ACTUARIAL STANDARDS BOARD

Actuarial Standard
of Practice
No. 26

Compliance with Statutory and Regulatory Requirements for the Actuarial Certification of Small Employer Health Benefit Plans

Developed by the
Health Committee of the
Actuarial Standards Board

Adopted by the
Actuarial Standards Board
October 1996

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November 1996

TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Compliance with Statutory and Regulatory Requirements for the Actuarial Certification of Small Employer Health Benefit Plans

FROM: Actuarial Standards Board (ASB)

SUBJ: Actuarial Standard of Practice No. 26

This booklet contains the final version of Actuarial Standard of Practice (ASOP) No. 26, *Compliance with Statutory and Regulatory Requirements for the Actuarial Certification of Small Employer Health Benefit Plans*.

Background

Recently, statutes and regulations have been enacted by a majority of states that have imposed various constraints on carriers for small employer health benefit plans. These statutes and regulations often require an actuarial certification that a small employer carrier is in compliance with the statutory or regulatory constraints. This is a new area of practice for actuaries; therefore, this actuarial standard of practice has been developed to provide guidance for actuaries preparing such certifications.

The first draft of this standard was exposed for review in October 1995, with a comment deadline of March 29, 1996. Thirty-five letters of comment were received. Additionally, the Health Committee of the ASB, as the drafting committee of this standard, presented a workshop on the proposed standard at a Society of Actuaries meeting in June 1996. The committee took very seriously its responsibility to review all of the comments it received regarding the exposure draft. Most of the comments exhibited a great deal of thought, and many of the suggestions made were incorporated into the final standard. However, no substantive positions taken in the exposure draft were changed. The committee believes that the final standard—like that of the exposure draft—correctly reflects the ASB's mission to provide guidance relating to the actuarial certifications of compliance required by state laws and regulations. (For a detailed discussion of the issues raised in the comment letters, and the committee's responses to such, please see appendix 2. Note in particular the discussion on p. 11 regarding the fact that this standard imposes a higher documentation requirement than those required by some states.)

Format Changes

A number of format changes have also been made since publication of the exposure draft. The ASB voted in May 1996 to change the format of all future actuarial standards of practice. Thus, sections 3 and 4 now form an appendix titled, Background and Current Practices. (Appendix 1 of this standard contains sections 3 and 4 of the exposure draft.) Further, sections 5 and 6 of the exposure draft have now been renumbered as sections 3 and 4. The "new" sections 3 and 4, along with sections 1 and 2, now form the actual standard of practice. The heading *Preamble*, which used to apply to the first four sections of the standard, has been deleted. The board made these format changes to help the reader distinguish between a standard's substantive requirements and language intended for general information.

The Health Committee thanks everyone who provided input during the exposure process. The comments were helpful in making revisions. The ASB voted in October 1996 to adopt the final standard.

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ACTUARIAL STANDARD OF PRACTICE NO. 26

COMPLIANCE WITH STATUTORY AND REGULATORY REQUIREMENTS FOR THE ACTUARIAL CERTIFICATION OF SMALL EMPLOYER HEALTH BENEFIT PLANS

STANDARD OF PRACTICE

Section 1. Purpose, Scope, and Effective Date

1.1 Purpose—Many states require the filing of an actuarial certification of compliance stating that the rating methods and other actuarial practices applicable to carriers for small employer health benefit plans comply with relevant statutes, regulations, or other mandatory requirements set forth in any applicable, generally distributed interpretative materials. (Hereafter, the phrase *regulatory requirements* will refer to such statutes, regulations, and/or applicable, generally distributed interpretative materials.) The purpose of this actuarial standard of practice is to guide the preparer of a certification of compliance by identifying the issues to be addressed and the required documentation regarding relevant regulatory requirements.

1.2 Scope—This standard applies to actuarial certifications of compliance prescribed by regulatory requirements that a carrier's rating methods and other actuarial practices applicable to small employer health benefit plans comply with statutory and regulatory rating constraints. Since specific regulatory requirements for such certifications vary between jurisdictions, the actuary must satisfy the specific regulatory requirements of a jurisdiction in preparing the certification.

This standard applies to rating methods and other actuarial practices only and does not apply to other market conduct activities (e.g., marketing, enrollment and billing procedures, and renewal notices) that may be covered under regulatory requirements.

