

ASOP No. 42—March 2004

Appendix 2

Comments on the Second Exposure Draft and Committee Responses

The second exposure draft of this standard, *Determining Health and Disability Liabilities Other Than Liabilities for Incurred Claims*, was exposed for review in October 2003, with a comment deadline of January 31, 2004. Seventeen comment letters were received. The Health Committee of the ASB carefully considered all comments received. Many helpful ideas and suggestions were offered in the comment letters and are reflected in the standard as appropriate. Summarized below are the significant issues and questions contained in the comment letters, and the committee's responses to these issues and questions. Unless otherwise noted, the section numbers and titles used below refer to those in the second exposure draft.

GENERAL COMMENTS	
Comment	One commentator observed that the term "liability" appeared to be used synonymously with the term "reserve." The commentator suggested a number of changes throughout the standard to reflect this comment.
Response	The committee believes that the use of the term "liability" is appropriate and is reflective of common usage. Where the term "reserve" is used, it applies to a specific terminology recognized in regulation and practice, such as "premium deficiency reserve," "contract reserve," or "unearned premium reserve."
Comment	Several commentators questioned whether this standard was intended to cover situations such as disability and medical benefits provided through pension plans, benefits provided through voluntary employees' beneficiary association's (VEBAs), calculations under SFAS No. 106, <i>Employers' Accounting for Postretirement Benefits Other Than Pensions</i> , and SFAS No. 112, <i>Employers' Accounting for Postemployment Benefits</i> , 401(h) accounts, and incidental health benefits provided under other plans.
Response	The committee considered these questions and added clarifying language to section 1.2, Scope, which states that this standard does not apply to actuaries determining liabilities in accordance with other standards of practice. This standard does not apply for liabilities determined in accordance with standards of practice such as ASOP No. 4, <i>Measuring Pension Obligations</i> , and ASOP No. 6, <i>Measuring Retiree Group Benefit Obligations</i> . Furthermore, this standard does not apply in situations where a benefit is included within a plan subject to another standard, which may include a disability benefit under a life plan, or to a 401(h) account that is part of a pension plan. The committee believes that this standard does apply to self-insured plans (including VEBA plans) that are not subject to other standards such as those referenced above. This is specifically noted in the definition of health benefit plan, and is identical to the treatment of ASOP No. 5, <i>Incurred Health and Disability Claims</i> .
Comment	One commentator observed that the standard uses the term "premium" frequently, and also uses the term "policy form," and asked whether the standard was to apply to non-insured arrangements.
Response	The standard does apply to certain self-insured health plans, and the committee believes that the terms noted by the commentator are appropriate.
Comment	One commentator observed that contract reserves are merely a special case reserve that is defined at issue and cannot be subsequently recalculated unless shown to be inadequate. The commentator suggested a number of changes to the definition of contract reserve and the assumptions to be used.
Response	The committee believes that the standard provides appropriate flexibility to the actuary, and that any further descriptive definition would be prescriptive and limiting.

