



AMERICAN ACADEMY *of* ACTUARIES

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To: Jane Kipper, Dan Daveline, NAIC Staff to Codification of Statutory Accounting Principles Working Group

From: Academy of Actuaries Health Codification Subgroup of the State Health Committee

Date: March 6, 1998

Re: Exposure of Health Related Issue Papers

Dear Ms. Kipper and Mr. Daveline:

This responds to the February 13, 1998 exposure of seven modified SSAPs and two new SSAPs. While you requested comments by March 3, 1998, you agreed to receive some preliminary comments about key actuarial issues from the Academy by today. We anticipate providing farther comments on all of the changes within another few weeks, but after the NAIC public hearing in Salt Lake City. We appreciate your flexibility.

The Academy is the public policy organization for actuaries within the United States. A major purpose of the Academy is to act as the public information organization for the profession. The Academy is non partisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations and NAIC proposed models, and works closely with state officials on issues related to insurance.

The Academy is also responsible for setting actuarial standards of qualification, conduct and practice, and for investigating complaints against actuaries who are accused of violating those standards. Several of the SSAPs (including No. 54) have references to the Actuarial Standards of Practice. The Academy has noted concerns that different language in the Issue Papers and the Appendices will lead to confusion (see our letter of October 28, 1997 - Attachment 1). We would request the Codification of Statutory Accounting Principles Working Group meet with the Life and Health Actuarial Task Force (LHATF) to address the differences noted in that letter plus those below.

We note that both SSAP #54 and #55 have several separate paragraphs for indemnity contracts and managed care contracts. We do not believe that there are any differences in the reserve standards for these and such separation in paragraphs dealing with reserves is not necessary

The Academy is concerned that Issue Paper No. 54 inadvertently produces a conflict between the NAIC's Health Insurance Reserves Model Regulation (exposed for comment by LHATF in Seattle -Attachment 2) and the reserve requirements in the Issue Paper for both indemnity carriers and health maintenance organizations.

For example, in paragraph 15 the focus is "over the policy period." Because of HIPAA and the premium rating limitations of many State's Small Employer Health Insurance Availability laws, LHATF is changing the reserve standards to allow a "rating block" to be used to determine the need and amount of contract reserves where "the total premiums for the block were developed to support the total risk assumed and expected expenses for the block each year, and a qualified actuary certifies the premium development. The actuary should state in the certification that premiums for the rating block were developed such that each year's premium is intended to cover that year's costs without any prefunding." We believe that in those situations where this new approach would apply, it is most important that the exception in the Model Regulation should be applied within Codified Statutory Accounting.

Paragraph 19 uses the term "mean reserve" but this issue paper, and Appendix A-0 10 do not address the necessary recognition of deferred premiums for health insurance. The requirement that the "mean reserve on any policy should never be taken as less than one-half the valuation net premium" must allow for deferred premiums.

Paragraph 20 is under a title: Claim Reserves - Managed Care Contracts. The focus of the paragraph is not claim reserves but the need for additional reserves for future claims not yet incurred but expected to exceed in total the premiums for a portion of the reporting entity's business. We think it is very important that the requirement in Appendix A-010: "a prospective gross premium valuation is the ultimate test of reserve adequacy" should be the basis for this paragraph. As the paragraph now reads, the portion of the premium needed to cover non-claims expenses is not excluded from the calculation. We believe that the contracts to which this paragraph applies all will meet the "rating block" requirement of the Model Regulation.

If SSAP #54 is going to retain the distinction between indemnity contracts and managed care contracts, then the title above paragraph 25 should be expanded to include managed care contracts.

Finally on SSAP 454, we ask that one of the issues to be discussed with LHATF is the "clarification" in paragraph 35 of "SAP to require contract reserves on group accident and health policies."

The Academy is concerned that paragraph 9 of Issue Paper No. 55 does not include all of the sources of unpaid claims. Subsection 9.a.i. should relate to reported costs incurred but unpaid as of the valuation date. Subsection 9.a.ii. should relate to IBNR: payment, other than prepaid amounts, for services which have occurred for a covered event but the services have not been reported. A new subsection 9.a.iii. should relate to "Projected

costs to be incurred, other than prepaid amounts, related to future care of a subscriber, member or policyholder for a covered or insured event which has occurred prior to the valuation date (reported or unreported)."

The Health Codification Subgroup wishes to add its voice to the comments already received from other Academy representatives about the inconsistency between "best estimate" values (see paragraph 12 of Issue Paper No. 55) and the Actuarial Standards of Practice which in No. 5 Incurred Health Claim Liabilities provides:

5.1 Conservatism - Recognizing the fact that determination of liabilities for incurred but unpaid health claims is at best an estimate of the true liabilities that will emerge, varying degrees of conservatism or margin will be appropriate, depending on the purpose of the estimate.

Again, we appreciate this opportunity, as well as the many past opportunities, that the Working Group has provided for Academy comments during the project.

