Large Group Medical Insurance Reserves, Liabilities, and Actuarial Assets

Darrell D. Knapp, MAAA, FSA
Chairperson, Large Group Medical Business Practice Note Work Group

Cheryl G. Allari, MAAA, FSA
Member, Large Group Medical Business Practice Note Work Group

Webinar-September 27, 2013

Agenda

- Purpose of practice notes
- Large Group Medical Insurance Reserves, Liabilities, and Actuarial Assets
  - General questions
  - Asset adequacy analysis
  - Premium deficiency reserves
  - Other considerations
- Questions

Purpose of Practice Notes

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- Hierarchy of guidance
  - Actuarial Standards of Practice (ASOPs)
    - Developed by Actuarial Standards Board
    - Broadly exposed and reviewed
    - Content defines appropriate practice
    - Language tends to include “should” and “must”
  - Practice Notes
    - Developed by Academy work groups
    - Limited exposure
    - Designed to elaborate on ASOP or address emerging issues
    - Reflects observations of current practice
    - Purpose is to provide information rather than to be prescriptive
    - Language tends to include “might” and “may”

General Questions

General Questions

- Q1.-What does this practice note address?
  - Addresses issues regarding responsibilities of the valuation actuary under the following pertinent National Association of Insurance Commissioners (NAIC) documents:
    - *Actuarial Opinion and Memorandum Regulations*
    - *Model Reserves Model Regulations*
    - *Health Reserves Guidance Manual*
    - *Health Annual Statement Instructions*
    - *Accounting Practices & Procedures*

General Questions (cont.)

- The practice note also addresses relevant ASOPs related specifically to determining reserve levels and other actuarial assets and liabilities for large group medical (LGM) insurance
- The practice note comments on Generally Accepted Accounting Principles (GAAP) accounting, however the primary focus is on statutory accounting
- The practice note is not intended to cover liability estimation for self-funded employer groups

General Questions (cont.)

- Q2.-What is large group medical insurance business?
  - Includes fully insured medical plans (basic health plans, basic with supplemental major medical, comprehensive coverage)
  - Includes minimum premium plans, as well as specific and aggregate stop-loss
  - Short-term and supplemental products also may be included such as short-term disability, prescription drug, dental, and vision care
  - Under the Affordable Care Act (ACA), large group is defined as group insurance covering employers with an average of more than 100 employees
  - Other group sizes (51+) have been common in the industry

General Questions (cont.)

- Q3.-What funding arrangements are currently used?
  - Administrative Services Contract (ASC) - Differs from administrative services only (ASO) in that claims are paid from the insurer's bank account and then reimbursed by the plan sponsor
  - Minimum Premium - Group policyholder funds claim payments up to a certain limit and pays a "minimum premium" to fund only the risks for excess claims, stop-loss, administration and (sometimes) claim liability
  - Prospective Rating - Premium is not dependent on the experience during the policy period

General Questions (cont.)

- Retrospective Rating - Final premium is based on the experience of the risk during the policy term for which the premium is paid
- Cost Plus - Policyholder pays a variable premium, typically equal to the prior month's paid claims, plus a retention component
- Stop-Loss - Method of protecting self-funded plans from unusually high claim levels (either at individual claimant or aggregate plan level)

General Questions (cont.)

- Q4.-What assets and liabilities related to large group are within the scope of the actuarial opinion?
  - For the *NAIC Life and Accident & Health Annual Statement*, assets and liabilities are defined in the *Actuarial Opinion and Memorandum Regulation* and instructions for the actuarial opinion of the *NAIC Life and Accident & Health Annual Statement*
  - For the *NAIC Health Annual Statement*, assets and liabilities are defined in the *Health Insurance Reserves Model Regulation*, the instructions for the actuarial opinion of the *NAIC Health Annual Statement*, and the practice note on the *Revised Actuarial Statement of Opinion Instructions*

General Questions (cont.)