ASOP No. 42—March 2004

SECTION 1. PURPOSE, SCOPE, CROSS REFERENCES, AND EFFECTIVE DATE	
Section 1.1, Purpose	
Comment	One commentator suggested that adding, “This ASOP is not intended to be prescriptive of specific methods or procedures, nor is it intended to require that specific liabilities can be established,” would clarify the intent of the section.
Response	The committee believed the existing language was appropriate and made no change.
Section 1.2, Scope	
Comment	One commentator suggested changing, “This standard applies to actuaries when they...” to “This standard applies when actuaries....”
Response	The committee believed the existing language was appropriate and made no change.
Comment	One commentator suggested deleting everything starting with “provided the actuary discloses....”
Response	The committee disagreed, and believed the existing language was appropriate.
Comment	One commentator suggested that this section could be taken to mean this standard does not apply to work performed for statutory or GAAP reporting.
Response	The committee confirms that the standard does apply to work performed for statutory or GAAP reports, and believed the language was sufficiently clear.
Comment	One commentator suggested that the language detailing the meaning of “determining” may more logically fit in section 2, Definitions.
Response	The committee believed this sentence was appropriately included in section 1.2, Scope.
SECTION 2. DEFINITIONS	
Comment	One commentator suggested that the ASOP define “incurred claims.”
Response	The committee believed this term was of common usage and did not need further definition for purposes of this standard.
Section 2.4, Contract Period	
Comment	One commentator suggested the phrase “contract is effective” should be replaced with “coverage is effective.”
Response	The committee believed the existing definition was appropriate and made no change.
Section 2.5, Contract Reserve	
Comment	<p>One commentator suggested that the definition of contract reserve and section 3.3, Considerations for Contract Reserves, were either wrong or poorly worded. Specifically, the commentator believed that the statement did not adequately address the difference between a contract reserve and a premium deficiency reserve. The commentator believed that contract reserves are a special case of premium deficiency reserve, even though the actuarial language has not evolved in this way. Contract reserves are created by the difference in slope in premiums over time relative to the slope of the claims. Only in the NAIC statutory reserve model laws is the term actually defined.</p> <p>The ASOP as drafted, unfortunately, gave so much more latitude to the actuary in calculating the reserve, and even defining what the liability is, as not to make it very valuable in practice.</p> <p>In summary, a contract reserve is nothing more than a special case reserve that is defined at time of issue, and cannot be recalculated for changes in future periods, unless a gross premium reserve calculation shows an inadequacy. Even in that case, one can argue the contract reserve stays the same, and an additional reserve is put up as a deficiency reserve. The definitions should reflect this, as should the entire standard.</p>

ASOP No. 42—March 2004

Response	<p>The committee notes that this ASOP does not supersede existing GAAP or statutory requirements, and that the actuary should comply with these requirements. The committee believed that contract reserves are not unique in that their determination is based solely on benefit and does not consider expenses. This ASOP is not intended to prescribe how the actuary should so comply, and is intended to provide guidance on what the actuary should consider in determining liabilities. Further, the committee believed these aspects of the definitions of contract reserves and premium deficiency reserves in the ASOP were sufficiently clear for the purpose of providing such general guidance.</p> <p>The committee did clarify that a contract reserve may or may not include a provision for an unearned premium reserve in response to a comment on section 3.7.2.</p>
Section 2.9, Premium Deficiency Reserve	
Comment	One commentator suggested that the definition should be changed to “when, for the remainder of the contract, the value of future premiums....”
Response	The committee believed the existing language was appropriate and made no change.
Section 2.12, Risk-Assuming Entity	
Comment	One commentator suggested that this definition should be more specific. There are situations in which the entity for which the actuary’s work is being performed is not the risk-assuming entity (for example, when the work is an analysis of a potential acquisition or an analysis performed for a regulatory agency). This would be especially true when the actuary is evaluating the adequacy of the reserves of a risk-assuming entity.
Response	The committee modified the language for clarification.
Section 2.13, Risk-Sharing Arrangement	
Comment	One commentator suggested that the words “related to a specific service” be replaced by “directly for a specific service” or “associated with a specific service” because risk sharing arrangements are “related to” (the aggregate of) all specific services.
Response	The committee believed the existing language was appropriate and made no change.
Section 2.14, Trends	
Comment	One commentator suggested changing “of the elements affecting the determination of certain liabilities” to “of certain elements affecting the determination of liabilities.”
Response	The committee believed the existing language was appropriate and made no change.
Section 2.15, Unpaid Claims Liability	
Comment	One commentator suggested that many of the ASOPs are inconsistent in the use of the term claim liability. In the definition of “unpaid claims liability,” the phrase “unpaid portion of incurred claims” could be construed to mean future benefits on incurred claims. It might help to clarify the language by referring to the “due and unpaid” portion of incurred claims.
Response	The committee believed the existing language was appropriate and made no change.
SECTION 3. ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES	
Section 3.2, General Considerations	
Comment	One commentator suggested removing “or claim trends” as they are one of several environmental factors that can affect liabilities.
Response	The committee did not make a change, as claim trends may be a significant source of the need to establish a liability.

