ACTUARIAL STANDARDS BOARD

● EXPOSURE DRAFT ●

Proposed Revision of
Actuarial Standard
of Practice
No. 42

Health and Disability Actuarial Assets and Liabilities Other Than Liabilities for Incurred Claims

Comment Deadline:
September 30, 2017

Developed by the
Task Force to Revise ASOP No. 42 of the
Health Committee of the
Actuarial Standards Board

Approved for Exposure by the
Actuarial Standards Board
May 2017

TABLE OF CONTENTS

Transmittal Memorandum iv

STANDARD OF PRACTICE

Section 1. Purpose, Scope, Cross References, and Effective Date 1
- 1.1 Purpose 1
- 1.2 Scope 1
- 1.3 Cross References 2
- 1.4 Effective Date 2

Section 2. Definitions 2
- 2.1 Block of Business 2
- 2.2 Capitation 2
- 2.3 Carve-Outs 2
- 2.4 Contract Period 2
- 2.5 Contract Reserve 2
- 2.6 Exposure Unit 2
- 2.7 Health Benefit Plan 2
- 2.8 Long-Term Product 3
- 2.9 Premium Deficiency Reserve 3
- 2.10 Providers 3
- 2.11 Provider-Related Asset or Liability 3
- 2.12 Risk Adjustment Data Validation (RADV) 3
- 2.13 Risk-Bearing Entity 3
- 2.14 Risk-Sharing Arrangement 3
- 2.15 Time Value of Money 3
- 2.16 Trends 3
- 2.17 Unearned Premium Reserve 3
- 2.18 Valuation Date 3

Section 3. Analysis of Issues and Recommended Practices 3
- 3.1 Introduction 4
- 3.2 Purpose or Use of the Asset or Liability Estimate 4
- 3.3 Considerations for Estimating Assets and Liabilities 4
  - 3.3.1 Health Benefit Plan Provisions and Business Practices 4
  - 3.3.2 Risk-Sharing Arrangement Provisions 4
  - 3.3.3 Economic and Other External Influences 5
  - 3.3.4 Risk Characteristics and Organizational Practices by Block of Business 5
  - 3.3.5 Legislative Requirements 5
  - 3.3.6 Coordination of Benefits (COB), Subrogation, and Government Programs 5
  - 3.3.7 Carve-Outs 5
  - 3.3.8 Time Value of Money 5

3.3.9 Special Considerations for Long-Term Products 6
3.3.10 Reinsurance Arrangements 6
3.3.11 Expenses 6
3.3.12 Consistency of Assumptions and Methodology 6
3.4 Considerations for Estimating Contract Reserves 6
3.4.1 Interest Rates 6
3.4.2 Morbidity 6
3.4.3 Persistency 7
3.4.4 Expenses 7
3.4.5 Trends 7
3.4.6 Premium Rate Changes 7
3.4.7 Previously Established Assumptions for Contract Reserves 7
3.4.8 Valuation Method 7
3.5 Considerations for Estimating Premium Deficiency Reserves 7
3.5.1 Block of Business 7
3.5.2 Time Period 8
3.5.3 Exposure 8
3.5.4 Premium Rate Changes 8
3.5.5 Claim Trend 8
3.5.6 Risk-Sharing Arrangements 8
3.5.7 Interest Rates 9
3.5.8 Reinsurance 9
3.5.9 Taxes 9
3.5.10 Expenses 9
3.5.11 Applicable Authority 9
3.6 Reserve for Insufficient Administrative Fee for Self-Insured Contracts 9
3.7 Considerations When Estimating Provider-Related Assets and Liabilities 9
3.7.1 Provider Risk-Sharing and Capitation Arrangements 10
3.7.2 Provider Financial Condition 10
3.7.3 Provider Incentive or Penalty Payments 10
3.7.4 Provider Risk-Bearing Entities 10
3.8 Claim Adjustment Expense Liabilities 10
3.9 Risk Adjustment Settlements 10
3.9.1 Market Neutrality 11
3.9.2 Risk Adjustment Payment Methodology 11
3.9.3 Risk Adjustment Data Validation (RADV) Audit 11
3.10 Other Assets and Liabilities 11
3.10.1 Liabilities for Payments to State Pools 11
3.10.2 Reserves for Unearned Premiums 11
3.10.3 Assets and Liabilities for Dividends, Experience Rating, and Premium Rebates 11
3.10.4 Reserves for Extension of Benefits and Contingent Benefits Provisions 11
3.10.5 Prescription Drug Rebates 11
3.10.6 Cost Sharing Subsidies 12
3.11 Follow-Up Studies 12
3.12 Provision for Adverse Deviation 12

