20036

The following are my comments to the ASOP No. 6 Exposure Draft in the question and answer format requested by the ASB:

Q1: Is the level of guidance and educational content appropriate?

Yes

Q2: Is the distinction among retiree group benefits plan, benefit plan, and optional benefits helpful to the actuary or not? Could it be further clarified?

Including a definition of "plan" in ASOP No. 6 will improve the standard. However, in my opinion, only one definition is required (or desirable). The normal connotation of "plan" includes not only the benefit structure, but eligibility, contribution requirements, etc. I would suggest the following:

Retiree Group Benefits Plan – The plan specifying retiree group benefits including eligibility requirements, participant contributions, the design of the benefits being provided and the provisions related to the termination of benefits (highlighted text is added text)

Including the terms "benefit plan" and "optional benefits" are confusing, in my opinion.

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Q3: Is the revised guidance regarding the use of the "community-rated concept" appropriate? Are there any challenges that an actuary could encounter in deriving age-specific claims costs for employers participating in fully pooled health plans covering active participants and retirees? For those respondents who can do so, please provide specific examples of any challenges encountered in obtaining information from managers of pooled health plans?

Caveat on my comments - My comments on this question relate only to those situations where the actuary's work product is intended for the purposes of complying with FASB and/or GASB OPEB financial reporting standards. Whether ASOP No. 6 should make a distinction between work products of this nature and other OPEB work products is not addressed in the following comments.

Summary comment - I would delete all references to the change in treatment for community-rated plans being prompted by the discovery that a few large plans have indicated that they would make claims experience available. With this omission, I would fully support the revised guidance regarding the "community-rated concept".

Support for recommended deletion - The lack of claims experience was never the justification for the special community-rated plan treatment in FAS 106 (now FASB ASC 715-60) or GASB 45/43. Nor was the lack of available claims experience the reason for the special treatment being awarded community-rated plans in the current version of ASOP No. 6. In developing both FAS 106 and GASB 45, both accounting bodies considered the fact that in many cases, the actuary's work is based on uncertainties. In both standards, it was held that a good attempt at a reasonable estimate is better than no estimate at all. The following from GASB 45, paragraph 78 is instructive:

"…Uncertainly and the prospect of continual change obviously are factors that affect the ability to project future events with precision. However, the Board rejected the notion that those characteristics defeat the possibility or usefulness of measurements of OPEB obligations and costs, based on estimates at any given point in time, for financial reporting purposes. Nor does the inability to obtain a precise measure justify reporting as if no cost or obligation has been incurred prior to the distribution of cash. The Board continues to believe that a reasonable estimate based on available evidence and current expectations will provide more useful information than no estimate at all….."

It is for this reason that I believe including the comments related to newly discovered plans willing to share claims information does not add to the discussion but rather only muddies the waters.

Background information - The current special treatment of "community-rated plans" is clearly one of the most contentious aspects of both the OPEB accounting standards and ASOP No.6, in my opinion. I think that it is helpful to consider how the various accounting and actuarial standards and other literature related to such special treatment awarded community-rated plans has evolved over the last 20+ years. The following background information is provided for this purpose:

1. FAS 106, paragraph 10 (12/1990) – A postretirement benefit plan may be part of a larger plan or an arrangement that provides benefits currently to active employees as well as to retirees. In those circumstances, the promise to provide benefits to present and future retirees under the plan shall be segregated from the promise to provide benefits currently to active employees and shall be accounted for in accordance with the provisions of this Statement.

2. Q&A #11 of FAS 106 Implementation Guide (8/1993) - ... In some situations, such as in a community-rated insurance plan that provides the type of benefits covered by the employer's plan and in which the premium cost to the employer is based on the experience of all participating employers, the claims experience of a single employer generally will have little impact on its premium. Accordingly, in those situations a projection of future premiums based on the current premium structure and expected changes in the general level of healthcare costs may provide a reasonable estimate of the employer's obligation....

3. Paragraph 3.4.5 of ASOP No. 6 (12/2001) - ....The actuary should consider that the actual cost of health insurance varies by (age see section 3.4.7), but the premium rates paid by the plan sponsor may not. 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 retiree were covered.

4. GASB 45, paragraph 13.a(2) (6/2004) – When an employer provides benefits to both active employees and retirees through the same plan, the benefits to retirees should be segregated for actuarial measurement purposes, and the projection of future retiree benefits should be based on claims costs, or age-adjusted premiums approximating claims costs, for retirees in accordance with the Actuarial Standards Board[8]. However, when an employer participates in a community-rated plan, in which premium rates reflect the projected health claims experience of all participating employers rather than that of any single participating employer, and the insurer or provider organization charges the same unadjusted premiums for both active employees and retirees, it is appropriate to use the unadjusted premiums as the basis for projection of retiree benefits, to the extent permitted by actuarial standards[9]. (Both notes 8 and 9 refer to ASOP No. 6.)

<u>My comments</u>

1. <u>Similarity of language</u> - Note the similarity of the language in paragraph 10 of FAS 106 and the first sentence of paragraph 13.a(2) of GASB 45. The reason for the similarity is because both sections spell out a very important (maybe the most important) concept underlying the respective standard. If a retiree plan is to be accounted on an accrual basis, it is imperative that such plan, in all aspects, be segregated from the plan covering the active employees.

2. <u>Basis of Q&A 11 of FAS 106 Implementation Guide</u>

   a. <u>Underlying assumption</u> - In speaking with members of the FASB technical support staff soon after the publication of the Implementation Guide, I was told that the assumption underlying the answer to Question 11 was that the community-rated plan used in the example based its rates on a population of retirees only. Unfortunately this premise was not included in the answer. As a result, Question 11 has been used to justify the use of community rates for FAS 106 purposes which were based on active and retiree experience. This is clearly inconsistent with paragraph 10 of FAS 106.

   b. <u>0% credibility requirement</u> – The special treatment granted community-rated plans is only available to plans that have 0% (or limited) credibility. While this implies that there is a credibility level at which the special treatment does not apply, Q&A #11 provides no guidance as to what such level would be. In any event, having one accounting standard for employers whose group health plan has no (or limited) credibility and a different accounting standard for all other employers does not seem to be consistent with my understanding that GAAP accounting applies to all employers, irrespective of how credible their experience is with respect to the other employers participating in the pool.

3. <u>Paragraph 3.4.5 of ASOP #6</u> – The requirement to split apart the active employee and retiree plans (as required by the applicable FASB and GASB accounting standards) is not conditioned on the practices of insurance companies regarding retiree only coverage. Thus, in my opinion, the special treatment identified in the example of paragraph 3.4.5 of the current ASOP No. 6 is not consistent with the concept requiring active and retiree plans to be split apart. Please refer to the "Community-Rated Premiums" paragraph under the section "Measurement Using Premiums Rates" in Appendix 2 of the current ASOP No.6. Such paragraph includes a sentence that reads "If the insurer appears to be committed to continuing such subsidy for the retirees……." It's worthy to note that this sentence and the one following was deleted from the Exposure Draft, correctly, in my opinion as it is not the insurer but the active employees in the group who are subsidizing the cost of retiree coverage. This reasoning leads me to believe that the paragraph 3.7.8 wording in the Exposure Draft is appropriate.

Q4. Are the changes to the standard to make it consistent with ASOP No. 4 appropriate?

Yes

Q5. Are there any other areas in which the guidance should be revised?

None that I am aware of.

I would be glad to discuss the above if there are any questions and/or comments.

Sincerely,

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JRH:wp