C/c: Tom Foley, Chair LHATF  
Julia Philips, Chair, Accident & Health Working Group  
Diana Wright, NAIC Staff

AMERICAN ACADEMY of ACTUARIES

October 28, 1997

Ms. Jane Kipper  
Life Accountant  
NAIC  
120 West 12th Street  
Kansas City, Missouri 64105

Re: Statutory Codification Project

On behalf of the Committee on Life Insurance Financial Reporting (COLIFR) of the American Academy of Actuaries we are requesting the opportunity to speak at the Public Hearing on Codification on November 20.

In addition to some technical comments included in the attached pages, we have general comments.

With respect to the changes made to the various SAPS agreed upon at the open hearings, we have found that, in general, most of them have been made as agreed upon. Unfortunately, in a few cases the addition of the appendices has made clear consistency problems between the SAP's and the Appendices. This is particularly the case with respect to SAP 54 and SAP 55 and Appendix 010.

In the attached, we have attempted to identify where these inconsistencies occur and to suggest corrections. In general, they occur where the SAP attempted to restate material already in the Appendix. We recommend that these situations be avoided by eliminating duplicative material in the SAP. The short exposure period, however, has made a complete review of these changes impossible and we would strongly recommend that a close review of all the SAPS and Appendices to locate all inconsistencies be commenced as soon as possible with sufficient time to do a complete review. On behalf of the Academy, COLIFR would be glad to assist in this review.

Second, we are concerned about which NAIC pronouncements are included in Codification both initially and for the future. This concern is prompted by the inconsistent handling of various NAIC pronouncements in the current Appendices. In particular, it was our assumption that the Appendices would include all accounting instructions included in Model Laws and Regulations passed by the NAIC. Further, the SAP's generally sweep in all Actuarial Guidelines through Part 9 of the NAIC Financial Examiners Handbook. Although this is generally the case, the text of one Actuarial Guideline (Guideline 33) was among the Appendices while the Valuation of Life Insurance Policies Model Regulation (XXX) is not included even though it has been passed by the NAIC.

Our suggestion is that all accounting guidance included in Model Laws and Regulations passed by the NAIC be included in the Appendices. In a similar vein, we were surprised to find the Reinsurance Q&A among the Appendices since it is not a model or actuarial guideline and has never been adopted by the NAIC membership. We believe that a consistent rule for including or not including Models and their interpretations is important as a basis for future changes to Codification as new issues arise.

Finally, we want to confirm that the reserving SAP's and their related Appendices establish minimum reserve standards as indicated in the titles of many of the model laws. It is consistent with the Preamble, we believe, that companies be allowed to hold higher reserves than the minimum where prudence and conservative practice suggest it. Furthermore, this is in accord with ASOP #28, Compliance with Statutory Statement of Actuarial Opinion, Requirements for Hospital, Medical, and Dental Service or Indemnity Corporations, aM for Health Maintenance Organizations, which states in paragraph 3.3.1 "The actuary should be satisfied that the reserves and related items opined on are adequate to cover obligations under moderately adverse conditions."

Henry Siegel  
Chair, COLIFR Working Group on Codification

cc. COLIFR Members  
S. Rentner  
B. Snyder  
R. Wilcox  
J. Lommele  
L. Johansen

## Specific Technical Comments on SAP's and Appendices

SAP 54, SAP 55 and Appendix 010

In general, there a number of places where this SAP and Appendix are inconsistent. Below we attempt to indicate where this is the case.

The changes to paragraphs 3 and 6 in SAP 54, defining advance premium, is incorrect. The rule should read "Advance premiums are those premiums that have been received by the insurance company prior to the valuation date which are

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premium reserves for claims incurred or premiums received after that date and for contract reserves on policies issued after that date. Contract reserves on contracts issued prior to... domiciliary state."

*SAP 55, paragraph 6a* - We suggest that the language other than the final sentence be removed to avoid confusion with Appendix 010. It should be sufficient to refer readers to SAP 54 without repeating language.

*SAP 55, paragraphs 9 and 10* - The third sentence of Paragraph 9 should be amended to read "...shall include an analysis of the amount of variability in the estimate and management's best estimate may take this variability into account."

#### SAP 74

There is a word processing error in paragraph 20 "...to the ceding company which limits the risk to the reinsurer."

#### SAP 89

In paragraph 31, we recommend that the third sentence be clarified to read "As a result, funds received under existing policy contracts or under new contracts utilizing existing policy forms after the effective date of the Codification..." This will clarify, for example, that under a COLI arrangement new employees can be offered the same arrangement as old employees without developing a new contract.

#### Appendix 010

We suggest rewording paragraph 27.1.ii.(b) to read: "For group disability ... reserves may be based on the insurer's experience for which the insurer maintains underwriting and claim administration control if such experience is considered credible. For experience to be considered credible for purposes of this paragraph, the company...". This corrects the order in the first sentence and limited the specific credibility standard to the group claims between 2 and 5 years in duration which is consistent with the model.

Exhibit 2 should be eliminated from the Appendix since it is only "explanatory material".

#### Appendix 585

In paragraph 8f, the annuity symbols should be referenced as defined in b above.

Attachment 2

Health Insurance Reserves Model Regulation  
is in the December Mailing of the  
Life & Health Actuarial Task Force  
Pages 278-295