3.13 Reliance on Data or Other Information Supplied by Others 12
3.14 Reliance on Assumptions and Methods Selected by Others 12
3.15 Documentation 13

Section 4. Communications and Disclosures 13
4.1 Actuarial Communication 13
4.2 Additional Disclosures 13

APPENDIX

Appendix—Background and Current Practices 15
Background 15
Current Practices 15

May 2017

TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Health and Disability Liabilities Other Than Liabilities for Incurred Claims

FROM: Actuarial Standards Board (ASB)

SUBJ: Proposed Revision of Actuarial Standard of Practice (ASOP) No. 42

This document contains an exposure draft of a proposed revision of ASOP No. 42 now titled *Health and Disability Actuarial Assets and Liabilities Other Than Liabilities for Incurred Claims*. Please review this exposure draft and give the ASB the benefit of your comments and suggestions. Each response will be acknowledged, and all responses will receive appropriate consideration by the drafting committee in preparing the final document for approval by the ASB.

The ASB accepts comments by either electronic or conventional mail. The preferred form is e-mail, as it eases the task of grouping comments by section. However, please feel free to use either form. If you wish to use e-mail, please send a message to **comments@actuary.org**. You may include your comments either in the body of the message or as an attachment prepared in any commonly used word processing format. **Please do not password protect any attachments**. **If the attachment is in the form of a PDF, please do not "copy protect" the PDF**. Include the phrase "ASB COMMENTS" in the subject line of your message. Please note: Any message not containing this exact phrase in the subject line will be deleted by our system's spam filter.

If you wish to use conventional mail, please send comments to the following address:

ASOP No. 42 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Unsigned or anonymous comments will not be considered by the ASB nor posted to the website. The comments will not be edited, amended, or truncated in any way. Comments will be posted in the order that they are received. Comments will be removed when final action on a proposed standard is taken. The ASB website is a public website, and all comments will be available to the general public. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

Deadline for receipt of comments in the ASB office: **September 30, 2017**

Background

ASOP No. 42, then titled *Determining Health and Disability Liabilities Other Than Liabilities for Incurred Claims*, was adopted in 2004 and updated for deviation language in 2011.

This proposed revision of ASOP No. 42 reflects a number of changes to other standards that have been made since its 2004 adoption, including updating the ASOP, where appropriate, to incorporate reference to new standards that have since been issued, eliminate guidance that does not conform to current ASOP practices regarding references to other standards of practice, and make consistent the definitions used in the standard with those of other standards of practice. In addition, this proposed revision of ASOP No. 42 reflects relevant legal, regulatory, and practice developments that have occurred since its initial adoption.

Key Changes

Key changes from the current standard reflected in this exposure draft include the following:

1. clarified language to ensure reasonable guidance exists for actuarial liabilities and assets that are now common, which generally did not exist when ASOP No. 42 was originally adopted;

2. updated language to reflect relevant legal, regulatory, and practice developments that have occurred since ASOP No. 42 was originally adopted;

3. updated language to incorporate reference to new standards since ASOP No. 42 was adopted, where appropriate, and to eliminate specific guidance in the standard that does not conform to current ASOP practice regarding references to other standards of practice;

4. revised and added definitions for clarity;

5. provided clarity in the guidance regarding premium deficiency reserves;

6. added section 3.2, Purpose or Use of the Asset or Liability Estimate;

7. added section 3.6, Reserve for Insufficient Administrative Fee for Self-Insured Contracts;

8. added section 3.9, Risk Adjustment Settlements; and

9. expanded the discussion of items in section 3.10, Other Assets and Liabilities (formerly section 3.7, Other Liabilities).

The task force appreciates comments on all areas of this proposed revision.

Task Force to Revise ASOP No. 42

Matthew P. Chamblee, Chairperson
Richard A. Lassow, Vice Chairperson

Cheryl G. Allari	Todd Sherman
Annette V. James	David O. Thoen
Amy Pahl	

Health Committee of the ASB

Donna C. Novak, Chairperson

Karen Bender	Richard A. Lassow
Robert M. Damler	Jinn-Feng Lin
Annette V. James	Timothy J. Wilder
Shannon C. Keller	

Actuarial Standards Board

Maryellen J. Coggins, Chairperson

Christopher S. Carlson	Barbara L. Snyder
Beth E. Fitzgerald	Kathleen A. Riley
Darrell D. Knapp	Frank Todisco
Cande J. Olsen	Ross A. Winkelman

The ASB establishes and improves standards of actuarial practice. These ASOPs identify what the actuary should consider, document, and disclose when performing an actuarial assignment. The ASB's goal is to set standards for appropriate practice for the U.S.