- Q5.-What would be prudent to consider regarding the claims processing environment?
  - Electronic Data Interchange (EDI) Gateway
  - Process for paper claims and correspondence
  - Authorization and review process
  - Claims processing system
  - Disbursement system
  - Claim recovery process

General Questions (cont.)

- Q6.-What other operational and product issues might the appointed actuary consider?
  - Guidance can be found in ASOP No. 5 (Incurred Health and Disability Claims)
  - Benefit structure
  - Business practices
  - Trend and performance guarantees
  - Provider-related impacts
    - Contract disputes or terminations
    - Retroactive effective dates
    - Incentive arrangements

General Questions (cont.)

- Q7.-What regulatory and legislative issues might the actuary consider?
  - State regulations:
    - Minimum valuation reserve standards
    - Prescribed reporting
    - Actuarial opinion and memoranda requirements (See practice note)
  - Federal regulations:
    - Health Insurance Portability & Accountability Act of 1996 (HIPAA)
    - Employment Retirement Income Security Act of 1974 (ERISA)
    - Consolidated Omnibus Budget Reconciliation Act (COBRA)
    - ACA

General Questions (Q7 cont.)

- Large group effects of ACA regulations include:
  - Establishment of medical loss ratio (MLR) based rebate requirements that can lead to rebates of premium which involves regulation at the federal and state level
  - Coverage requirements [coverage of dependents up to age 26, no pre-existing conditions for children (elimination of medical underwriting), removal of lifetime limits, and preventative benefit requirements]
  - If a large group provides essential health benefits, removal of annual limits on those benefits
  - New rules for patient communications
  - Integration of wellness benefits

General Questions (Q7 cont.)

- Introduction of employer "pay or play" rules that will affect employer group decisions about whether to continue existing plans or pay government penalties
- Auto-enrollment requirements for large groups with 200+ employees
- Additional reporting requirements for employers and insurance companies
- Additional taxes and fees on certain medical supplies and services, and on insurance companies

General Questions (cont.)

- Q8.-How are incurred and paid dates typically defined and reviewed?
  - Consider the incurred and paid date conventions being used in the valuation data sources and consistency with financial reporting conventions
    - Inpatient (interim bills, readmissions)
    - Stop-Loss
    - Disability
    - Extension of benefits
  - Reserve liabilities are established based on the incurred date
  - Tracking of incurred dates and paid dates allows for a health plan to conduct claim payment studies

General Questions (cont.)

- Q9.-What claim reserve margins generally are held for large group medical business, and does this depend upon the funding arrangement?
  - Contingency margins typically are held through the use of conservative assumptions or through an explicit provision
  - Relevant SSAPs and ASOPs
    - SSAP 55 Unpaid Claims, Losses and Loss Adjustment
    - ASOP No. 22 Statements of Opinion Based on Asset Adequacy Analysis by Actuaries for Life and Health Insurers
    - ASOP No. 28 Statements of Actuarial Opinion Regarding Health Insurance Liabilities and Assets

General Questions (Q9 cont.)

- Additional items to consider:
  - Historical claim fluctuations
  - Recent changes in claims trends
  - Loss ratios
  - Adjudication practices or other claim lag factors
  - Introduction of new benefit designs and products
  - Size of block, lapses, and growth
  - Duration of the block
  - Influenza prevalence or pandemics
  - Sensitivity testing or stochastic modeling
  - Government regulation (actual or anticipated)

Asset Adequacy Analysis

Asset Adequacy Analysis

- Q10.-What is asset adequacy analysis for large group medical?
  - Involves an examination of the underlying liability characteristics, such as:
    - Product design and contractual guarantees and obligations
    - Expected timing and magnitude of disbursements
    - Sensitivities to various internal and external uncertainties
  - Analyzing the likelihood that the company's asset portfolio attributable to this block of business will be able to meet various product-related demands

Asset Adequacy Analysis (cont.)