ASOP No. 42—March 2004

Comment	One commentator suggested deleting wording that suggests a need to determine if “management is an appropriate source of information about a specific item,” as well as disclosure of reliance in this section.
Response	The committee believed that there may be situations where management may not be the best source (for example, where certain types of health benefit plans are handled by a separate TPA), and it is appropriate for the actuary to consider the appropriateness of each source. While disclosure requirements are consolidated in section 4, ASOPs may note them in other sections as well.
Section 3.2.1, Health Benefit Plan Provisions and Business Practices	
Comment	One commentator suggested revising the third sentence to clarify that the actuary is to consider “material differences between the plan provisions and actual operation of the plan,” and noted that the remainder of the sentence contains examples, such as differences in definitions of payment allowances, etc.
Response	The committee agreed and made the proposed change.
Comment	Another commentator suggested removing the last sentence, as it is included in ASOP No. 5.
Response	The committee believed the sentence was appropriate for this ASOP.
Section 3.2.3, Economic Influences	
Comment	One commentator suggested wording to clarify that “to the extent changes are material” should be a view of the future by changing to “to the extent such changes, in the actuary’s judgment, are likely to be material.”
Response	The committee agreed and made the proposed change.
Section 3.2.10, Consistency of Bases	
Comment	One commentator was concerned with a blanket requirement for consistency, and that immaterial differences may be interpreted as violating the standard.
Response	The committee believed that the language did not dictate that the assumptions be identical, and allowed for some differences.
Section 3.3.1, Assumptions	
Comment	One commentator expressed concern that contract reserve assumptions, which are changed at the time of acquisition of a block, might not reflect experience prior to the acquisition, and proposed adding a new second sentence to say that “assumptions used must be reasonable relative to the entire block or blocks of business from issue.”
Response	The committee believed that the existing first sentence requiring the use of “assumptions that are reasonable in the aggregate” would include the use of reasonable assumptions for prior periods and no change.
Comment	One commentator suggested adding additional examples of factors specific to disability plans in section 3.3.1(b).
Response	The committee did not feel additional examples were necessary.
Section 3.4, Considerations for Determining Premium Deficiency Reserves	
Comment	Several commentators suggested that the first sentence was not clear as to the basis for “when necessary.”
Response	The committee revised the wording in sections 3.4 and 3.3 to clarify the basis as an outside requirement. The next two sentences in 3.4 remain as the principal sources of an “outside requirement” on the actuary.
Section 3.4.1, General Considerations	
Comment	Regarding section 3.4.1(e), one commentator suggested that amounts due from providers would normally be considered a receivable from a non-insurance entity and, therefore, problematic.
Response	The committee made no change. It does understand that some receivables may have special rules applied to them under some financial reporting rules. The ASOP, being more general, recognizes the potential for value.

ASOP No. 42—March 2004

Comment	Regarding section 3.4.1(h), one commentator expressed concern that the ASOP would not be consistent with the NAIC Health Reserves Guidance Manual.
Response	The committee believed that the existing language was appropriately broad and recognized that “applicable law, regulation or other binding authority” may be more restrictive.
Comment	Regarding section 3.4.1(i), one commentator noted that the treatment of expense allocation in calculating deficiency reserves is frequently different than for financial reporting in general and asked if the ASOP should address this.
Response	The committee agreed with the comment and added “for the purpose of determining premium deficiency reserves” at the end of this section.
Section 3.4.2, Additional Considerations for Financial Reporting	
Comment	Regarding section 3.4.2(a), one commentator suggested that certain blocks of business (for example, group conversions) are never intended (or allowed by law) to be profitable and that this would then require a premium deficiency reserve.
Response	The committee believed that defining a block of business will vary. If there are no other sources than the premiums, the policy form may need contract or additional reserves at issue. In some situations, other sources of revenue (for example, conversion charges) may be a source of funding such reserves. In some situations it may be appropriate to combine these forms into a larger block that is intended to support the unprofitable forms. The ASOP allows for reasonable approaches subject to applicable financial reporting requirements.
Comment	Regarding section 3.4.2(b), several commentators expressed concern that the time period language was not clear, especially with respect to the end of the period. Of particular concern were examples like conversion policies, blocks that “wander in and out of year-by-year profitability” and situations involving contracts committed to (new or renewal) by the risk-assuming entity that will result in a loss.
Response	The committee removed the wording requiring some level of profitability as the basis for the end of the period and revised the wording to clarify that the end of the period would normally be the date in the future, under the assumptions used to determine the reserve currently, when no premium deficiency reserve would then be required, including new business written at a loss. This will generally result from premium changes, increasing contract reserves or adding additional reserves or a combination. During such a period some portion of the block may be expected to produce profits before the entire block reaches the “end.” Expected profits during this period, but not later periods, are a reasonable offset to the reserve.
Section 3.5.1, Non-Provider Risk-Assuming Entities	
Comment	Several commentators expressed concern that the actuary may not have sufficient information to determine a liability relating to added costs following a provider failing or leaving a network. One suggested that the ASOP make it clear that “it is not the actuary’s responsibility to review the financial soundness” of providers. Others requested examples.
Response	The committee did not believe examples were appropriate for the ASOP but could be a part of a practice note. The committee did revise the language to require the actuary to “consider whether” there is a material risk relating to providers failing or leaving the network so that a liability should be determined. Such considerations would not normally involve the financial review of providers just for this purpose. Financial analyses of providers, if completed for other reasons, should be reviewed. The committee revised the prior paragraph to be consistent with this approach.