EXPOSURE DRAFT—May 2017

PROPOSED REVISION OF ACTUARIAL STANDARD OF PRACTICE NO. 42

HEALTH AND DISABILITY ACTUARIAL ASSETS AND LIABILITIES OTHER THAN LIABILITIES FOR INCURRED CLAIMS

STANDARD OF PRACTICE

Section 1. Purpose, Scope, Cross References, and Effective Date

1.1 Purpose—This actuarial standard of practice (ASOP) provides guidance to actuaries estimating or reviewing health and disability actuarial assets and liabilities, other than liabilities for incurred claims, when preparing or reviewing financial reports, claims studies, rates, or other actuarial communications as of a **valuation date**, under a **health benefit plan**, as defined in section 2.7 of this standard. This ASOP complements ASOP No. 5, *Incurred Health and Disability Claims*.

1.2 Scope—This standard applies to actuaries who estimate or review health and disability actuarial assets and liabilities, other than liabilities for incurred claims, under **health benefit plans** on behalf of risk-bearing entities, such as managed care entities, insurance companies, self-funded employer plans, health care **providers**, government-sponsored plans or risk contracts, or government agencies. This standard does not address interpretations of statutory or generally accepted accounting practices.

This standard does not apply when such assets or liabilities are estimated in accordance with other ASOPs, such as ASOP No. 4, *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*, and ASOP No. 6, *Measuring Retiree Group Benefits Obligations and Determining Retiree Group Benefits Program Periodic Costs or Actuarially Determined Contributions*. Furthermore, this standard does not apply in situations where a health or disability benefit is included within, and is incidental to, a plan subject to another practice-specific standard, such as a disability benefit under a life plan or a 401(h) account that is part of a pension plan.

This standard applies to the actuary only with respect to asset and liability estimates that are communicated as an actuarial finding (as described in ASOP No. 41, *Actuarial Communications*). Actions taken by the actuary's principal regarding the use of such estimates are beyond the scope of this standard.

If the actuary departs from the guidance set forth in this standard in order to comply with applicable law (statutes, regulations, and other legally binding authority), or for any other reason the actuary deems appropriate, the actuary should refer to section 4.

1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.

1.4 Effective Date—This standard will be effective for any actuarial work product covered by this standard's scope issued on or after four months after adoption by the Actuarial Standards Board (ASB).

Section 2. Definitions

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

2.1 Block of Business—All policies of a common coverage type (for example, major medical, preferred **provider** organization, or capitated managed care), demographic grouping (for example, size, age, or area), contract type, or other segmentation used in estimating assets and liabilities for actuarial purposes, or used by a **risk-bearing entity** for evaluating its business.

2.2 Capitation—The amount of money paid to a **provider**, usually per covered member, to provide specific health care services under a **health benefit plan** regardless of the number or types of services actually rendered.

2.3 Carve-Outs— Contractually designated services provided by specified **providers**, such as prescription drugs or dental, or condition-specific services such as cancer, mental health, or substance abuse treatment. **Carve-outs** are often provided by a separate entity specializing in that type of designated service.

2.4 Contract Period—The time period for which a contract is effective.

2.5 Contract Reserve—A liability established when a portion of the premium due prior to the **valuation date** is designed to pay all or a part of the claims expected to be incurred after the **valuation date**. A **contract reserve** may or may not include a provision for the **unearned premium reserves**. A **contract reserve** may also be referred to as an active life reserve or policy reserve.

2.6 Exposure Unit—A unit by which the cost for a **health benefit plan** is measured. For example, an **exposure unit** may be a contract, an individual covered, $100 of weekly salary, or $100 of monthly benefit.

2.7 Health Benefit Plan—A contract, such as an insurance policy, or other financial arrangement providing medical, prescription drug, dental, vision, disability income, long-term care, or other health-related benefits, whether on a reimbursement, indemnity, or service benefit basis, regardless of the form of the **risk-bearing entity**.

2.8 Long-Term Product—A **health benefit plan** that provides medical or disability benefits for an extended period of time. Some examples are cancer, long-term care, and long-term disability policies. The plan's benefits may not begin for several years after policy purchase and claims usually extend beyond the **valuation date**.

2.9 Premium Deficiency Reserve—A reserve that is established when future revenues and current reserves are estimated to be insufficient to cover future claims and expenses.

2.10 Providers—Individuals, groups, or organizations providing health care services or supplies, including but not limited to doctors, hospitals, independent physician associations, accountable care organizations, physical therapists, medical equipment suppliers, and pharmaceutical suppliers.

2.11 Provider-Related Asset or Liability—An amount established for expected future incentive payments or receipts or for non-claim related payments or receipts.