- Q11.-Is cash flow testing necessary for large group medical?
  - May not be necessary due to the following:
    - Short-term nature of most LGM obligations
    - Relative predictability of medical claims run-out
    - LGM obligations are insensitive to interest rate fluctuations
  - Actuarial opinion and memorandum regulations in some states may require asset adequacy analysis
  - If performed at a preliminary date, need to consider activity between the preliminary date and the valuation date

Asset Adequacy Analysis (cont.)

- Q12.-What methods other than cash flow testing can be used to demonstrate asset adequacy?
  - Testing of the sufficiency of reserves related to LGM such as gross premium valuation and conservatism in unpaid claim liabilities
  - Testing of the sufficiency of assets to support liabilities
  - Sensitivity analysis of contract provisions and key assumptions

Asset Adequacy Analysis (cont.)

- Q13.-Is reserve adequacy typically examined on a closed block basis or a going concern basis?
  - LGM reserves for purposes of asset adequacy analysis are examined on the existing block of business without regard to new business
  - Premium deficiency reserves may be an exception to this rule

Asset Adequacy Analysis (cont.)

- Q14.-How might an actuary demonstrate that reserves for a block of business are relatively insensitive to changes in economic conditions or interest rate scenarios?
  - Consider whether liabilities or assets have options or liquidity issues that may change with economic conditions
  - Sensitivity analysis of contract provisions and key assumptions under various economic conditions or interest rate scenarios

Asset Adequacy Analysis (cont.)

- Q15.-Is it advisable to perform a gross premium valuation to demonstrate reserve adequacy?
  - LGM provides coverage over a 12-month contract period
  - Gross premium valuation is more likely to be used to assess premium adequacy over a period of 12 months or longer

Asset Adequacy Analysis (cont.)

- Q16.-What obligation risks might be considered? How may assumptions be set?
  - Consider all contractual obligations and guarantees using best estimate assumptions, which include:
    - Premium or other contractual guarantees
    - Claim trends
    - Anticipated rate increases
    - Member lapses
    - Conversions
    - Experience rating refunds and deficits
    - Administrative expense levels

Asset Adequacy Analysis (cont.)

- Q17.-How are claim cycles and underwriting cycles reflected in projection assumptions?
  - Claim cycles and underwriting cycles are reflected in the following:
    - Pricing
    - Gross premium valuations
    - Other actuarial projections to the extent those claim cycles or underwriting cycles can be demonstrated to exist based on benefit design, company or industry experience, historical data, etc.
  - Seasonality generally predictable and reflected while underwriting cycle generally not predictable and not usually reflected

Asset Adequacy Analysis (cont.)

- Q18.-How long are projection periods for large group medical business when performing cash flow testing or gross premium valuations?
  - Projection periods for gross premium valuations may vary depending on the intended purpose
    - Premium deficiency reserves consider the length of contract
    - Asset adequacy analysis may be based on length of runout of assets and liabilities

Premium Deficiency Reserves

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Premium Deficiency Reserves

- Q19.-When are premium deficiency reserves required for large group medical?
  - Generally when claims and expenses exceed future premiums and existing liabilities
  - Questions that arise from how to interpret SSAP 54 guidance:
    - How finely to group the business
    - What administrative expenses are required
    - How long is the projection period

Premium Deficiency Reserves (cont.)

- Q20.-What does the actuary generally consider regarding business not yet issued as of the valuation date?
  - See SSAP 54 (Individual and Group Accident and Health Contracts) for statutory guidance regarding premium deficiency accruals
    - "accruals shall be made for any loss contracts, even if the contract period has not yet started"

Premium Deficiency Reserves (cont.)