ASOP No. 42—March 2004

Section 3.6, Claim Adjustment Expense Liabilities	
Comment	One commentator suggested that, in practice, the actuary may not determine this liability, and that in such situations this liability is similar to those in section 3.7 and should be moved there.
Response	The committee made no change but notes that the ASOP uses the word “determines” to encompass both determining and reviewing liabilities, and within this concept, the actuary is required to determine a value of the liability. The committee believed that the ASOP provided flexibility for the actuary, even if not the one to calculate the liability, to be satisfied that the liability is covered in accordance with the financial reporting rules applicable.
Comment	Another commentator questioned whether implicit approaches should be allowed.
Response	The committee believed that so long as the liability is determined, the manner of reporting should not be defined by the ASOP. No change was made.
Section 3.7, Other Liabilities	
Comment	Several commentators noted that certain of these liabilities may be included in the liabilities subject to an actuarial opinion. They were concerned that the language seemed to suggest that actuaries are not responsible.
Response	The committee agreed with this concern and revised the second sentence to provide for two reasons for the actuary to be involved—a request to assist or where the liability is subject to the actuary’s opinion.
Section 3.7.2, Reserves for Unearned Premiums	
Comment	One commentator noted that the definition of contract reserve would normally include the unearned premium reserve.
Response	The committee did not intend to include premiums for the balance of the contract year, as of the valuation date, in the basis for contract reserves. The committee intended to allow flexibility in the methodology of calculating contract reserves, such that the contract reserve can be calculated with or without the provision for unearned premiums. Section 2.5 was changed to reflect this. The committee believed that section 3.7.2 allowed the actuary to take this into account when determining reserves for unearned premiums.
Comment	One commentator asked how one could match future liabilities with unearned premium.
Response	The committee believed that the description of the unearned premium reserve was appropriate.
Section 3.7.3, Liabilities for Dividends and Experience Refunds	
Comment	One commentator asked if premium stabilization reserves were to be considered under this section.
Response	The standard would cover premium stabilization reserves in this section, as stabilization reserves are usually established for dividends or experience refunds.
Section 3.8, Follow-Up Studies	
Comment	Several commentators raised concerns about whether follow-up studies by the actuary were necessary. Some provided alternative wording to clarify positions.
Response	The committee believed that follow-up studies, while of great value, are the responsibility of the risk-assuming entity. An actuary is frequently involved but may not be the same actuary as the one determining the liability. The committee revised the wording to note that the responsibility of the actuary, under this ASOP, begins when the actuary is required or is asked to conduct (or assist) in completing a follow-up study. A disclosure statement was also added to section 4.1, Communications and Disclosures.
Section 4.2, Reliance on Others	
Comment	One commentator suggested that the sentence concerning disclosure be deleted from this section.
Response	The committee disagreed and made no changes.

ASOP No. 42—March 2004

ASOP No. 42—March 2004