July 2018

Milliman

PERiScope Public Employee Retirement Systems

New accounting rules in the United States for postemployment benefits other than pension (OPEB), first implemented in 2016, are now in effect. Successful implementation of the new rules will require an understanding of a variety of technical concepts regarding the newly required calculations. In this multipart PERiScope series, we explore these technical topics in detail.

The new ASOP 6: Implications for OPEB reporting

Markella Roma, FSA, EA, MAAA

Actuarial Standard of Practice No. 6 (ASOP 6) is the standard that governs how actuaries should perform valuations of retiree medical and death benefit plans. A revised version of this standard was adopted by the Actuarial Standards Board in May 2014. The standard is effective for any plan with a measurement date on or after March 31, 2015. An exception is allowed for plans that used roll-forward techniques so that it is not effective for them until three years after the last full measurement before March 31, 2015. This allows small entities who do triennial valuations to not have to do an additional valuation simply to adopt this standard.

ASOP 6 requires that actuaries value the "true cost" of providing health benefits. Employers frequently pay premiums on behalf of retirees that are based on a mix of the experience of the retiree and the active employee cost. The actual cost of providing benefits to retirees if their experience alone was used could be considerably higher, as medical costs tend to increase with age. Therefore, to calculate the liability associated with a retiree medical plan, actuaries develop estimated claims by age that represent the true cost of the benefits. The difference between the claims developed to represent the true cost of retiree medical benefits and the cost of the premiums charged by the insurance company is commonly called the "implicit rate subsidy." These costs by age are developed based on the benefits provided by the plan, the demographics of the plan, and, if available, the plan's claims experience. It can also be done based on the premium rates charged by the insurer in cases where claims experience is not available.

Prior versions of ASOP 6 had allowed actuaries to use premiums unadjusted for the implicit subsidy in cases where a plan was community-rated; premium rates for community-rated plans are based on the combined experience of a pool of policies such that all groups in the pool receive the same premium rates or, under adjusted community rating, rates that vary only by preset factors for items such as geographic region and family structure. Governmental Accounting Standards Board No. 45 (GASB 45) also allowed the same exception. It required that the plan be community-rated and additionally that the "actuary has evaluated whether the community rated plan would offer the same unadjusted premium rate if all of that employer's plan members were non-Medicare eligible retirees." This allowed many small government entities that participated in large statewide pools to use unadjusted premium rates to evaluate their liabilities. This exception is specifically prohibited under the newest version of ASOP 6 and there is no exception in the more recent GASB 74/75 that would allow an entity to continue to use unadjusted premium rates for such community rated plans. There are some limited exceptions to the rule provided by 3.7.7 (c) of ASOP 6, but none are likely to apply to a GASB 75 valuation.

Unadjusted premiums might be appropriate for projection of short-term cash flows, if age-specific cost differentials are not material, or if there are no age-related implicit subsidies between actives and retirees and these rates would be sustainable for the entity being measured, even if they are the only group covered. Unadjusted premiums might also be appropriate for funding purposes if a plan sponsor decides that it wishes to fund the premium amount and not the implicit rate subsidy. However, the implicit rate subsidy must be measured for accounting purposes under GASB 75.

Some government entities participate in pooled health plans in which the premiums are based on the experience and demographics of the entire covered pool and not adjusted to the demographics of the particular entity. In these cases the age-adjusted claims should be developed based on the demographics of the total population covered. It may be difficult or impossible for an actuary to obtain this information, and in that case ASOP 6 recommends making reasonable assumptions about the composition of the total covered group.

Government entities that participate in pooled health plans may see significant increases in their liabilities, because in general the claims that are developed to represent the true cost of a plan will be higher than the premiums. Most e entities will notice this impact before the implementation of GASB 74/75 because the effective date for the new ASOP 6 is prior to the implementation date of GASB 74/75. This is especially true for unfunded plans if they are not required to report under GASB 74. The impact is generally larger for pre-Medicare liabilities than for Medicare liabilities, because many plans have separate premium rates for Medicare retirees that are developed based on the experience of only the Medicare retirees and so are more reflective of the true cost of covering this population. In cases where the same premium rates are charged for Medicare retirees and pre-Medicare retirees it is even possible for the impact to be a decrease in the liabilities, because Medicare will be primary for these retirees so the cost to the plan may be less than the premiums at younger Medicare ages. However, these cases will be rare and most plans will see an increase in their liabilities.

