

July 12, 2012 - Comment #8 - 5:08 p.m.

Actuarial Standards Board

1850 M St NW, Suite 300
Washington, DC 20036

Re: Proposed Revision of ASOP No. 6

Dear Actuarial Standards Board:

This letter provides comments on the Exposure Draft of the Proposed Revision of Actuarial Standard of Practice No. 6 – Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Plan Costs or Contributions.

Bartel Associates, LLC is an actuarial consulting firm specializing in providing California public agencies with actuarial consulting including pension plan valuations and retiree medical valuations. We have prepared “Other Postemployment Benefit” actuarial studies under GASB Statement No. 45 for over 300 California public agencies.

We appreciate all the hard work that went into preparing the Exposure Draft and commend the Board and participating actuaries for their effort. In general we agree with the changes suggested. However, we understand Exposure Draft section 3.7.8 would change the community rated exception, requiring an implied subsidy be included for all employers. Claims costs would be developed based on expected age specific claims costs for the entire pool (if available), or based on manual rates or other sources. As summarized in this letter, we believe requiring this approach for smaller employers may be inappropriate, leading to illogical results in certain cases and reducing the accuracy of valuations for individual employers participating in a pool.

Examples

To illustrate, enclosed are 3 examples based on a pooled health plan with the following characteristics:

- Employees and early retirees are charged the same single premium annual rate of \$6,900.
- All participants under age 55 are active employees and all over 55 are retired.
- Premiums are equal to expected per capita claims.
- Age specific costs (per capita claims) are assumed to increase by 3% with each year of advanced age (amounts are rounded to nearest \$10), with average claims for 5 year age bands provided for simplicity.
- All participants have single coverage.
- Employer pays full single premium for actives and retirees up to Medicare eligibility.

Note that the pooled health plan characteristics were selected to represent a reasonable structure that does not create unusual results. The demographics of the employers in the following examples are not expected to be typical, but similar employers in pools almost certainly exist.

Example 1

Employer 1 has 3 employees (under age 55) and 3 retirees (over age 55). The annual per participant premium is \$6,900 and the average annual claim for this employer’s lowest age group is \$6,960. This



means claims will exceed premiums for all participants in the current year, and would be expected to in the future. Including an implied subsidy in the actuarial valuation creates a liability for this employer that will not be paid.

Any reasonable liability must be paid off over the long term with cash. If a liability is not reduced by actual cash payments that eventually eliminate that liability, it is unreasonable to classify it as a liability in the first place. The Exposure Draft definition of Actuarial Present Value of Projected Benefits is:

“The actuarial present value of benefits that are expected to be **paid** in the future taking into account the effect of such items as future service, advancement in age, and expected future per capita health care costs (sometimes referred to as the present value of future benefits).” (emphasis added)

The implied subsidy in this case will not be paid by the employer.

Also note that the premium paid is \$6,900 per year and per capita claims for the employer are \$8,820. The difference is, of course, being paid by other members of the pool.

Example 2

Our next example is based on a current client. Employer 2 has no employees and 10 retirees. Total premiums are \$69,000. Expected claims are \$108,000. However, it is important to note, the excess of claims over premiums will not be paid by this employer, nor will they be paid by the active employees of the employer (since there are none). Instead, the excess of claims over premiums will be paid by the other participating employers in the pool. Again, the implied subsidy in this case will not be paid by the employer and reflecting a liability that ignores this fact is not consistent with the basic concept of a liability.

The problem is more evident if all retirees are age 64. In this case an actuary prepares a valuation, in compliance with the exposure draft, and tells the employer the Actuarial Accrued Liability is \$108,000 (for simplicity, example ignores interest discount and mortality). The employer deposits this amount into an irrevocable trust at the beginning of the year. Premiums of \$69,000 are withdrawn during the year, leaving \$39,000 in the trust (assuming no investment earnings). All actuarial assumptions have been met, and yet the trust is overfunded at the end of the year.

Example 3

Employer 3 has 20 employees (under age 55) and 40 retirees (over age 55). Total premium payments (for actives and retirees) are \$414,000. However, the allocated claims for retirees are \$432,000, exceeding premiums paid by this employer:

	Actives	Retirees	Total
Premiums Paid	\$ 138,000	\$ 276,000	\$ 414,000
Implied Subsidy Transfer	<u>(156,000)</u>	<u>156,000</u>	<u>-</u>
Net	(18,000)	432,000	414,000

Traditionally, the implied subsidy has simply been a re-allocation of the current (and future) premiums between actives and retirees. However, in this case, the reallocation defies logic. The employer has a total payment to the pool of \$414,000, which then would be characterized as a \$432,000 payment for retirees, with a \$18,000 refund from the pool for the active coverage. Certainly the pool has not paid the employer for the right to provide the active employees medical coverage.



