AMERICAN ACADEMY *of* ACTUARIES

October 17, 2013

Dennis Julnes
Chair, Health Risk-Based Capital Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Response to Questions on Concentration Risk Model (dated Nov. 9, 2012)

Mr. Julnes,

On behalf of the American Academy of Actuaries'[1] Health Solvency Work Group, I am submitting the following responses to questions from the National Association of Insurance Commissioners (NAIC) Health Risk-Based Capital Working Group on the model our work group submitted to the NAIC last November that examines administrative expenses within the context of business concentration risk (attached).

Q. Did the work group model underwriting risk or business risk?

A. The work group offered a hypothetical model that illustrates the potential cost of administrative expenses when downsizing an entity under the stated assumptions. As such, the model illustrated business risks. The work group does agree that there is a marginal risk of concentration in business risk, but the magnitude of the risk was not quantifiable within the comment period.

As the work group considered a response to this question, there were additional discussions about the potential magnitude of added claim risk. The claim risk may result from an increase in claim utilization by covered members as a result of the termination of concentrated business. The majority of such terminations involves transitions to a new carrier or coverage and is seldom associated with a total loss of coverage. The work group also considered that the release of the underwriting risk charges (15 percent/9 percent) of the claims of the concentrated area that no longer exists should be sufficient to cover any increased utilization

Q. Had the actuaries considered entities with only one contract (e.g., an entity with a Medicaid contract with a single state)?

[1] The American Academy of Actuaries is a 17,500-member professional association whose mission is to serve the public and 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.

A. The work group did not focus on an entity with a single contract or industry. In subsequent discussions, the work group observed that concentration can exist to varying degrees, which is evident from lines of business that are reported separately. These include Medicaid, Medicare Advantage, and the Federal Employee Health Benefits Program (FEHBP) or TRICARE.

There was a discussion on stand-alone entities that insure Medicaid or Medicare business. The loss of these contracts would be known several months before the termination date. This would give the entity time to start adjusting expenses, which would lessen the magnitude of the business risk. The same is true for a large group with a single policy that makes up 20 percent or more of the entity's premium. The work group also had not segregated considerations to any differences between a single contract versus a single industry, or to potentially different effects of some versus all concentrated business being terminated. The model illustration was based on 100 percent probability of loss of business without notice.

Q. What are considerations for developing an appropriate risk factor?

A. The work group's illustrative model was created so that various assumptions could be tested by the NAIC. The assumptions included in the model were not recommended by the work group as proposed assumptions. The model included a 100 percent probability factor for a 20 percent concentration. The intention was to test a variety of reasonable assumptions and determine a range of required RBC as a result.

The Academy would be willing to assist the NAIC in determining the appropriate assumptions for the model and factor for this risk. If you have any questions regarding the comments in this letter, please contact Tim Mahony, the Academy's state health policy analyst (202.223.8196; Mahony@actuary.org).

Sincerely,

Donna Novak, MAAA, FCA
Chairperson, Health Solvency Work Group
American Academy of Actuaries

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November 9, 2012

Dennis Julnes
Chair, Health Risk-Based Capital Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Cost of Concentration if a Carrier Had Lost all of the Concentrated Business

Mr. Julnes,

The American Academy of Actuaries'[2] Health Solvency Work Group is pleased to provide a model that examines administrative expenses within the context of business concentration risk.

This model can be used to determine the amount needed to cover administrative expenses that cannot be reduced quickly when a large portion of business is lost with minimal time to prepare for such loss. Normally, when a carrier loses business, even a concentrated block of business, the carrier will be notified before the block cancels coverage and will have time to react and start reducing expenses before premium income declines. However, the model attempts to address the situation where the business is lost without significant warning because of business circumstances of covered businesses. The model assumes X% probability of loss of some portion of the insurer's business. Currently that percentage is set at 100% as the worst case scenario. We expect that the Health Risk-Based Capital Working Group will discuss and adjust assumptions including the probability of loss, before any change is implemented.

The unreduced administrative expense is calculated based on an administrative percentage and a schedule of administrative cost reduction. The present value of the amount needed to cover administrative expenses is reduced by the estimated amount of reserve margin that it will release. The final result is the present value of the amount needed to cover administrative expenses compared to the total carrier premium.

Assumptions include:

- Percent of premium in a concentrated industry, etc.
- Administrative percentage
- Percent of cost reduction (schedule of cost reduction)
- Discount rate
- Reserve conservatism level (margin)
- Unpaid portion of claims at beginning of period

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- Loss ratio

The factors used in the model are based on the views of a limited number of actuaries and not any actual experience. If you desire to incorporate a change to the HRBC Formula, a review of actual experience with the loss of a significant portion of an insurer's business appears to us to be the next step.

We look forward to continuing to work with you on this project. Should you have any questions in the meantime, do not hesitate to contact Tim Mahony, The Academy's state health policy analyst (202.223.8196; Mahony@actuary.org).

Respectfully,

Donna Novak, MAAA, FCA
Chairperson, Health Solvency Work Group