1.3 Effective Date—This standard will be effective for all certifications rendered on or after January 1, 1997, regardless of the time period covered.

Section 2. Definitions

The definitions below are defined for use in this actuarial standard of practice.

2.1 Actuarial Soundness—Small employer health benefit plan premium rates are actuarially sound if, for business in the state for which the certification is being prepared and for the period covered by the certification, projected premiums in the aggregate, including expected reinsurance cash flows, governmental risk adjustment cash flows, and investment income, are adequate to provide for all expected costs, including health benefits, health benefit settlement expenses, marketing and administrative expenses, and the cost of capital.

For either a retrospective or a prospective certification, the determination of actuarial soundness is based on information available at the time the premium rates were established.

2.2 Carrier—Any entity subject to state regulation that offers health benefit plan coverage for sale. *Carrier* includes an insurance company, a prepaid hospital or medical service plan, a fraternal benefit society, a health maintenance organization, and any other entity offering for sale a plan of health insurance or health benefits.

2.3 Cost of Capital—The rate of return that capital could earn in an alternative investment of equivalent risk. The source of the capital may be internal or external.

2.4 Health Benefit Plan—Any hospital or medical policy or certificate; medical expense insurance; or subscriber contract or contract of insurance provided by a prepaid hospital, medical service plan, or health maintenance organization.

2.5 Small Employer—Any person, firm, corporation, partnership, or organization that employs a number of eligible employees within a statutorily specified range that has an upper bound and that satisfies any other statutorily defined criteria.

2.6 Subsequent Events—Subsequent events are events (1) that have occurred since the end of the certification period and before the date of the certification, (2) that could materially affect current or future certifications rendered, and (3) about which the actuary has knowledge.

Section 3. Analysis of Issues and Recommended Compliance

3.1 Introduction—The purpose of the actuarial certification of compliance is to satisfy applicable regulatory requirements. This certification should be appropriate to the circumstances. The actuary should review the applicable regulatory requirements, which generally contain a statement of purpose that the actuary should keep in mind when preparing the certification of compliance. The actuary should also consider any other mandatory requirements set forth in any applicable, generally distributed interpretive materials issued by regulators in support of the applicable regulatory requirements, and should satisfy those requirements when preparing the certification.

3.2 Testing of Rates for Compliance with Rating Constraints—The actuary should ensure that sufficient testing has been done so that he or she is reasonably satisfied that there are no material violations of the rating constraints. Such testing should be detailed enough to assure that an appropriate range of health benefit plan designs and demographic characteristics has been tested.

3.3 Analysis of Rates for Actuarial Soundness—If required, the actuary should perform sufficient analysis so that he or she is reasonably satisfied the rates are actuarially sound. For a *retrospective* certification of actuarial soundness, the certification relates to the premium rates in effect during the time period to which the certification applies, and the determination of actuarial soundness should be based on information that was reasonably available at the point in time when the premium rates were established. For a *prospective* certification of actuarial soundness, the certification relates to the premium rates developed for the time period to which the certification applies.

3.4 Documentation of Compliance—Documentation should be available to support the actuarial certification, and should include the items listed in sections 3.4.1–3.4.3 below, if applicable. The state will define what documentation should be submitted, if any.

3.4.1 Rating Methods and Underwriting Practices—Materials that have been reviewed in order to certify compliance with requirements for rating methods and new business and renewal underwriting practices, such as the following:

a. a description of the carrier's rating methods and new business and renewal underwriting practices; this should include any exceptions or variations that may be used for the business or any subset of the business for which rates are determined;

b. when actuarial soundness is being certified, experience, reinsurance, pooling considerations, and other relevant data used in the analysis of the business for which rating practices are being certified;

c. the health benefit plan contracts and certificates;

d. the sales brochures and other materials for each health benefit plan;

e. the rating manual;

f. formulas for calculating any group's rate from the rating manual, including both new business rates and renewal rates;

g. a sufficient sample of test calculations of the rating formulas to verify that the rates actually being charged are in accordance with the rating manuals;

h. a description of any material changes to previously reviewed health benefit plan contracts and certificates that were not mandated by regulatory requirements;

i. information concerning any policy fees, administrative charges, or application charges that may apply to any group in any class of business, regardless of whether such fees or charges are remitted to the carrier; and

j. any other information prescribed by the regulatory requirements.