2.12 Risk Adjustment Data Validation (RADV)—The process of verifying the accuracy of information submitted for use in the risk adjustment model.

2.13 Risk-Bearing Entity—The entity with respect to which the actuary is estimating liabilities or assets associated with **health benefit plans** or **risk-sharing arrangements**. Examples of risk bearing entities include but are not limited to managed-care entities, insurance companies, health care **providers**, self-funded employer plans, government-sponsored plans or risk contracts.

2.14 Risk-Sharing Arrangement—An arrangement involving two or more entities, calling for payments contingent upon certain financial, operational, or other metrics. Examples include, but are not limited to, **provider risk-sharing arrangements** such as **provider** incentives, bonuses, and withholds or governmental **risk-sharing arrangements** such as risk corridor and risk-adjustment programs.

2.15 Time Value of Money—The principle that an amount of money available at an earlier point in time has different usefulness and value than the same amount of money has at a later point in time.

2.16 Trends—Measures of rates of change, over time, of the elements, such as cost, incidence, and severity, affecting the estimation of certain assets or liabilities.

2.17 Unearned Premium Reserve—An amount established to reflect premiums that have been collected prior to the **valuation date** for coverage after the **valuation date**.

2.18 Valuation Date—The date as of which the assets or liabilities are estimated.

Section 3. Analysis of Issues and Recommended Practices

3.1 Introduction—The estimation of actuarial assets and liabilities is fundamental to the practice of health actuaries. It is necessary for the completion of financial statements; for the analysis and projection of **trends**; for the analysis or development of rates; and for the development of various management reports, regardless of the type of **risk-bearing entity**.

3.2 Purpose or Use of the Asset or Liability Estimate—The actuary should identify the intended purpose or use of the estimate. Potential purposes or uses of estimates include, but are not limited to, estimates for external financial reporting, pricing, internal management reporting, appraisal work, and scenario analyses. Where multiple purposes or uses are intended, the actuary should consider the potential conflicts arising from those multiple purposes and uses and should consider adjustments to accommodate the multiple purposes to the extent that, in the actuary's professional judgment, it is appropriate and practical to make such adjustments.

3.3 Considerations for Estimating Assets and Liabilities—The actuary should include items associated with the estimation that, in the actuary's professional judgment, are applicable, material, and are reasonably foreseeable to the actuary at the time of estimation.

In determining which items to include in the estimation of assets and liabilities, the actuary should consider items including but not necessarily limited to those described below and may rely on others as described in sections 3.13 and 3.14.

3.3.1 Health Benefit Plan Provisions and Business Practices—The actuary should consider the **health benefit plan** provisions and related business practices, including special group contract holder requirements and **provider** arrangements, which in the actuary's judgment may materially affect the cost, frequency, and severity of claims. These include, for example, elimination periods, deductibles, preexisting conditions limitations, maximum allowances, and managed-care restrictions.

The actuary should make a reasonable effort to understand any changes in plan provisions or business practices made since the last estimate of assets or liabilities. The actuary should consider how such differences or changes are likely to affect the estimation of assets or liabilities.

3.3.2 Risk-Sharing Arrangement Provisions—The actuary should consider the **risk-sharing arrangement** provisions that, in the actuary's professional judgment, are likely to materially affect the financial results of the arrangement. Examples of such provisions include the following:

a. for arrangements including a **provider** organization, allowances for items such as number of enrolled lives included, the results of membership satisfaction surveys, and actual usage of certain facilities; and

b. for arrangements including a governmental organization, such as medical loss ratio rebates, required adjustments to premiums or claims.

When estimating an asset related to an amount payable to the **risk-bearing entity** under such an arrangement, the actuary should consider the collectability of the amount due.

3.3.3 Economic and Other External Influences—The actuary should consider economic and other external influences such as changes in price levels, unemployment levels, medical practice, managed care contracts, cost shifting, **provider** fee schedule changes, medical procedures, epidemics or catastrophic events, and elective claims processed in recessionary periods or prior to contract termination.

3.3.4 Risk Characteristics and Organizational Practices by Block of Business—The actuary should consider how marketing, underwriting, and other business practices can influence the types of risks accepted. Claims administration practices can influence claim rates and **trends** and in turn influence actuarial asset and liability estimates. Furthermore, the pattern of growth or contraction and relative maturity of a **block of business** can influence the magnitude of actuarial assets or liabilities.

3.3.5 Legislative Requirements—The actuary should consider relevant legislative and regulatory requirements and changes as they pertain to the estimation of assets and liabilities. For example, governmental mandates can influence the provision of new benefits, risk characteristics, care management practices, rating, reserving and underwriting practices, methods used to estimate assets and liabilities, or claims processing practices.