Comments/Suggestions on Examples

There is an inherent transfer from younger to older participants, and the suggested approach includes some of this transfer in the claims. However, the implied subsidy in a pool is not only a subsidy between younger and older participants, but a subsidy between employers. Therefore, allocating the claims costs to individual employers with demographics noticeably different from the pool's demographics is inconsistent with the nature of a pool. If the employer is not large enough to significantly affect the pool's average claims, then any reflection of expected pool claims does not reflect amounts that will be paid, unless that adjustment also reflects the subsidy between employers.

An approach that results in the same aggregate liability for 100 different employers whether or not they are in a single pool undoubtedly makes sense. However, this should not be achieved by sacrificing the integrity of the individual results of the 100 employers. Actuarial results will be used to disclose and develop financial statement information for employers and a reader of a financial statement that is misled by the liabilities developed by an actuary will find little consolation with the fact that the aggregate results of all employers that are in that healthcare pool are accurate.

It seems to us that there are two solutions to this problem:

1. Rather than requiring an implied subsidy be calculated for all employers in a pool, we think clear guidance about when an employer is community rated would be more appropriate.
2. Allocate costs to employers in the pool in a manner much more consistent with how each member employer will pay.

“Exceptions”

Exposure Draft section 3.7.8 states “In some very limited cases, the use of the pooled premium rate may be appropriate without regard to adjustments for age.” The Exposure Draft goes on to provide an example. The language should be made very clear as to whether or not any of the above examples would (or would not) fall under this exception language.

We appreciate your consideration of these comments.

Sincerely,

A handwritten signature in blue ink, appearing to read 'John E. Bartel'.

John E. Bartel
President

enclosure

c: Doug Pryor, Bartel Associates

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Example 1

Total Pool									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Per Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	200	768,000	1,380,000	(612,000)	Paid	18,630,000	4,830,000	23,460,000
30 - 34	4,440	300	1,332,000	2,070,000	(738,000)	IS Transfer	(2,154,000)	2,154,000	-
35 - 39	5,160	500	2,580,000	3,450,000	(870,000)	Net	16,476,000	6,984,000	23,460,000
40 - 44	6,000	600	3,600,000	4,140,000	(540,000)				
45 - 49	6,960	600	4,176,000	4,140,000	36,000				
50 - 54	8,040	500	4,020,000	3,450,000	570,000				
55 - 59	9,360	400	3,744,000	2,760,000	984,000				
60 - 64	10,800	300	3,240,000	2,070,000	1,170,000				
		3,400	23,460,000	23,460,000	-				
Per Capita Cost			6,900	6,900					

Employer 1									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Per Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	-	-	-	-	Paid	20,700	20,700	41,400
30 - 34	4,440	-	-	-	-	IS Transfer	(10,260)	10,260	-
35 - 39	5,160	-	-	-	-	Net	10,440	30,960	41,400
40 - 44	6,000	-	-	-	-				
45 - 49	6,960	2	13,920	13,800	120				
50 - 54	8,040	1	8,040	6,900	1,140				
55 - 59	9,360	1	9,360	6,900	2,460				
60 - 64	10,800	2	21,600	13,800	7,800				
		6	52,920	41,400	11,520				
Per Capita Cost			8,820	6,900					

All Other Employers									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Per Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	200	768,000	1,380,000	(612,000)	Paid	18,609,300	4,809,300	23,418,600
30 - 34	4,440	300	1,332,000	2,070,000	(738,000)	IS Transfer	(2,143,740)	2,143,740	-
35 - 39	5,160	500	2,580,000	3,450,000	(870,000)	Net	16,465,560	6,953,040	23,418,600
40 - 44	6,000	600	3,600,000	4,140,000	(540,000)				
45 - 49	6,960	598	4,162,080	4,126,200	35,880				
50 - 54	8,040	499	4,011,960	3,443,100	568,860				
55 - 59	9,360	399	3,734,640	2,753,100	981,540				
60 - 64	10,800	298	3,218,400	2,056,200	1,162,200				
		3,394	23,407,080	23,418,600	(11,520)				
Per Capita Cost			6,897	6,900					