3.4.2 Demonstration of Compliance with Rating Constraints—A written demonstration supporting the actuarial certification that the rates are in compliance with applicable regulatory requirements. The demonstration should include an explanation as to how items such as classes of business, average rates, rating bands, and rate increases comply with statutory and regulatory rating constraints.

3.4.3 Demonstration of Compliance with Actuarial Soundness—If a certification of actuarial soundness is required, a written demonstration supporting the determination, including documentation of underlying assumptions.

3.5 Time Period Covered by Certification—The actuary's certification that the rates are in compliance should apply to the time period specified by applicable regulatory requirements. In the absence of any specification in such regulatory requirements, the actuary should generally certify to the prior calendar year. In any event, the actuary should explicitly state the time period to which the certification applies.

3.6 Qualified or Limited Opinions—If the actuary is aware that any rating methods or other practices are not in compliance with applicable regulatory requirements, such noncompliance should be reported in a qualified opinion. If the regulatory requirement requires a certification of actuarial soundness and the actuary does not believe the rates are actuarially sound, even though they are in compliance with the regulatory requirements, this should be noted in a qualified opinion. If the actuary is not able to certify some of the items required in the regulatory requirement, this should be noted in a limited opinion.

Section 4. Communications and Disclosures

4.1 Content of Certification—The content of the certification should include, as a minimum, the following:

a. certification whether all practices, as required by regulatory requirement to be included in the certification, are in compliance;

b. a listing of practices that are covered in the certification;

c. identification of the time period covered by the certification;

d. changes in rating methods and other practices that have occurred during the time period covered by the certification and that affect compliance;

e. a description of any subsequent events;

f. where a qualified certification is given, any actions that are being taken to bring the carrier into compliance; and

g. where a limited certification is given, any sections of the regulatory requirements regarding certification that are not addressed.

4.2 Additional Required Disclosure—If the actuary is unable to certify actuarial soundness based on sections 2.1 and 3.3 of this standard, but certifies actuarial soundness based on regulatory requirements at variance with those sections, the actuary should so state in the certification.

4.3 Deviation from Standard—An actuary must be prepared to justify the use of any procedures that depart materially from those set forth in this standard and must include, in any actuarial communication disclosing the results of the procedures, an appropriate statement with respect to the nature, rationale, and effect of such departures.

Appendix 1

Background and Current Practices

Note: This appendix is provided for informational purposes, but is not part of the standard of practice.

Background

In 1990, the National Association of Insurance Commissioners (NAIC) adopted a model act relating to small employer health insurance availability titled, *Premium Rates and Renewability Coverage for Health Insurance Sold to Small Employer Groups*. Since that time, two additional model acts have been adopted: *Small Employer Health Insurance Availability (Allocation with or without an Opt-out)*, and *Small Employer Health Insurance Availability (Prospective Reinsurance with or without an Opt-out)*; as well as a model regulation, *Model Regulation to Implement the Small Employer Health Insurance Model Act (Prospective Reinsurance with or without an Opt-out)*.

Recently, statutes and regulations enacted by a majority of states, often adopting some sections of the NAIC model regulations, have imposed statutory and regulatory constraints on carriers for small employer health benefit plans. These constraints may vary substantially from the NAIC model regulations, but generally have a similar intent. In particular, many of these statutes and regulations focus on narrowing the differences between premium rates charged to individual small employers with similar plan designs and case characteristics. The stated goals of these regulations often include the broad pooling of risks, the avoidance of extreme rate differences (which have occurred under certain tier and durational rating methods), and the expansion of access to health insurance coverage.

Current Practices

As noted above, applicable regulatory requirements vary considerably as to the extent of rating constraints imposed, as well as the specific language describing such constraints. In most situations, few, if any, restrictions exist as to the number and design of health benefit plans that can be offered in the marketplace. The current variety of state statutes and regulations renders it extremely difficult to provide precise rules for determining compliance. These conditions necessitate that the actuary apply a great deal of judgment in completing the certification of compliance.

Appendix 2

Comments on the Exposure Draft and Committee Responses

The first draft of this standard was exposed for review in October 1995, with a comment deadline of March 29, 1996. Thirty-five letters of comment were received. Additionally, the Health Committee of the ASB presented a workshop on the proposed standard at a Society of Actuaries meeting in June 1996 at Colorado Springs, which was attended by thirty-seven individuals (most responded positively to the proposed standard's text). Summarized below are the significant issues raised and questions contained in the comment letters, printed in lightface. The committee's responses to those issues appear in **boldface**.

