Surplus Policies for Health Pools
Association of Governmental Risk Pools
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Agenda

- Key Reasons for Surplus
- Common Trust Approaches to Surplus
- Background of NAIC Risk-Based Capital (RBC) Formula
- Best Practices: Trust-Specific Approach
Key Reasons for Surplus

- Long-term solvency
- Premium stability
- Support for growth
- Other ongoing insurance considerations
  - Lag in pricing cycle exacerbates effect of setting premiums too low in a given year
  - Incurred but not paid (IBNP) claim reserve - 2019 premiums should cover all claims incurred in 2019

Long-Term Solvency Assessment

Analysis of Aggregate Claim Variability with $100,000 Individual Stop-Loss

- 34.4% chance of exceeding 105% of the average
- 13.8% chance of exceeding 115% of the average
- 4.0% chance of exceeding 125% of the average

Results based on a sample company
Example: Impact of Lag in Pricing Cycle

- 2019 Premium rates – set to cover expected claims incurred from 1/1/19 to 12/31/19
  - Rates developed in July through September 2018
  - Common approach – use most recent full year of available claims, i.e., 1/1/17 to 12/31/17
    - 2018 YTD claims are hard to use with confidence due to claim lag (IBNP)
    - First few months of 2018 are more complete but too small a portion of the year

- When setting 2019 rates, actuary can assess three things
  1. Estimated 2019 premiums based on trending 2017 claims and making other adjustments as appropriate (e.g., changes in members, plan design, etc.)
  2. 2017 underwriting gain/loss based on ratio of 2017 premiums to 2017 claims
  3. Estimated 2018 underwriting gain/loss based on ratio of 2018 premiums to preliminary estimate of 2018 claims. This provides an early warning about the adequacy of 2018 premiums.

- The 2019 premiums will generally be based on a best estimate of #1, with reasonable margin added

- Treatment of expected underwriting gains and losses from #2 and #3 are usually viewed as a surplus management/premium smoothing issue

Common Trust Approaches to Surplus

<table>
<thead>
<tr>
<th>Hold a premium-based amount of surplus</th>
<th>Lower End</th>
<th>Common</th>
<th>Higher End</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on # of months of premiums</td>
<td>One</td>
<td>Two to Three</td>
<td>Four to Six</td>
</tr>
<tr>
<td>Based on comparable % of premiums</td>
<td>5% to 10%</td>
<td>15% to 25%</td>
<td>30% to 50%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Purchase individual and/or aggregate stop-loss insurance*</th>
<th>Smaller/More Risk Averse</th>
<th>Medium Size/Risk Aversion</th>
<th>Larger/Less Risk Averse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual stop-loss</td>
<td>$75,000-$100,000</td>
<td>$125,000 to $175,000</td>
<td>$200,000 to $500,000</td>
</tr>
<tr>
<td>Aggregate stop-loss</td>
<td>110%</td>
<td>125%</td>
<td>None</td>
</tr>
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*Stop-loss needs vary considerably, depending on a variety of factors including group size and risk tolerance
Minimum and Maximum Surplus

- Regulatory approach to minimum and maximum surplus requirements varies considerably by state
- Focus is primarily on minimum surplus requirements, but excessive surplus can be an issue too
- When surplus gets too high, it can be addressed in several ways
  - Modify premium rate increase for next year (reduce increase, hold flat or even decrease relative to current year)
  - Declare a premium holiday for final months of the current year
  - Refund portion of premium contributions already collected

Background of NAIC Risk-Based Capital (RBC) Formula

- The development of the NAIC formula was driven by a string of large-company insolvencies in the late 1980s and early 1990s
- Prior to RBC, there was only a fixed capital requirement that was unrelated to risk
  - States still use fixed capital requirements during the licensure process
- RBC was created to provide a capital adequacy standard that:
  - Is related to risk
  - Provides a safety net for insurers
  - Is uniform among states
  - Provides regulatory authority for timely action
- RBC consists of two main components:
  - It established a minimum capital level that is compared with a company’s actual capital level
  - A model law that grants authority to the state to take specific actions based on the level of impairment (Action Levels)
Health RBC Components

The NAIC Health RBC calculation is formulaic and represents five types of risk:

- H0: Asset Risk, Affiliates
  - Risk associated with asset default for certain affiliated investments such as directly or indirectly owned insurers, alien companies and MCOs subject to RBC
- H1: Asset Risk, Other
  - Risk of asset default of principal and interest or fluctuation in market value
- H2: Underwriting Risk
  - Risk of underestimating liabilities from business already written or inadequate pricing of business in the coming year
- H3: Credit Risk
  - Risk of recovering receivable amounts from creditors
- H4: Business Risk
  - General business risk includes administrative expenses, non-underwritten and limited risk business, premiums subject to guaranty fund assessments and excessive growth

Impact of HRBC Components

\[ H_0 + \sqrt{(H_1^2 + H_2^2 + H_3^2 + H_4^2)} \]
Health Underwriting Component (RBC H2)

Example: Comprehensive medical for employer-based plans

<table>
<thead>
<tr>
<th>Annual Underwriting Revenue</th>
<th>Base % of Underwriting Revenue</th>
</tr>
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<tbody>
<tr>
<td>&lt;$3,000,000</td>
<td>15%</td>
</tr>
<tr>
<td>$3,000,000 - $25,000,000</td>
<td>15%</td>
</tr>
<tr>
<td>&gt;$25,000,000</td>
<td>9%</td>
</tr>
</tbody>
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Adjustments to Base
- Managed Care Discounts
  - Reduction based on structure of provider contracts, e.g. fee schedules/capitation
- Individual Stop-Loss Attachment Points
- Premium Guarantees Over 12 months
- Premium Stabilization Reserves (if held as a liability)

Regulatory Action Levels

- Total Adjusted Capital = Insurer’s Capital and Surplus Adjusted for Life and P/C Subsidiaries
- RBC Ratio = Total Adjusted Capital ÷ Authorized Control Level
- RBC Action Levels:
  - **Company Action Level:** 2.0 ≥ RBC Ratio > 1.5
    - Requires a Capital Plan to increase Surplus to acceptable levels
  - **Regulatory Action Level:** 1.5 ≥ RBC Ratio > 1.0
    - Company must conform to requirements in CAL and subject to a regulatory audit
  - **Authorized Control Level:** 1.0 ≥ RBC Ratio > 0.7
    - State has option to take control of insurance company
  - **Mandatory Control Level:** 0.7 ≥ RBC Ratio
    - Regulator is required to takeover insurance company
Best Practices: Trust-Specific Approach

- Because trusts have such unique considerations, individual modeling is preferred approach.
- Use trust-specific data to model ideal surplus range; parameters include:
  - Claim and membership history
  - Expectations for future growth
  - Regulatory considerations
  - Tolerance for risk
  - Impact of different stop-loss coverage
- Can update modeling periodically for new claim data, membership changes, etc.

Thank you

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