

ACTUARIAL BOARD FOR COUNSELING AND DISCIPLINE
FORMAL OPINION

The Actuarial Board for Counseling and Discipline ("ABCD") has received the following question regarding the application and scope of §3.7.7(c) of Actuarial Standard of Practice No. 6 (ASOP 6), "*Measuring Retiree Group Benefit Obligations and Determining Retiree Group Benefits Plan Costs or Contributions*" (adopted May 2014 - Doc. No. 177).

The Actuarial Standards Board establishes standards of actuarial practice. The Actuarial Board for Counseling and Discipline considers how these standards apply to a particular actuary's work based on the applicable facts and circumstances. A finding of a material breach of the Code of Professional Conduct can be made only after a detailed investigation. Hypothetical scenarios cannot contain sufficient detail to support clear findings in any actual case. However, they can be informative since they enable the ABCD to articulate the issues that are involved and the analysis the ABCD is likely to use in arriving at a finding. As such, the ABCD decided that a brief discussion of ASOP 6, § 3.7.7(c) will be of benefit to the profession. Under Article X, Section 10 of the American Academy of Actuaries bylaws that established the ABCD, the ABCD is authorized to communicate and disseminate educational materials to assist actuaries in understanding the application of the Code, which requires compliance with ASOPs, in various situations that may arise.

This document is intended as guidance to actuaries in accordance with the ABCD Rules of Procedure. It is not intended to supplant or replace the applicable ASOPs.

Question

Under what circumstances is the use of unadjusted premiums (i.e. without regard to adjustments for age) permissible to establish initial per capita health care costs and in the projection of future benefit plan costs?

Relevant Standards of Practice

ASOP 6, §3.7.7, Age-Specific Costs, states in part:

"Various factors influence the magnitude of costs for the group being valued, often including the ages, gender, and other characteristics of the benefit plan members."

ASOP 6, § 3.7.7(a), General Principles:

"In general, for health coverage, benefit costs vary by age. Therefore, except as noted in (c) below, the actuary should use age specific costs in the development of the initial per capita costs and in the projection of future benefit plan costs. In general, the development of the age-specific costs should be based on the demographics of the group being valued and the group's total expected claims or premiums. Any age ranges used should not be overly broad. The relationship between the costs at various ages is an actuarial assumption that may be based on normative databases."

ASOP 6, § 3.7.7(c) Possible Exceptions:

"In some very limited cases, the use of the pooled health plan's premium may be appropriate without regard to adjustments for age. The factors that an actuary should evaluate in determining whether the premium may be appropriate without regard to adjustments for age include:

§3.7.7(c).1 the purpose of the measurement (for example, for a projection of short-term cash flow needs the use of the premium may be appropriate);

§3.7.7(c).2 whether for the type of benefit plan being valued (for example, certain dental plans) the impact of using age-specific costs would not be material;

§3.7.7(c).3 the extent to which there are no age-related implicit subsidies between actives and retirees that occur within the pooled health plan; and

§3.7.7(c).4 whether the pooled health plan and its premium structure are sustainable over the measurement period, even if other groups or active participants cease to participate. The use of a premium without regard to adjustment for age is generally inappropriate if the pooled health plan and its premium structure are not sustainable over the measurement period if other groups or active participants cease to participate."

ASOP 1, §2.1(a), Terms of Construction:

~~"Must/Should-~~ The words 'must' and 'should' are used to provide guidance in the ASOPs. 'Must' as used in the ASOPs means that the ASB does not anticipate that the actuary will have any reasonable alternative but to follow a particular course of action. In contrast, the word 'should' indicates what is normally the appropriate practice for an actuary to follow when rendering actuarial services. Situations may arise where the actuary applies professional judgment and concludes that complying with this practice would be inappropriate, given the nature and purpose of the assignment and the principal's needs, or that under the circumstances it would not be reasonable or practical to follow the practice.

Failure to follow a course of action denoted by either the term 'must' or 'should' constitutes a deviation from the guidance of the ASOP. In either event, the actuary is directed to ASOP No. 41, *Actuarial Communications*."

ASOP 41, §4.4, Deviation from the Guidance of an ASOP:

"If, in the actuary's professional judgment, the actuary has deviated materially from the guidance set forth in an applicable ASOP, other than as covered under sections 4.2 or 4.3 of this standard, the actuary can still comply with that ASOP by providing an appropriate statement in the actuarial communication with respect to the nature, rationale, and effect of such deviation."

Our opinion

- Age specific rates should be used as opposed to premiums unless, as outlined in §3.7.7(c): the difference is deemed immaterial for the type of benefit plan being priced; the purpose of the measurement would justify using premiums; there are no age-related implicit subsidies between actives and retirees; or the pooled health plan and its premium structure are sustainable over the measurement period even if other groups or active participants cease to participate.
- ASOP 6 allows some opportunities for actuaries to develop a case for using premiums but these are very limited

situations. For example, if there is a guarantee that certain groups would continue for a sufficient number of years, an argument might be made that §3.7.7(c).4 applies if these groups make up a significant proportion of the pool. In the absence of specific guarantees, an actuary would need to specifically justify why the use of premiums would be acceptable over the use of age specific rates given the guidance in the ASOP (other than the specific examples cited in §3.7.7(c).1 through §3.7.7(c).3).

- If the ABCD received a complaint associated with an actuary who used premiums as opposed to age specific rates, the ABCD would carefully scrutinize the reasoning and rationale behind the use of premiums. Where relevant, the ABCD would expect to see written analyses that justified the computations met the exception to the general rule.

As an example, for a pooled health plan, if the premium structure would change significantly if all active members or just the active members of the employers that make up the majority of the pool were to cease to participate, §3.7.7(c).4 requires use of age specific rates. This conclusion is regardless of how long the plan has been in existence and the extent of historic changes in plan participation or a specific plan's enrollment. The conclusion is grounded in §3.7.7(c).4 which plainly states that the use of a premium without regard to adjustment for age is generally inappropriate if the pooled health plan and its premium structure are not sustainable over the measurement period if other groups or active participants cease to participate.

We believe the situation posed by this example is addressed in the General Comments section of ASOP 6 under §3.7.8 (in the final version of the ASOP, §3.7.8 was combined with §3.7.7 into new §3.7.7(a)) which states as follows:

Comment: Several commentators suggested that in cases where the cost of coverage is borne by a large independent community, the use of an unadjusted premium should be allowed if the aging or demographic distribution of the individual employer's population would not affect the program's premiums, such as for many small public sector plans.

Response: The reviewers believe that implicit subsidies do exist within pooled health plans and that such subsidies should be recognized in valuations of

retiree group benefits by incorporating age-specific costs in the measurement, except in some very limited cases. Thus the reviewers believe that the use of age-specific costs will generally result in a more appropriate representation of the employer's long term liabilities for retirees than the use of unadjusted premiums. They point out that there is no guarantee that the current premium structure or the pooled health plan will continue over the long term nor that the employer will continue or be allowed to continue in the pool and that the value of employer's benefit commitment independent of the method used to provide that benefit is the most appropriate basis for valuing the liability, except in some very limited cases. Accordingly, the reviewers added more guidance throughout section 3.7.7, which now also includes the guidance contained in section 3.7.8 of the second exposure draft."

Summary

Age specific rates should be used except in very limited situations. It is up to the responsible actuary to justify any other methodology.

Respectfully,

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Janet Fagan
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for Counseling and Discipline

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