Note also that, as mentioned in the transmittal memorandum to this standard of practice, the ASB adopted on May 1, 1996, a new format for all actuarial standards of practice. (See p. v for a detailed explanation of such changes.) Thus, the section numbers below refer to section numbers in the exposure draft, unless otherwise noted (some section numbers have remained the same).

General Observations

The nature of the comment letters reflected the divergence of opinion on the subject of the standard. Many respondents commented that they thought the standard represented a reasonable effort to assist the actuary in preparing the certification of compliance. Others thought that, given the "actuarially unsound" nature of the rating constraints prescribed by state law, it is impossible to produce a reasonable standard. Some respondents requested that the standard make clearer that it is simply a *guide* to compliance and does not represent a validation of the rating constraints. A few respondents suggested that the standard be expanded to go beyond certifications and include other aspects of rating and financial solvency. Others requested that the standard address issues unique to individual states. It was also suggested that the title be changed to more accurately reflect the nature of the standard.

Promulgation of this standard does not imply either approval or disapproval of the nature of prescribed laws in various states. The purpose of the standard is to provide the actuary with guidance regarding certifications of compliance with prescribed laws. In the event the actuary believes the rating constraints prescribed by law are "actuarially unsound," the standard allows the actuary to issue a qualified opinion regarding actuarial soundness (if necessary), while certifying compliance with other aspects of the law as necessary (see section 3.6). The scope of the standard has not been expanded to go beyond actuarial rating practices or other aspects of rating and financial solvency. Further, due to the variance in state laws, as well as the dynamic nature of these laws, it would not be appropriate nor realistic to address within the standard the compliance requirements for each state. The title of the standard was not changed. The ASB felt that the nature of the standard is adequately detailed in the purpose and scope sections (see sections 1.1 and 1.2).

Transmittal Memorandum Questions

In the transmittal memorandum to the exposure draft of this standard, the committee posed four questions to practitioners to keep in mind while reading the text. The questions are reprinted in full below:

1. Some regulations require an actuary to certify that market conduct activities, which are often non-actuarial in nature, are in compliance with the regulations. The proposed standard does not address these non-actuarial activities. Is this an appropriate approach?

2. Many regulations do not make specific provision for limited or qualified opinions. This standard provides that the actuary may issue such limited or qualified opinions. Is this approach satisfactory?

3. Sections 5.4 and 6.1 define minimum requirements for the documentation and content of certifications, respectively. Given the varying nature of statutes and regulations in effect, are the requirements in this proposed standard either too restrictive or not comprehensive enough?

4. Section 2.1 provides a definition of *actuarial soundness* for purposes of this standard. Is this definition satisfactory for the purposes of preparing a certification in those states requiring a certification of actuarial soundness?

Comments on the four issues listed above, and the committee responses to such, follow.

Transmittal Memorandum Issue #1: Non-Actuarial Matters—Several respondents commented on whether the standard should be expanded to address non-actuarial items. The responses ranged across the full spectrum of options. Some respondents thought it would be inappropriate for non-actuarial issues to be addressed in an actuarial standard of practice. Others thought it was a weakness for the standard not to give detailed guidance regarding all matters relative to which the actuary is certifying. One respondent pointed out that there is not necessarily a clear distinction between actuarial and non-actuarial topics, and he suggested that the standard should address all issues that could be interpreted to be actuarial in nature. Some respondents suggested that some general guidance would be helpful relative to non-actuarial matters, such as enlisting an officer of the company to certify those items that are beyond the scope of the actuary's expertise. **The committee continues to believe that it is not appropriate for this actuarial standard of practice to set standards for any non-actuarial activities related to actuarial certification of compliance with statutes or regulations (hereafter referred to as *regulatory requirements*) for small employer health benefit plans. Thus, the standard does not address any such non-actuarial activities.**

