Letter of Comment No. 76
File Reference No. 34-1E
Date Received: 10/29/2014

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Re: Project 34-1E (OPEB Employer standard)

I appreciate the opportunity to submit my comments at this late date. I see a significant problem evolving related to the revised GASB OPEB standards with respect pooled health plans and subsidies from other employers thereunder. The following simple example and commentary will illustrate my concerns:

A. Simple example:

1. Plan – retiree coverage from date of retirement until age 65 (i.e. no spousal coverage)

2. Demographics

   a. Pooled health plan average age – 40

   b. Employer A – no active employees and 10 retirees, all age 64 with one year of coverage remaining

3. Premium – 3,000/year

4. Actuarial assumptions:

   a. Discount rate – 0%

   b. Mortality- None

   c. Age adjusted cost – 6,000/year

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Letter of Comment No. 76
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B. GASB 45 values without considering subsidies from other employers (both positive and negative) – two alternatives with direct costs based on the following:

1. Direct costs based on age adjusted premium (A)

Alternative	Ref.		Active	Retiree	Total
			Participant category		
No subsidies from other employers - A	a	Census count	0	10	10
	b	Expected costs	0	60,000	60,000
	c	Premiums paid	0	30,000	30,000
	d	Employer A implicit subsidy	(30,000)	30,000	0
	e	OPEB direct costs = c + d	N/A	60,000	N/A
	f	OPEB liability on 65th birthday	N/A	0	N/A
	g	Actuarial gain (loss) = b - e	N/A	0	N/A

2. Direct costs based on unadjusted premium (B)

Alternative	Ref.		Active	Retiree	Total
			Participant category		
No subsidies from other employers - B	a	Census count	0	10	10
	b	Expected costs	0	60,000	60,000
	c	Premiums paid	0	30,000	30,000
	d	Employer A implicit subsidy	(30,000)	30,000	0
	e	OPEB direct costs = c	N/A	30,000	N/A
	f	OPEB liability on 65th birthday	N/A	0	N/A
	g	Actuarial gain (loss) = b – e	N/A	30,000	N/A

Note that the dark border on the above table (and the table in paragraph F) indicates changes from the prior table.

C. Actuarial valuation methods must be logical - A credible valuation method must be logical. A key test is whether actuarial gains and losses are treated in a reasonable manner. Actuarial gains and losses should arise from experience being different from what was assumed. They should not include illogical distortions in the experience results based on assumptions that are known in advance to be anything other than the best estimates of future experience.

Letter of Comment No. 76
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D. Logic Table – the following table provides answers to basic questions of logic related to the two alternatives illustrated in paragraph B above:

	Paragraph B alternatives	
Question	A	B
Does method produce logical active employee costs?	No	No
Does method use logical direct costs?	No	Yes
Are actuarial gains and losses determined in a logical manner?	Yes	No

It can be seen in paragraph B above that when subsidies from other employers are not considered, both of the two illustrated alternatives from such paragraph fail the logic test miserably. A significant logic failure is the negative cost for the active employee group which I do not think can be justified under any circumstances. Another significant problem is the illogical handling of actuarial gains and losses which arise in when direct costs are defined as the unadjusted premium which is appropriate considering the demographics of Employer A.

E. Decision for those actuaries not wanting to use what they consider an illogical valuation method – Actuaries who believe not considering subsidies from other employers (both positive and negative) is illogical will be faced with two alternatives as described below (assuming they do not think considering such subsidies is permitted under ASOP 6 guidance). The two alternatives assume that the Board accepts the American Academy of Actuaries' (AAA) recommendation under the heading Actuarial Standards and Guidance in its 8/29/14 letter which would require actuaries to follow the guidance provided in ASOP 6 in performing OPEB valuation services related to pooled health plans under the revised GASB OPEB standards.

1. Follow the ASOP 6 guidance with a disclosure that they do not think the results are reasonable. Such approach would only be taken to comply with the revised GASB OPEB standard. The actuary may or may not supplement the results following the ASOP 6 guidance with an alternative set of values that he/she believes to be more appropriate.

2. Comply with ASOP 6 by not following the guidance combined with disclosing the reasons for not doing so. Such approach would not comply with the revised GASB OPEB standard.

F. GASB 45 values with considering subsidies from other employers (both positive and negative) – If subsidies from other employers (both positive and negative) are considered, the actuarial values would be as shown in the following table:

			Participant category		
Alternative	**Ref.**		**Active**	**Retiree**	**Total**
Subsidies from other employers considered	a	Census count	0	10	10
	b	Expected costs	0	60,000	60,000
	c	Premiums paid	0	30,000	30,000
	d	Employer A implicit subsidy	0	0	0
	e	Subsidy from other employers	0	30,000	30,000
	f	OPEB direct costs = c	N/A	30,000	N/A
	g	OPEB liability on 65th birthday	N/A	0	N/A
	h	Actuarial gain (loss) = b – e – f	N/A	0	N/A

As shown in the table below, answering the questions from paragraph D above for the actuarial method considering subsidies from other employers produces logical results.

