

From: Stu Alden
Sent: Monday, December 19, 2016 5:10 PM
To: Director - GASB <director@gasb.org>
Subject: RE: GASB 74/75 Implementation Guide Exposure Draft - Comments from Aon

December 19, 2016

Director of Research and Technical Activities
Project No. 34-1E

Dear Sir or Madam,

Aon appreciates the opportunity to provide comments to the Governmental Accounting Standards Board (GASB) pursuant to request for comments regarding the Proposed Implementation Guide of the Governmental Accounting Standards Board No. 201X-X, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans. In the proposed guide, the GASB requested comments on the implementation of various aspects of the new Statement No. 74 that will be addressed in the final implementation guide.

Aon is providing comments on two specific areas pertaining to *Projecting Postemployment Healthcare Benefits Based on Claims Costs or Age-Adjusted Premiums*.

Who We Are

Aon plc (NYSE: AON) is the leading global provider of risk management, insurance and reinsurance brokerage and human resource solutions and outsourcing services. We have 66,000 colleagues worldwide. Aon unites to empower results for organizations in over 120 countries via innovative and effective risk and people solutions and through industry-leading global resources and technical expertise.

Through its Consulting divisions, Aon empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. We advise, design and execute a wide range of solutions that enable companies to cultivate talent to drive organizational and personal performance and growth, navigate retirement risk while providing new levels of financial security, and redefine health solutions for greater choice, affordability and wellness. Aon is the global leader in human resource solutions, with over 30,000 professionals in 90 countries serving more than 20,000 organizations worldwide.

Our Comments

As noted, we have comments on two specific sections of the proposed implementation guide for Statement No. 74:

- 1) Section 4.123, regarding the valuation treatment of “caps” on the employer subsidy toward coverage. Apart from any public-policy or accounting-policy intentions (on which we are not equipped to comment), we believe that the treatment being suggested here is contrary to fundamental actuarial principles and historical practice (at least since the adoption of FAS 106 for private-sector

accounting). Accordingly, if the proposed valuation treatment of caps must be preserved, the way in which it violates actuarial principles and removes actuarial judgment from the valuation must be noted.

2) Section 4.126, regarding the valuation treatment of Federal subsidies provided through an employer group waiver (EGWP) Part D program. We believe that the answer here may be confusing common modern EGWP arrangements with earlier (and now relatively uncommon) “wrap” arrangements. Moreover, we believe the allocations of cost that appear to be required by this section would often be artificial and meaningless for many typical EGWP arrangements.

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Item 1 – Employer contributions caps – Answer to question 4.123

This response indicates that employer subsidy caps, designed to trigger in the future but often communicated in writing to plan participants at the time of initial adoption, should not be reflected until the caps are reached and enforced. This would perhaps be uncontroversial guidance if, for the particular plan, there was general consensus that the cap was in fact a sham, and had been raised several times in the past, with no real intent ever to be enforced. For any other situation, though, it is potentially misleading.

This response introduces a concept of a “current substantive plan” which we believe is fundamentally different from the original “substantive plan” concept introduced by FAS 106 and in place under GASB 43/45. In effect, it is saying that the substantive plan can only be discerned with respect to established past practice and not with respect to any future intent, regardless of how well that intent is communicated to and understood by all parties (plan sponsor, plan participants, and preparers and users of the financial statements).

This approach for cap accounting could lead to artificial dislocations in actuarial valuation results. For example, assume that the cap is expected to be breached not in the current year but in the following year, and when it is breached, it is enforced. This year’s valuation would assume no cap, and next year’s valuation would assume a fully-enforced “hard” cap in all future years. The difference in valuation results (measured obligation) could be 40% or more. The valuation results therefore treat the cap as a “surprise” when in fact it was fully anticipated.

Although the actuary is likely to use different underlying techniques more compatible with the valuation system in use, we view this issue as one where i) the probability of the cap being enforced should be assessed, and ii) that probability should be reflected in the valuation. Whatever the estimate of that probability, it will be informed by past practice and current understanding and it will be subject to revision as conditions warrant.

The guideline is saying, essentially, that the probability must be assumed to be zero. There may be policy rationales for this guideline, or accounting-conservatism rationales, but if so, those should be identified as such. Otherwise, this is a guideline on an actuarial assumption that is independent of the facts and circumstances surrounding the plan. That would (in our opinion) set a dangerous precedent for the applicability of actuarial principles to financial accounting.

Item 2 – EGWP Accounting - Answer to question 4.126

In this response, we are concerned that an older (and now relatively rare) plan delivery arrangement may be confused with a newer, more prevalent arrangement:

--The older arrangement was to send retirees to the individual PDP (Prescription Drug Plan) market, where they would secure the standard (minimum) Part D benefit. The employer plan would then provide a “wrap” benefit that would fill in some or all of the benefit gaps in the PDP benefit. This arrangement has nothing to do with EGWP at all—indeed, it was discussed frequently in the early days of Part D, before carriers (by which we mean insurance companies and other entities administering benefits under Medicare Part D) had secured the necessary contracts and developed the administrative systems needed to sell and service EGWP.

Assuming retirees are paying their own PDP premiums (if any), then clearly--and consistent with the answer here--it makes sense to ignore the PDP (benefits, government subsidies, participant premiums) for employer accounting purposes. In this situation, the answer to question 4.126 makes sense - only the “wrap” benefits should be reflected.

--The more prevalent arrangement now is for the carrier to contract with CMS and secure a waiver that permits them to provide an Employer Group Waiver Plan (EGWP) Part D plan – generally self-insured—that covers only the retirees of a single employer (as opposed to being a publicly-available plan). The employer’s EGWP pays claims based on the cost share communicated to plan members and receives CMS subsidies less administrative expenses charged by the carrier. The carrier provides an accounting of all cashflows involved with the EGWP benefit plan, and taps the employer’s bank account for the net payments required. There is, in general, no longer any explicit concept of “wrapping.” Unless the plan design happens to match the minimum required benefit precisely, there is no reference to the minimum plan design whatsoever in member communications.

With these more common EGWP designs, the answer provided in question 4.126 may lead to a great deal of unnecessary estimation and approximation to produce results which i) do not reflect accurately the substance of the EGWP plan arrangement and ii) do not provide the financial report reader any useful additional information. Just to cite a few likely scenarios:

--A self-insured EGWP with a benefit richer than the minimum required. Typical carrier reporting would not provide a breakout of “standard Part D” claims” versus “wrap or supplemental” claims, nor would it identify the amount by which subsidies are reduced due to the richer-than-standard Part D benefit. Accordingly, the actuary needing a “standard Part D/wrap” split would be entirely dependent on manual rate type calculations for that allocation.

--A fully-insured EGWP would entail a similar problem, where no allocation of premium between standard Part D and wrap would be provided (nor would it be possible define unambiguously).

--With an insured combined Group Medicare Advantage / EGWP Part D (MA-PD) arrangement, there is the further problem of premium allocation between medical and prescription drug, before the drug premium can be further subdivided.

Essentially, we see no substantive economic difference to the plan between EGWP subsidies and other types of Medicare subsidies such as Part A and B reimbursements (for traditional integrated plans) and

Medicare Advantage payments. All serve to reduce the plan's net outlay. Identifying which elements of drug benefit and subsidy are "standard" and which are "wrap" is generally a theoretical process which has little or no applicability to the actual structure of the benefit program.

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We hope our comments are clear and helpful. Please don't hesitate to contact me or any of the copied recipients if you have questions or would like additional detail.

Sincerely,

Stu Alden

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