Transmittal Memorandum Issue #2: Limited or Qualified Opinion—With one exception, the respondents agreed that it *is* appropriate for the standard to authorize the issuance of a limited or qualified opinion. The contrary respondent stated that "the regulation need not mention a partial or qualified opinion for one to be given by an actuary with integrity." Several of the respondents noted that the qualified or limited opinion should include clear statements as to the nature of the

qualification or limitation. One respondent asked for more details in the standard regarding the circumstances that would necessitate such an opinion and its contents. Another respondent noted that it would be the regulators' decision as to whether to accept that such an opinion satisfied a state's regulatory requirements. **The committee was pleased with the overwhelming support for the option of using a limited or qualified opinion, which is contained in section 3.6 of the standard. However, individual states will still need to determine—on an individual basis—how to respond to any qualified opinions that may be submitted.**

Transmittal Memorandum Issue #3: Minimum Requirements for Documentation and the Content of the Certification—For this issue, responses varied between those that thought the standard's requirements are reasonable and those that believed the requirements are excessive. The most common criticism was that the documentation and certification requirements should not extend beyond those explicitly mandated by law. One respondent was particularly concerned that the inclusion of "subsequent events" in the certification went beyond any regulatory requirement. Another thought that some guidance ought to be given where state law mandated different requirements than the standard. **It was the intention of the committee to set high standards for required documentation, as evidenced in the exposure draft. Given the nature of the certification of compliance required and the potential reliance placed upon such certification, the required documentation was established at a level the committee felt represented good actuarial practice. The committee felt that supporting documentation at this level would be to the actuary's advantage if the actuary were ever required to support the relevant certification. However, note that only documentation specifically required by a state need actually be submitted. The "subsequent events" test was another area where, because the committee believes it to be good actuarial practice, the committee deliberately set a standard that was higher than that specifically required by several states.**

Transmittal Memorandum Issue #4: Definition of *Actuarial Soundness*—Many respondents voiced the opinion that state laws pertaining to small employer health benefit plan ratemaking are inherently actuarially unsound. In light of this perception, many argued that not only should no definition of *actuarial soundness* be attempted, but that the existence of any standard of practice at all is, at best, giving undue credibility to unsound laws. Other respondents went even further and suggested that it is professionally unconscionable to promulgate any standard on this particular subject. Some felt that a standard could be produced without including a definition of *actuarial soundness*, but they argued that the standard should make clear that it was merely a tool for implementing statutorily mandated certifications. Others argued for producing a standard without a definition of *actuarial soundness* because states interpret this phrase in different ways, thereby making any single definition impossible. One respondent argued that no definition is needed because the drafters of the model legislation probably did not have a precise concept in mind when they inserted this phrase.

Many of the respondents suggested changing the definition. Some wanted to include a clearer statement that this definition only applies to the small group certification, and that other situations would call for differing definitions. Several respondents asked for clarification as to whether the definition is prospective or retrospective in nature. Many questioned limiting the time period to that "covered by the certification," arguing that actuarial soundness is more long-term in nature. Several respondents questioned the aggregate nature of the definition, and

suggested that *actuarial soundness* necessitates that each rate is determined using appropriate methods. Some respondents asked that the definition allow for expenses to be determined on a marginal basis and that subsidies be permitted between the small group and other lines of business. One commentator suggested that the definition be made more general so as to allow the carrier to better respond to competitive forces.

Another respondent suggested that the restriction to a single state is too narrow, and also requested some recognition of initial losses incurred by start-up companies. One writer suggested that the phrase "based on information that was reasonably available at the point in time when the premium rates were established" be added. Another asked for clarification as to how this definition relates to the standards on risk classification and rate filings [see Actuarial Standard of Practice (ASOP) Nos. 8 and 12]. Some respondents asked that *investment income* be added to the definition, and one asked that the phrase *cost of capital* be clarified.

The committee carefully considered all of the responses received regarding the definition of *actuarial soundness*, but basically reaffirmed the scope of the definition used in the exposure draft. In developing the definition, the committee grappled with two main issues: (1) the definition needed to work within the context of the certification of compliance being prepared, and (2) the definition had to be one such that an actuary addressing a small group line of business could reasonably certify to. The committee feels the definition in this standard meets these two defining characteristics.

With regard to the comment that no definition of *actuarial soundness* should be attempted, the committee believes that, since the standard relates to actuarial issues, and since many of the applicable laws, including the NAIC model laws, require the actuary to address *actuarial soundness*, it *is* appropriate to address the issue within this standard. Further, the committee believes it has created a better standard of practice by doing so.