3.3.6 Coordination of Benefits (COB), Subrogation, and Government Programs—The actuary should make a reasonable effort to understand the relevant organizational practices and regulatory requirements related to COB, subrogation, and government programs (state or federal). The actuary should consider how these items are reflected in the data (for example, negative claims or income) and make appropriate adjustments for COB, subrogation, and payments or recoveries resulting from government programs.

3.3.7 Carve-Outs—The actuary should consider the pertinent benefits, payment arrangements, and separate reporting of those benefits subject to **carve-outs** in the estimation of assets and liabilities.

3.3.8 Time Value of Money—The actuary should consider if the **time value of money** will have a material effect in the estimation of assets and liabilities. The use of any interest discounts depends on the purpose for which assets and liabilities are being estimated and should reflect any applicable regulation or accounting standards.

3.3.9 Special Considerations for Long-Term Products—The actuary should consider the benefits available in **long-term products**, such as lump-sum, fixed, or variable payments for services; provisions such as cost of living adjustments and inflation protections; payment differences based on institutional or home-based care; social insurance integration; and the criteria for benefit eligibility.

3.3.10 Reinsurance Arrangements—The actuary should consider the effect of reinsurance arrangements in estimating assets and liabilities. In particular, the actuary should consider the effect of extended reporting or recovery periods, delayed or diminished collectability, any amounts already received, and any regulatory limitations associated with certain types of reinsurance. Reinsurance arrangements may also include risk-sharing provisions.

3.3.11 Expenses—The actuary should consider whether an explicit provision for expenses should be included, or whether a particular asset or liability implicitly provides for future expenses.

3.3.12 Consistency of Assumptions and Methodology—The actuary should use assumptions and methodology consistent with those used for estimating related assets, liabilities and reserves, such as incurred health and disability claims, unless it would be inappropriate to do so.

3.4 Considerations for Estimating Contract Reserves—The actuary should estimate a **contract reserve** when such a reserve is required by the rating approach. For example, **contract reserves** are typically estimated for entry-age-rated **health benefit plans** (where premium rates are based on entry age and may be level over the lifetime of the contract), or where flat premium rate guarantees or premium rate change limitations apply for multiple-year periods. The actuary may estimate the reserve using a seriatim basis, grouping techniques, or a combination of both. The actuary should use assumptions that are reasonable and consistent with the purpose for which the reserve is being calculated, and reasonable in the aggregate. Certain assumptions may vary over time or be subject to durational effects.

3.4.1 Interest Rates—The actuary should use interest rates to reflect the **time value of money** in the present value calculation.

3.4.2 Morbidity—The actuary should use morbidity assumptions that reflect the underlying risk. These assumptions may reflect factors such as age, gender, and marital status of the insured as well as the elimination period and dependent status. In addition, the actuary should take into account the impact of durational effects such as risk selection and pre-existing condition limitations, changes in **health benefit plans**, changes in **provider** agreements, adverse selection due to premium rate increases and plan design, and other factors that, in the actuary's professional judgment, materially affect future claim payments.

3.4.3 Persistency—The actuary should consider using persistency or termination assumptions that include both involuntary terminations, such as deaths and disablements, and voluntary terminations, as appropriate. Voluntary termination assumptions, if any, should reflect the expected impact of future premium rate increases.

3.4.4 Expenses—The actuary should consider whether an assumption is appropriate for expenses such as maintenance, acquisition, and claim settlement.

3.4.5 Trend—The actuary should consider trend assumptions for inflation, utilization, morbidity, and expense rates.

3.4.6 Premium Rate Changes—When using an assumption to reflect premium rate changes in the reserve calculation, the actuary should use a premium rate change assumption that is reasonable in relation to the projected claims costs and the manner in which the rate change will be implemented (for example, on a given date for an entire **block of business** or on the next policy anniversary). This assumption should take into account factors such as market conditions, regulatory restrictions, and rate guarantees.

3.4.7 Previous Assumptions for Estimating Contract Reserves—The actuary may determine that previous assumptions are not appropriate and may change them in accordance with the standards of the financial statements in which the reserves are reported. The actuary should follow the process set forth in sections 3.4.1-3.4.6 when selecting new **contract reserve** assumptions for future **valuation dates**.

3.4.8 Valuation Method—For a new policy form, in addition to the assumptions discussed above, the actuary may need to determine the valuation method. Examples of valuation methods are the gross premium method, the net level premium method, and the full preliminary term (one- or two-year) method. Except where the valuation method is prescribed, the actuary should choose a method appropriate for the intended use of the reserve, such as in statutory financial statements or analysis of operating income. When not using a net level premium method, the actuary should consider the expense structure, such as higher first-year costs, in selecting the valuation method.