Question	
Does method produce logical active employee costs?	Yes
Does method use logical direct costs?	Yes
Are actuarial gains and losses determined in a logical manner?	Yes

G. Controversial nature of the age rating process related to pooled health plans - There is a substantial amount of controversy surrounding the age adjustment process for employers participating in pooled health plans. This topic was the hottest at a recent GASB 45 actuarial study group that I participated in. The controversial nature of this issue is also indicated by the following comment from the committee responsible for the recently revised ASOP 6.

> Comment – Several commenters agreed with the use of age-specific costs, but suggested that the standard should state explicitly that an adjustment be made to recognize in the liability calculation the age-specific subsidies (both positive and negative) from other employers, and that if this were not done the liability would be either too large or too small depending on the average age of the group relative to that of the pool.

Letter of Comment No. 76
File Reference No. 34-1E
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Response – The reviewers note that all employers participating in a pooled health plan share in the collective risks and costs (some positive and some negative). As such, the reviewers believe developing a set of age-specific costs based on the total pooled health plan to measure retiree health benefits for any and all participating employers is appropriate, except in very limited circumstances as set forth in the standard. In other words, absent evidence to the contrary, the reviewers do not believe that non-guaranteed subsidies should be assumed to persist indefinitely. The reviewers, therefore, made no change.

The source of the above is PDF page 65 of 74 (printed page 56) from the revised ASOP 6 which can be accessed at the following link:

http://www.actuarialstandardsboard.org/pdf/asops/asop006_177.pdf

Of the four actuaries who have contributed to this letter (I and three peer reviewers) there are the following four views on the subject:

ID	View
1	Actuary does not believe subsidies from other employers should be considered.
2	Actuary does believe that subsidies from other employers should be considered and that actuaries are permitted to do so under ASOP 6, section 3.7.7.c.4 guidance if certain conditions are met.
3	Actuary does believe that subsidies from other employers should be considered but is not permitted to do so under ASOP 6 guidance. This actuary would follow ASOP 6 guidance with a caveat that he does not believe that the results are appropriate. He would provide supplemental information for OPEB reporting that he considers being more appropriate.
4	Actuary does believe that subsidies from other employers should be considered but is not permitted to do so under ASOP 6 guidance. This actuary would not follow ASOP 6 guidance but would disclose the reason why and therefore comply with ASOP 6. Such approach would result in this actuary not complying with the revised GASB OPEB standard (assuming that the GASB adopts the above referenced recommendation of the AAA).

H. Question regarding the extent to which subsidies from other employers (both positive and negative) should be considered – There are subsidies from other employers (both positive and negative) for most employers participating in a pooled health plan. The extent to which such subsidies (both positive and negative) should be considered is an open question in my mind. What seems clear, however, is that there are situations where the demographics of the participating employer are so skewed that considering subsidies from other employers (both positive and negative) is imperative to avoid obviously illogical results.

Letter of Comment No. 76
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I. Advantages of the GASB standards being subject to public disclosure – I have always been impressed with how the GASB standards are subject to public disclosure. Such public disclosure it critical, in my opinion, in getting public compliance to the greatest extent possible. The recent decision by the GASB to subject the Comprehensive Implementation Guide to public disclosure is further indication of the GASB's appreciation of this point. It needs to be noted that actuarial standards do not benefit from the advantages of public disclosure.

J. Recommendations

1. AAA's recommendation in its 8/29/14 comment letter, the section titled Actuarial Standards and Guidance - I would encourage the Board not to adopt the AAA's recommendation in their 8/29/14 comment letter, the section titled Actuarial Standards and Guidance recommendation. This would allow those actuaries who believe that subsidies from other employers (both positive and negative) should be considered in the valuation of employer plans participating in pooled health plans to do so and be able to comply with both ASOP 6 and the revised GASB OPEB standards.

   Should the Board follow the recommendation of the AAA on this point, there will be situations where:

   a. ASOP 6 is complied with but

   b. the revised GASB OPEB standard is not complied with.

Letter of Comment No. 76
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2. Take the lead in promoting a full airing of how the age rating process should be handled for pooled health plans – I suggest that the GASB take the lead in airing the question as to how the age rating process for pooled health plans should be handled. This would include whether subsidies from other employers should be considered and, if so, to what extent. While ostensibly an actuarial issue, there are certain aspects of age rating within the context of pooled health plans that clearly relate to basic accrual accounting principles. As such, the GASB should play a key role in guiding the actuarial standard setters on the age adjusting issue. This, plus the well-established policy of fully disclosing the development of accounting standards makes the GASB the natural choice, in my opinion, for taking the lead on this important matter.

Respectfully submitted,

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