Although the committee did not alter its position on the scope of the definition or the necessity of including such a definition within the standard, the committee did make the following changes to the definition of *actuarial soundness*, based on the comments received: (1) combined the original retrospective and prospective definitions into a single definition; (2) inserted the phrase "including expected reinsurance cash flows, governmental risk adjustment cash flows, and investment income, . . ."; (3) inserted the word *expected* before *costs*; (4) changed *health benefit expenses* to *health benefits*; (5) changed *operational* to *marketing*; and (6) inserted a second paragraph, as follows: "For either a retrospective or a prospective certification, the determination of actuarial soundness is based on information available at the time the premium rates were developed."

The committee notes that the definition of *actuarial soundness* used is an aggregate definition. It is based on the premise that actuarial soundness is an aggregate rate adequacy test. Some commentators suggested a more specific definition be used, based on the rates having appropriate actuarial balance or equivalence between benefit plans or demographic risk characteristics. This approach was considered by the committee, but ultimately rejected.

Issues relating to how to address expense allocations were viewed as too narrow to be considered here. These are valid issues for the pricing actuary to consider in practice.

As noted in section 2, the definitions included in the standard are defined for use *in this standard of practice*. Although it might be helpful to develop definitions that would have more widespread acceptance, the nature of the certification seems to preclude the development of such definitions. However, the committee did add one definition, that of *cost of capital*.

With regard to the request for clarification as to how this definition relates to the standards of practice on risk classification and rate filings, the committee believes that this standard does not conflict with these other ASOPs.

Section 1. Purpose, Scope, and Effective Date

Section 1.1, Purpose—Two comments were received on this section. One suggested that the purpose of the standard be broadened to address more elements of small group reform that may impact the certification. The other suggested that the phrase "actuarial practices applicable to carriers for small employer health benefit plans" was too broad, in that there are actuarial practices, such as setting reserves, that are beyond the scope of the standard. **The committee believes that the language in the Purpose section is appropriate. It is the purpose of this standard of practice to address actuarial items relative to which the states require a certification of compliance. It is not appropriate for the standard to go beyond that.**

Section 1.2, Scope—One respondent proposed that the standard be expanded to include issues pertaining to financial solvency. (Comments regarding certification of market conduct compliance are discussed above under Transmittal Memorandum Issue #1.) **As stated in the committee response to section 1.1 (see above), the committee believes it is not appropriate to extend the scope beyond the required *actuarial* aspects of the certification.**

Section 1.3, Effective Date—Comments were received asking for clarification as to the meaning of the January 1, 1997 date. **The committee changed the wording in an effort to clarify its intent.**

Section 2. Definitions

Section 2.1, Actuarial Soundness—See the comments above (again, the committee's response is in **bold**) under Transmittal Memorandum Issue #4.

Section 2.2, Carrier—One respondent suggested changing "*Carrier* includes an insurance company, . . ." to "*Carrier* includes, but is not limited to, an insurance company . . .". It was also suggested that the standard clarify that it is the definition of *carrier* in the state regulation that is the controlling factor. **The committee believes the existing language is suitable and is sufficiently broad to include any entity regulated by the states.**

Section 2.3, Health Benefit Plan—Comments included substituting *medical* for *health* and changing the words to read "provided by a small employer carrier." **The committee believes that the existing language is consistent with common usage in regulatory requirements.**

Section 2.4, Small Employer—One respondent suggested that the actuary certify that the small employers that are insured meet the statutory definition. Others suggested that the definition be modified to clarify that statutory constraints may exist as to who is considered an eligible employee, over what time period the number of eligible employees is determined, and the handling of small employers whose employees are in more than one state. Another suggested that an example of a specific upper bound be provided, such as 50, in order to list specifically what size group would typically be subject to this standard. Another respondent suggested that the phrase *For purposes of this standard* be added at the beginning of the definition, and another suggested that the definition be changed to eliminate the reference to *association*. **Based on the comments received, the committee made the following changes: (1) the word *association* was changed to *organization*; (2) the word *eligible* was inserted before *employees*; and (3) the phrase *and that satisfies any other statutorily defined criteria* was added. In addition, all standards of practice now contain the following introductory sentence, which applies to all definitions listed in section 2: "The definitions below are defined for use in this actuarial standard of practice."**

Section 2.5, Subsequent Events—One commentator suggested dropping the phrase *or future*. **The committee considered this suggestion, but decided not to make this change.**

Section 3. Background and Historical Issues (now in Appendix 1 under Background)