Example 2

Total Pool									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Annual Per Capita	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	200	768,000	1,380,000	(612,000)	Paid	18,630,000	4,830,000	23,460,000
30 - 34	4,440	300	1,332,000	2,070,000	(738,000)	IS Transfer	(2,154,000)	2,154,000	-
35 - 39	5,160	500	2,580,000	3,450,000	(870,000)	Net	16,476,000	6,984,000	23,460,000
40 - 44	6,000	600	3,600,000	4,140,000	(540,000)				
45 - 49	6,960	600	4,176,000	4,140,000	36,000				
50 - 54	8,040	500	4,020,000	3,450,000	570,000				
55 - 59	9,360	400	3,744,000	2,760,000	984,000				
60 - 64	10,800	300	3,240,000	2,070,000	1,170,000				
		3,400	23,460,000	23,460,000	-				
Per Capita Cost			6,900	6,900					

Employer 2									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	-	-	-	-	Paid	-	69,000	69,000
30 - 34	4,440	-	-	-	-	IS Transfer	(39,000)	39,000	-
35 - 39	5,160	-	-	-	-	Net	(39,000)	108,000	69,000
40 - 44	6,000	-	-	-	-				
45 - 49	6,960	-	-	-	-				
50 - 54	8,040	-	-	-	-				
55 - 59	9,360	-	-	-	-				
60 - 64	10,800	10	108,000	69,000	39,000				
		10	108,000	69,000	39,000				
Per Capita Cost			10,800	6,900					

All Other Employers									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	200	768,000	1,380,000	(612,000)	Paid	18,630,000	4,761,000	23,391,000
30 - 34	4,440	300	1,332,000	2,070,000	(738,000)	IS Transfer	(2,115,000)	2,115,000	-
35 - 39	5,160	500	2,580,000	3,450,000	(870,000)	Net	16,515,000	6,876,000	23,391,000
40 - 44	6,000	600	3,600,000	4,140,000	(540,000)				
45 - 49	6,960	600	4,176,000	4,140,000	36,000				
50 - 54	8,040	500	4,020,000	3,450,000	570,000				
55 - 59	9,360	400	3,744,000	2,760,000	984,000				
60 - 64	10,800	290	3,132,000	2,001,000	1,131,000				
		3,390	23,352,000	23,391,000	(39,000)				
Per Capita Cost			6,888	6,900					

Example 3

Total Pool									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Per Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	200	768,000	1,380,000	(612,000)	Paid	18,630,000	4,830,000	23,460,000
30 - 34	4,440	300	1,332,000	2,070,000	(738,000)	IS Transfer	(2,154,000)	2,154,000	-
35 - 39	5,160	500	2,580,000	3,450,000	(870,000)	Net	16,476,000	6,984,000	23,460,000
40 - 44	6,000	600	3,600,000	4,140,000	(540,000)				
45 - 49	6,960	600	4,176,000	4,140,000	36,000				
50 - 54	8,040	500	4,020,000	3,450,000	570,000				
55 - 59	9,360	400	3,744,000	2,760,000	984,000				
60 - 64	10,800	300	3,240,000	2,070,000	1,170,000				
		3,400	23,460,000	23,460,000	-				
Per Capita Cost			6,900	6,900					

Employer 3									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Per Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	-	-	-	-	Paid	138,000	276,000	414,000
30 - 34	4,440	-	-	-	-	IS Transfer	(156,000)	156,000	-
35 - 39	5,160	5	25,800	34,500	(8,700)	Net	(18,000)	432,000	414,000
40 - 44	6,000	6	36,000	41,400	(5,400)				
45 - 49	6,960	4	27,840	27,600	240				
50 - 54	8,040	5	40,200	34,500	5,700				
55 - 59	9,360	-	-	-	-				
60 - 64	10,800	40	432,000	276,000	156,000				
		60	561,840	414,000	147,840				
Per Capita Cost			9,364	6,900					

All Other Employers									
Implied Subsidy Calculation						Implied Subsidy Transfer			
Age Group	Per Capita Claims	Number of Participants	Total Claims	Total Premiums	Current Year IS		Actives	Retirees	Total
25 - 29	3,840	200	768,000	1,380,000	(612,000)	Paid	18,492,000	4,554,000	23,046,000
30 - 34	4,440	300	1,332,000	2,070,000	(738,000)	IS Transfer	(1,998,000)	1,998,000	-
35 - 39	5,160	495	2,554,200	3,415,500	(861,300)	Net	16,494,000	6,552,000	23,046,000
40 - 44	6,000	594	3,564,000	4,098,600	(534,600)				
45 - 49	6,960	596	4,148,160	4,112,400	35,760				
50 - 54	8,040	495	3,979,800	3,415,500	564,300				
55 - 59	9,360	400	3,744,000	2,760,000	984,000				
60 - 64	10,800	260	2,808,000	1,794,000	1,014,000				
		3,340	22,898,160	23,046,000	(147,840)				
Per Capita Cost			6,856	6,900					