3.5 Considerations for Estimating Premium Deficiency Reserves—The actuary should estimate a **premium deficiency reserve** when such a reserve is required. **Premium deficiency reserves** are typically established for financial reporting purposes. They may also be established for other purposes such as management reporting. When estimating **premium deficiency reserves**, the actuary should use reasonable assumptions that are appropriate for the intended purpose, and also reasonable in the aggregate.

3.5.1. Blocks of Business—In order to evaluate whether or not a premium deficiency exists, the actuary should consider blocks of business in a manner consistent with

applicable financial reporting requirements. The characteristics of a **block of business** may include but are not limited to benefit type (for example, major medical, preferred **provider** organization, or capitated managed care), contract type (for example, group or individual policies), demographic grouping (for example, group size or geographical area), and length of rate guarantee period. Whatever criteria are used, a **block of business** should be large enough so that its financial results are material relative to the **risk-bearing entity** as a whole. The actuary may need to estimate a **premium deficiency reserve** for a **block of business** where a premium deficiency exists even if the **contract period** has not started.

3.5.2 Time Period—The actuary should use the **valuation date** as the beginning of the time period used to project losses from a **block of business**. In determining the end of the time period, the actuary should take into account items including, but not limited to, the end of the **contract period**, anticipated renewal of coverage, and the point at which the block no longer requires a **premium deficiency reserve**.

3.5.3 Exposure—The actuary should consider reasonable increases and decreases in **exposure units** over the time period of the calculation in the **premium deficiency reserve** calculation. This assumption should reflect changes due to factors including, but not limited to, morbidity, mortality, lapses, and the impact of expected premium rate changes.

3.5.4 Premium Rate Changes—When using a premium rate change assumption, the actuary should use an assumption that is reasonable in relation to the projected claims costs and the **risk-bearing entity's** expectations. This assumption should consider factors such as market conditions, regulatory restrictions, and rate guarantees.

3.5.5 Claim Trend—The actuary should consider factors that may materially affect future claim payments, such as durational effects, changes in **health benefit plans**, changes in **provider** agreements, adverse selection due to premium rate increases, and plan design.

3.5.6 Risk-Sharing Arrangements—The actuary should consider **risk-sharing arrangements** between the **risk-bearing entity** and other entities, such as **providers**, governmental organizations, and employers. If, for example, one of the entities is a **provider** organization and the actuary anticipates there will be a payout for **risk-sharing arrangements** associated with a **block of business** that is being tested for premium deficiency, the actuary should treat the amount of the payout as an expense. Some of these arrangements require **providers** to share in losses as well as gains. The actuary should include any such amount due from the **providers** only to the extent that the actuary reasonably expects it to be collectible.

Similarly, if one of the entities is a governmental organization, the actuary should be familiar with the specifics of the **risk-sharing arrangement**, including any funding changes, and consider how the amounts due or payable under these arrangements are represented in the data (for example, as adjustments to premiums or claims). The actuary should include any amount due only to the extent that the actuary reasonably expects it to be collectible.

3.5.7 Interest Rates—When using an interest rate assumption to reflect the **time value of money** in a present value calculation, the actuary should consider items such as duration and market conditions.

3.5.8 Reinsurance—The actuary should consider the expected effects of reinsurance and changes in reinsurance premiums in estimating the **premium deficiency reserve**.

3.5.9 Taxes—The actuary should consider the effect of losses assumed in the calculation of the **premium deficiency reserve** on the **risk-bearing entity's** taxes and may include a tax credit in the calculations where appropriate.

3.5.10 Expenses—The actuary should consider total expenses of the **risk-bearing entity** in estimating a **premium deficiency reserve** and should consider whether the expenses allocated to the **block of business** are reasonable for the purpose of estimating **premium deficiency reserves**. If only a portion of expenses are allocated to the otherwise deficient **blocks of business**, the actuary should verify that the remaining blocks of business cover the remaining expenses.

3.5.11 Applicable Authority—The actuary should consider any applicable law, regulation, or other binding authority when estimating **premium deficiency reserves** for financial reporting.

3.6 Reserve for Insufficient Administrative Fee for Self-Insured Contracts—A liability under a self-insured contract may need to be established if the administrative fees are insufficient to cover the direct fixed and variable expenses allocated to the self-insured contract. When estimating such a liability, the actuary should consider the expected income and expense flows under the contract using methods that are similar to those used in estimating a **premium deficiency reserve** for an insured **health benefit plan** and assumptions that are appropriate for self-insured contracts (see section 3.5 for further discussion).