Suggestions included removing the last sentence, adding the phrase *and case characteristics* in the next to last sentence of the second paragraph, and removing the first paragraph entirely on the grounds that these points are more appropriately included in the Scope and Purpose sections. **The committee added the phrase *and case characteristics* to more accurately reflect the intent of the regulatory requirements. The committee also decided to leave the first paragraph in this section, because it believes that this material *does* address the historical background pertaining to the subject of the standard.**

Section 4. Current Practices and Alternatives (now in Appendix 1 under Current Practices)

The only comment on this section was a suggestion to revise the last paragraph to read, "While the current variety of state statutes and regulations and the variety of reasonable interpretations of these statutes and regulations render it extremely difficult to provide precise rules for determining compliance, . . .". **The committee revised the wording in the paragraph to improve readability.**

Section 5. Analysis of Issues and Recommended Compliance (Now Section 3)

Section 5.1, Introduction (now section 3.1)—One respondent suggested adding as a separate item the interpretive material distributed by the state insurance department to the list of items for review. Another suggested deleting the last clause of the last sentence. **The committee added the following sentence:**

> **The actuary should also consider any other mandatory requirements set forth in any applicable, generally distributed interpretive materials issued by regulators in support of the applicable regulatory requirements, and should satisfy those requirements when preparing the certification.**

Section 5.2, Testing of Rates for Compliance with Rating Constraints (now section 3.2)—One respondent suggested adding the following text: "Testing of rates in a community rating system may consist of an examination of the methods and factors used, and audits of their implementation." Another suggested adding the sentence, "All known violations of the rating constraints that result in a rate materially higher than permitted by the statute or regulation must be addressed in a qualified opinion." This respondent suggested that *material* be defined as no greater than 5%. Another thought the words *reasonably*, *materially*, and *appropriate* were too general to be consistently interpreted. **As for the first comment, the committee believes that the suggested language represents a specific example, whereas the standard (appropriately) addresses only the general case. It would be very difficult indeed to create a standard that could address all specific concerns, and, thus, the change was not made. As for the second comment, the committee did not provide definitions for the words *material*, *reasonable*, or *appropriate*, since these words are used frequently in actuarial literature. The definitions of such words are dependent on the context of their use.**

Section 5.3, Testing of Rates for Actuarial Soundness (now section 3.3 and titled Analysis of Rates for Actuarial Soundness)—A couple of respondents suggested substituting *testing* for *analysis* in the first sentence. Several respondents also questioned whether the description of the *retrospective* certification makes sufficiently clear that it is not a test of actual results. One respondent suggested that adding the word *expected* before the word *costs* in the definition of *actuarial soundness* might make this point clearer. Two of the respondents suggested that a retrospective certification is theoretically inappropriate, in that such a certification ignores the most relevant information available. One respondent suggested that only the first sentence be retained, or that the remaining sentences be modified to be more general in nature. Another asked for clarification as to how a certification that is both retrospective and prospective should be handled, and another suggested that the language more specifically point out that "each rate certified is clearly subject to certification only once." Another questioned the value of prospective certifications, given that rate schedules change so frequently. **In response to the first comment listed above, the committee did change the word *testing* to *analysis* (the title to the section was also changed accordingly). The definition of *actuarial soundness* was also revised so that the description of a retrospective certification is more clear. As for the remainder of the comments regarding this section, they apply to the appropriateness of state legislation, and, as such, the topic of these comments is outside the scope of the ASOP.**

Section 5.4, Documentation of Compliance (now section 3.4)—One respondent pointed out that there was no mention of a requirement within the standard relating to the documentation of the data used and commentary on the quality of the data. Another wanted the phrase *if applicable* added to the end of the first sentence. Another suggested that if the actuary receives information from a source outside the actuary's firm, the actuary should obtain signed correspondence from the source verifying the accuracy and completeness of the information. **As for the first comment, a standard already exists on data quality (see ASOP No. 23), so the committee did not believe that any additional language on this subject was necessary within this standard. As for the second comment, the phrase *if applicable* was added at the end of the first sentence. The suggestion regarding obtaining signed correspondence may be a good idea in practice, and the committee notes that such a practice can be used. However, this practice is not *required* by the standard.**