Funding

Plans that are currently pre-funding their other postemployment benefit (OPEB) liabilities based on the valuation results using pooled premiums will need to decide whether they wish to fund the liability at a level that includes the implicit rate subsidy or to continue funding it based on the pooled premiums. Plans that do not fund the implicit rate subsidy would only want to pay from the Trust the cost of premiums, while plans that do fund the implicit rate subsidy would also want to pay for the Trust the value of the implicit rate subsidy in addition to the cost of premiums. Any amount paid from trust representing the value of the implicit rate subsidy should theoretically be used to pay the portion of active employee premiums that represent the implicit rate subsidy of retiree premiums. A plan might want to fund benefits, including the implicit rate subsidy so that it would be 100% funded on a GASB accounting basis and could avoid having a liability on its financial statement. Or the plan might not want to fund this portion because it could be complicated to use a portion of a trust that is restricted to use for retirees to pay employee premiums.

Impact on sample plans

In the most extreme case, let's consider a small plan sponsor in a pooled health plan where retirees pay 100% of the premiums. Under GASB 45 and the previous version of ASOP 6, this entity would not have any OPEB liability, because retirees are paying the entire premium and the community-rating exception allowed for the implicit rate subsidy to be ignored. Under the new ASOP 6 and GASB 74/75, the entity will have a liability due to the "implicit rate subsidy," which must now be recognized even in community-rated plans.

Another type of plan where the impact will be large is one where the sponsor contributes a flat dollar amount per month to retirees in a pooled health plan. The liability under the prior version of ASOP 6 was based solely on the flat dollar amount paid by the employer. The liability could be calculated without consideration of the benefits provided or the impact of healthcare trend. Under the new version of ASOP 6, the liability will be the value of the flat dollar amount plus the value of the implicit rate subsidy. In some cases, especially prior to Medicare eligibility, the value of the implicit rate subsidy can be greater than the flat dollar amount paid, significantly affecting the magnitude of the liability.

In another example, suppose a city had several medical plan options, with a plan for actives and pre-Medicare retirees and a separate plan for Medicare retirees. All of its plan options met the criteria to use age-unadjusted premium rates prior to the implementation of the new ASOP 6. In this plan, retirees paid 50% of individual coverage and 35% of family coverage. Prior to the implementation of the new ASOP 6, the plan's liabilities were based solely on the city's share of the premiums, for both pre- and post-Medicare retirees. With the implementation of the new ASOP 6 its liabilities must be based on age-adjusted premiums less the amount paid by the retirees. On this plan, we estimated an overall increase in OPEB liability of about 15%, with pre-Medicare increasing approximately 18% and Medicare increasing about 13%, due to the requirement to use age-adjusted premiums.

In another case a small government entity had two plan options for retirees. In both benefit plans, the pre-Medicare premium rates and Medicare premium rates were the same. The plans were both treated as community-rated under GASB 45 and the old ASOP 6. In general, retirees paid 10% of individual coverage and 25% of family coverage. We estimated the increase in liability for this plan at about 3% under the revised ASOP 6, due to the requirement to use age-adjusted premiums in the liability calculation. The liability for pre-Medicare retirees increased significantly, by about 15%, while the Medicare liability decreased by approximately 5%. The Medicare plan had a decrease because the premiums charged to Medicare-eligible retirees at many ages were greater than the age-adjusted premiums developed to value the liability.

Plans that currently use premium rates without any consideration of implicit rate subsidy to calculate their retiree OPEB liabilities can generally expect to see liability increases under the new version of ASOP 6 as well as under GASB 74/75. Based on our analysis of sample entities, we expect the magnitude of the impact to vary greatly, depending on the specifics of the plan and the extent to which the retiree premiums are subsidized by active employees and other groups.

Visit milliman.com/GASB-73-74-75/ for the latest Milliman resources on the new statements.

CONTACT:
Markella Roma
markella.roma@milliman.com

Milliman

IT TAKES VISION