AMERICAN ACADEMY of ACTUARIES

October 4, 2010

Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2604

Re: Exposure Draft of SSAP 92—Other Postretirement Benefits other than Pensions and Proposed Revisions to SSAP 89—Pensions

To Whom It May Concern:

On behalf of the American Academy of Actuaries'[1] Joint Committee on Retiree Health and Pension Accounting Committee, we appreciate the opportunity to provide comments to the National Association of Insurance Commissioners (NAIC) on the exposure draft of Statement of Statutory Accounting Principles (SSAP) No. 92 and the proposed revisions to SSAP 89, which are intended to replace existing standards governing accounting for pension benefits and postretirement benefits other than pensions (OPEBs).

Although the issues are similar for both pension benefits and OPEBs, they stand in sharper contrast in the OPEB context. Our comments, therefore, will focus primarily on OPEB accounting, with the understanding that the same principles can be applied to the parallel provisions of pension accounting.

The NAIC exposure drafts closely follow Accounting Standard Codification Topic 715, which, with respect to OPEBs, codified the legacy standard Statement of Financial Accounting Standards (FAS) 106, as amended by FAS 132R and FAS 158.We understand the NAIC generally is amending SSAPs to align more closely with principles in financial reporting for the private sector, codified by the Financial Accounting Standards Board (FASB).

We note, however, that SSAPs have a different purpose than the statements issued by the Financial Accounting Standards Board (FASB), since they relate to the solvency of insurance companies instead of the operations of a going-concern enterprise. Our comments, therefore, concentrate on the potential need for SSAP accounting treatment to distinguish between long-term benefits that are binding and those that are not. Long-term benefits that are not binding may be discontinued by a company when insolvency is imminent and, therefore, arguably may not be a solvency obligation.

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

The nature of OPEB promises

In our experience, private-sector retiree health plans have frequently reduced valuable benefit provisions in significant ways over the years that a plan has been subject to FAS 106 reporting. On occasion, retiree and employee groups have responded with legal action against these reductions, but courts have found that OPEBs are not binding promises if the employer reserves the right to amend or terminate those benefits. As a result, most observers believe that when sponsors face financial stress, major changes—reducing or even terminating benefits—are very likely to occur. Given little resistance by participants to significant benefit reductions, participants may be aware of limitations on the employer's commitment (even if those limits are not explicitly stated by employers) or may discount the future value of any currently provided retiree health benefits.

The current concept of "substantive plan," embedded in the FAS 106/ASC 715 accumulated postretirement benefit obligation (APBO) measurement, does not account for these limits. The substantive plan concept permits companies to recognize regular, minor changes in cost-sharing provisions (such as premiums, deductibles, or copayments), but it does not incorporate the employer's ability to make major reductions, including termination, in an OPEB program—even if those rights are reserved and communicated as part of the substantive plan. Under the substantive plan concept, the actuarial projection of future OPEBs may assume future plan changes—but only if specifically patterned and communicated to participants. Liabilities are calculated as if the current substantive plan will last for participants' entire period of eligibility, which often means a half century or more. Although FASB has decided that liabilities including such projections are appropriate for going-concern financial reporting, it is at least questionable if such liabilities are suitable as a factor in determining current insurer solvency.

As actuaries, we believe that there is useful and relevant information in distinguishing between long-term benefits that will be paid and those that may or may not be paid, particularly for assessing solvency.

In 2006, when the Financial Accounting Standards Board (FASB) undertook a project to review retirement benefit accounting guidance, they elected to focus on placing the existing measurement on the balance sheet, deferring a discussion or review-of-measurement aspects (which the Academy urged to take precedence). FASB thus far has not provided a public debate or evaluation of the effectiveness of the measurement principles mandated in 1991 or whether a better method of measurement would be of use by the investing community. Such an evaluation could have provided valuable information about the appropriateness of using a measurement designed for general purpose financial reporting (the FAS 106 substantive plan approach) in determining the financial health and solvency of insurers.

The current NAIC approach

When FASB adopted FAS 106, the NAIC chose a method that followed FASB but disregarded the actuarial value of benefits for employees who may become eligible but are not yet vested. And although OPEBs don't traditionally vest, participants currently eligible to receive the benefits were treated by SSAP 14 as if they were vested. If one assumes that an insurer facing the threat of insolvency or other financial stress would pare benefits back to the vested amount (or less), currently vested benefit liabilities under SSAP 14 may be closer than the ASC 715 liabilities to what an insurer would actually owe to employees.

In judging the solvency of an insurer, we believe that both “retirement eligible” (values closer to SSAP 14) and “going concern” (proposed SSAP 92 and pension accounting) values provide useful and relevant information. The potential liability associated with the difference can be large in magnitude and may be important to recognize in NAIC regulation.

Conclusion

We agree that, for a plan sponsor that has indicated an intention to keep that plan for the duration of participants’ promised eligibility, the substantive plan is an appropriate basis for actuarial valuation and accounting liability. Most plan sponsors in the private sector, however, explicitly reserve the right to deviate from the substantive plan. For example, in 1988, 66 percent of major employers sponsored these plans, while in 2010 the number had fallen to 28 percent.[2] In a similar way, an increasing number of employers are freezing pension benefits or closing their plans to new employees.

The difference in future liabilities between a plan sponsor that reserves the right to change the substantive plan provisions and a plan sponsor that does not potentially are significant—and yet current FASB accounting does not allow any distinction. While such distinction may not be immediately evident, when present it makes a quantitative difference of considerable magnitude. If ignored, this could create concerns, otherwise unwarranted, about insurer solvency and adequacy of risk-based capital. Measuring that difference can take various forms, depending on the plan provisions.

The Academy would like to work with the NAIC to identify examples of different measurement approaches that could allow the NAIC to understand the relative merits of each approach for statutory accounting objectives and purposes, with particular emphasis on appropriately reflecting the obligations of plan sponsors that have reserved the unilateral right to change the benefit.

We would appreciate your consideration of our comments, and we request the opportunity to discuss this with you further. If you have any questions, please contact Heather Jerbi, the Academy’s senior health policy analyst, at 202.785.7869 or jerbi@actuary.org

Sincerely,

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[2] Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2010 Annual Survey*. (Exhibit 11.1) http://ehbs.kff.org/pdf/2010/8085.pdf