Section 5.4.1, Rating Methods and Renewal Underwriting Practices (now section 3.4.1 and titled Rating Methods and Underwriting Practices)—One respondent suggested changing the title to Rating Methods and New Business and Renewal Underwriting Practices. Others suggested deleting sections (b), (c), and (g) on the grounds of being overly burdensome on small companies. Another thought that all of the sections should be eliminated. If the sections were not eliminated, this respondent suggested combining sections (a), (d), and (e); combining sections (b) and (g); and eliminating section (c). Another suggested that the list of items should be expanded to include the basis of the data on which claims were estimated, corporate practices regarding expense and investment income allocation, pooling/reinsurance mechanisms, and any subsidizing of the small group line by other lines. A couple of respondents also suggested removing the parentheses from the parenthetical phrase in section (a). **In response to the above comments, the committee changed the title of this section by removing the word *renewal*. The committee also added a new section (b) in response to comments received on investment income, pooling/reinsurance, and other items. Further, the committee removed the parentheses in section (a), as was suggested.**

Section 5.4.2, Fees and Charges (now section 3.4.1(i))—One respondent welcomed the reference to fees or charges that may or may not be remitted to the carrier. Another respondent asked for clarification relative to the treatment of association dues. **This section was moved to section 3.4.1, Rating Methods and Underwriting Practices, as being one of several items that are usually reviewed in order to certify compliance with requirements for rating methods and new business and renewal underwriting practices. As for the latter comment, the answer is dependent on regulatory interpretation, and, thus, the material is too specific for this ASOP.**

Section 5.4.3, Demonstration of Compliance with Rating Constraints (now section 3.4.2)—One respondent asked for clarification as to whether the standard requires that the documentation supporting the certification be submitted to regulators. **The committee believes that *regulators* define what documentation they should receive, not the ASOP. Thus, no change was made to the text.**

Section 5.4.4, Demonstration of Compliance with Actuarial Soundness (now section 3.4.3)—One respondent asked for clarification as to whether the required documentation was similar to

the actuarial memorandum regulation required for the statutory annual statement. This respondent also asked for clarification regarding the extent to which this information would be considered confidential. One respondent suggested that methods be included as well as assumptions. Another respondent commented that while this section reflected "common sense," it was good to explicitly include it. Two others suggested that this section be eliminated. **All of the items described within this section of the standard (i.e., everything in sections 3.4.1–3.4.3) are to be available in the file, but not submitted to the regulator unless requested, as noted in the introductory paragraph of section 3.4.**

Section 5.5, Time Period Covered by Certification (now section 3.5)—One respondent suggested deleting the second sentence. Another suggested that compliance should only be certified prospectively. **The committee did not make any changes to the second sentence, since it believes that this text provides some flexibility and room for actuarial judgment. The other comment reflects upon the appropriateness of the *regulation*, which, again, is outside the scope of the ASOP.**

Section 5.6, Qualified or Limited Opinions (now section 3.6)—One respondent suggested deleting the second sentence. Another asked for more explanation regarding what circumstances would warrant a qualified or limited opinion. **The committee believes that the section contains sufficient information regarding the circumstances that necessitate a qualified or limited opinion.**

Section 6. Communications and Disclosures (Now Section 4)

Section 6.1, Content of Certification (now section 4.1)—One respondent stated that the certification should explicitly include the statement that the plan is actuarially sound for the period involved, and that the certification should explicitly include the definition of *actuarial soundness* that is being utilized. Another asked for clarification of section 6.1(d), and pointed out that many of the other sections within section 6.1 seem overlapping and redundant. Another asked that information regarding the name of the actuary and corporate affiliation be required, and that a description of the data used should be included.

Regarding the first point raised, the committee reaffirmed its decision that a certification need only address *actuarial soundness* if required by regulatory requirement. To do otherwise would significantly expand the scope of such a required certification in states where such a certification is not required. In practice, the actuary can always include a certification of actuarial soundness even when not required. If the actuary is using a definition of *actuarial soundness* that differs from that contained in the standard of practice, it must be so noted, either as indicated in the new section 4.2 or in a qualified opinion, as appropriate. (If the actuary is using the standard's definition of *actuarial soundness*, it is not necessary to include such in the certification.) As for the comment that the sections listed in section 6.1 seem overlapping and redundant, the committee believes that section 6.1 (now section 4.1) does not contain overlapping material. The committee decided to leave the items listed in this section unchanged.

The committee thanks everyone who took the time and made the effort to write comment letters. The input was helpful in developing the final standard.