3.7 Considerations When Estimating Provider-Related Assets and Liabilities—**Provider-related liabilities** may arise for a **risk-bearing entity**. **Risk-sharing arrangements**, such as incentive arrangements, penalty arrangements, and **capitation** arrangements can create potential assets or liabilities.

3.7.1 Provider Risk-Sharing and Capitation Arrangements—The actuary should consider the relevant contractual arrangements with **providers** to determine whether the contractual arrangements require an asset or liability to be estimated.

The actuary should consider whether a **provider-related asset or liability** for contracts in effect or not fully settled as of the **valuation date** should be estimated. In estimating the asset or liability, the actuary should consider any amounts due to or due from the **provider**, the overall financial condition of the **provider**, whether losses can be offset with profits, risk transfer arrangements (such as stop loss or quota share provisions), the timing of receipts and payments, and the likelihood of collecting amounts due.

Similarly, the actuary should consider whether the risk of a **provider** failing or leaving a network creates a need to estimate a liability for the contingency of the payment by the **risk-bearing entity** of higher **capitations** or fees for services while a replacement **provider** is identified and suitable arrangements are concluded.

3.7.2 Provider Financial Condition—When a **risk-bearing entity** shares risk with a **provider** under a risk-sharing or **capitation** arrangement, the actuary should estimate, to the extent practical, whether the **provider's** overall financial condition will allow it to meet its obligations, and, if not, adjust the asset or liability accordingly. To the extent that these assets or liabilities are not otherwise included in the claim liabilities of the **risk-bearing entity**, such assets or liabilities should be included in the **provider-related assets or liabilities**.

3.7.3 Provider Incentive or Penalty Payments—If a **provider** agreement calls for incentive or penalty payments if certain conditions are met, such as quality of care standards or claim targets, the actuary should consider whether the **risk-bearing entity** should estimate an asset or a liability for those payments.

3.7.4 Provider Risk-Bearing Entities—When the **risk-bearing entity** is a **provider**, the actuary should also consider relevant contractual arrangements with other **providers** as well as non-**provider** entities to determine whether the contractual arrangements require an asset or a liability to be estimated. One primary source of potential liability between **providers** is the receipt of **capitation** by one **provider** with payments due to other **providers** using fee-for-service.

3.8 Claim Adjustment Expense Liabilities—The actuary should estimate a liability for claim adjustment expenses associated with unpaid claims, unless such liabilities are included in the liability for unpaid claims, otherwise provided for appropriately, or not required by the relevant financial reporting guidance. The actuary may consider the company's cost allocation approach in the liability estimation.

3.9 Risk Adjustment Settlements—A risk adjustment settlement may exist that will be either an asset or a liability to the **risk-bearing entity**. In addition to the relevant guidance in

ASOP No. 45, *The Use of Health Status Based Risk Adjustment Methodologies*, the actuary should address the following components of the risk adjustment program, if applicable:

3.9.1 Market Neutrality—When the risk adjustment settlements are required to be revenue neutral across a market or other group of entities, the actuary should consider reasonably available aggregate market information, information specific to the **risk-bearing entity**, and collectability.

3.9.2 Risk Adjustment Payment Methodology—Risk adjustment payments typically follow a methodology that is governed by applicable law, regulation, or contractual arrangement. The actuary should review and understand the risk adjustment payment methodology used in estimating the settlement amounts.

3.9.3 Risk Adjustment Data Validation (RADV) Audit—The outcome of an **RADV** audit may be an amount that the insurer owes or is owed. When estimating the asset or liability that may be due from an **RADV** audit, the actuary should review relevant data validation reports.

3.10 Other Assets and Liabilities—The actuary may be requested to opine on the appropriateness of certain other assets or liabilities provided by another party. In some cases, the actuary may also estimate such assets and liabilities. When estimating or opining on such assets and liabilities, the actuary should refer to the appropriate section(s) below.

3.10.1 Liabilities for Payments to State Pools—The actuary should consider whether appropriate provision has been made for payments due under state assessment pools, such as insolvency pools, risk-sharing pools, or other arrangements.

3.10.2 Reserves for Unearned Premiums—The actuary should consider whether appropriate provision has been made for liabilities associated with the amount of premiums written and not yet earned.

3.10.3 Assets and Liabilities for Dividends, Experience Rating, and Premium Rebates—The actuary should consider the contract language or regulatory requirements defining the methodology prescribed for estimating the asset or liability, and refer to ASOP No. 5, if applicable.

3.10.4 Reserves for Extension of Benefits and Contingent Benefits Provisions—The actuary should consider whether the provisions of the **health benefit plan** require estimation of a reserve for extension of benefits or contingent benefits.