- Q21.-How are self-funded plans contemplated in developing premium deficiency reserves?
  - Premium deficiency reserves apply to insured business only
  - Complications may exist in the interplay between insured products that are priced, marketed, and managed alongside self-insured plans

Other Liabilities

Other Liabilities

- Q22.-What liabilities or assets might arise out of provider incentive arrangements?
  - Cash settlement or payment of withholds
  - Experience period/runout period
  - One-sided or two-sided sharing of risk

Other Liabilities (cont.)

- Q23.-What does an actuary investigate regarding the financial condition of capitated providers?
  - Guidance included in ASOP No. 5 (Incurred Health and Disability Claims)
  - Internal vs. external sources of information
  - Potential need to establish additional reserves in event of a provider insolvency

Other Liabilities (cont.)

- Q24.-How are liabilities with respect to stop-loss coverages established?
  - Stop-loss coverage is a form of reinsurance provided to self-insured employers
  - Can be on a specific or aggregate basis
  - Incurred period/paid period
  - Actuary may consider contract provisions, expected loss ratios, and developing claims when establishing contract liabilities

Other Liabilities (cont.)

- Q25.-How are experience rated refund liabilities or contingent premium receivables established?
  - Favorable experience => experience rated refund
    - Premium stabilization reserve
  - Unfavorable experience => contingent premium
  - Group specific projections/settlements

Other Liabilities (cont.)

- Q26.-What liabilities are established for risk pool assessments and guarantee fund assessments?
  - Provisions may be made for program assessments if such assessments are likely to be made
  - These provisions are reported as claim reserves by some carriers and as accrued expenses by others

Other Liabilities (cont.)

- Q27.-How does an actuary reflect obligations under extension of benefits provisions?
  - Extension of benefits provisions define how long payments continue after a termination of a contract or membership
  - Most policies extend benefits until the earlier of:
    - Member being discharged from the facility or no longer disabled
    - Other coverage being attained
    - A set period of time that can vary from 30, 60, or 90 days to as much as a year after termination

Other Liabilities (cont.)

- Q28.-How are estimates of MLR based rebates addressed?
  - ACA requires companies to give rebates to members and groups if the loss ratio in their category is not above an MLR based rebate requirement defined in the statute
  - MLR rebate categories are individual, small group, and large group insured business as defined in the statute
  - Practice still evolving with respect to the question of whether and how the actuary incorporates a contingency margin into the financial statement estimate of rebate liabilities

Other Liabilities (cont.)

- Q29.-How does an actuary reflect obligations under conversion provisions?
  - Most group contracts allow the subscriber to convert to an individual policy on termination from the group contract

Other Considerations

Other Considerations

- Q30.-How is reinsurance ceded and assumed for large group medical reflected in financial statements?
  - Divided into two categories:
    - Quota share
    - Stop-loss or excess loss
  - Most reinsurance is stop-loss
    - Stop-loss reinsurance can be written on either a specific or aggregate basis
  - Need to consider risk transfer issues
  - Reinsurance netted against direct (e.g., claim reserves reduced by anticipated reinsurance)

Other Considerations (cont.)

- Q31.-What other considerations might the appointed actuary need to be aware of?
  - Some other considerations are:
    - Federal income taxes
    - Tax reserves
    - State and local income taxes
    - Surplus notes
    - Liabilities related to pending or expected litigation
    - Risk-based capital

Other Considerations (cont.)

- Q32.-What are the considerations for tax reserves for large group medical?
  - Actuary may wish to work with tax counsel to determined exact methodologies and calculations for tax reserves
  - Guidance provided by:
    - Internal Revenue Code
    - Revenue rulings
    - Private letter rulings
    - Technical advice memoranda
    - U.S. Tax Reserves for Life Insurers (by Society of Actuaries)
  - Frequent areas of differences include discounting and unearned premium tax reserves

Question and Answer

American Academy *of* Actuaries

Staff Contact Information

Tim Mahony

Health Policy Analyst (State)

American Academy of Actuaries

1850 M St., NW (Suite 300)

Washington, DC 20036

202-223-8196

mahony@actuary.org