3.10.5 Prescription Drug Rebates—An asset may exist for an insurer receiving a rebate, or a liability may exist for a pharmaceutical firm or pharmacy benefits manager paying a rebate. The actuary should consider applicable rebate contracts or

agreements. The actuary should consider any available historical drug usage, projected drug usage, and current emerging experience.

3.10.6 Cost Sharing Subsidies—Cost sharing subsidies may exist that pay for part or all of the cost sharing for eligible participants. Insurers may be paid on a budgeted basis with a final payment to or from the insurer based on the actual experience. The actuary should consider the following:

a. applicable law, regulation, or other binding authority;

b. the historical enrollment for members eligible for cost sharing subsidies;

c. any changes in the market that would impact the eligible enrollment;

d. any potential changes in the insurer's relative market position that could impact the eligible enrollment; and

e. any uncertainty related to the collectability of the asset.

3.11 Follow-Up Studies—The actuary may conduct follow-up studies that involve performing tests of reasonableness of the prior period asset or liability estimates and the methods used over time. When conducting such follow-up studies, the actuary should, to the extent practicable, do the following:

a. acquire the data to perform such studies;

b. perform studies in the aggregate or for pertinent blocks of business; and

c. utilize the results, if appropriate, in estimating assets and liabilities.

3.12 Provision for Adverse Deviation—Recognizing the fact that assets and liabilities are an estimate of the true amounts that will emerge, the actuary should consider what explicit provision for adverse deviation, if any, might be appropriately included. If a provision for adverse deviation is included, the asset or liability should be appropriate, in the actuary's judgement, for the intended use. For example, in certain situations, a provision for moderately adverse deviation may be appropriate. In other situations, the appropriate provision for adverse deviation may vary as the level of uncertainty varies, for example, based on credibility of the data or stability of key assumptions.

3.13 Reliance on Data or Other Information Supplied by Others—When relying on data or other information supplied by others, the actuary should refer to ASOP No. 23, *Data Quality*, for guidance.

3.14 Reliance on Assumptions and Methods Selected by Others—When relying on assumptions and methods selected by others, the actuary should refer to ASOP No. 41 for

guidance.

3.15 Documentation—The actuary should document the methods, assumptions, procedures, and the sources of the data used. The documentation should be in a form such that another actuary qualified in the same practice area could assess the reasonableness of the work.

Section 4. Communications and Disclosures

4.1 Actuarial Communication—When issuing an actuarial communication subject to this standard, the actuary should refer to ASOP Nos. 23 and 41. In addition, such actuarial communications should disclose the following, as applicable:

a. important dates used in the analysis;

b. significant limitations, if any, which constrained the actuary's asset or liability estimate analysis such that, in the actuary's professional judgment, there is a significant risk that a more in-depth analysis would produce a materially different result;

c. specific significant risks and uncertainties, if any, with respect to whether actual results may vary from the asset or liability estimate;

d. the risk that **provider** insolvency may have a material effect on the **risk-bearing entity's** ultimate asset or liability, as described in section 3.7.2;

e. any follow-up studies the actuary may have used in the development of the estimate of assets or liabilities, as described in section 3.11;

f. any explicit provision for adverse deviation, as described in section 3.12; and

g. when updating a previous estimate, changes in assumptions, procedures, methods, or models that the actuary believes to have a material impact on the estimate, as well as the reasons for such changes to the extent known by the actuary. The actuary may need to disclose these changes in cases other than when updating a previous estimate, consistent with the purpose or use of the estimate. This standard does not require the actuary to measure or quantify the impact of such changes.

4.2 Additional Disclosures—The actuary should also include the following, as applicable, in an actuarial communication:

a. the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, and other legally binding authority);

b. the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and

c. the disclosure in ASOP No. 41, section 4.4, if, in the actuary's professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.

Appendix

Background and Current Practices

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

Background

Health and disability actuarial assets and liabilities other than incurred claims are important to many lines of health and disability business. New forms of these assets and liabilities arose in recent years with the rapid increase in managed care provider risk arrangements and healthcare reform. The attention to financial statements enhanced the importance of these assets and liabilities.

Current Practices

Actuaries are able to obtain guidance relating to actuarial assets and liabilities for health and disability coverages from various publications from the National Association of Insurance Commissioners, including the following:

- the Accounting Practices and Procedures Manual;
- the Health Insurance Reserves Model Regulation; and
- the Health Reserves Guidance Manual.

Similar guidance on when assets and liabilities are required by Generally Accepted Accounting Principles is available in Statements of Financial Accounting Standards.

Estimating assets and liabilities may be necessary or useful in situations other than financial statement reporting, such as the acquisition of a block of a business or in experience analysis.