AMERICAN ACADEMY of ACTUARIES

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September 4, 2019

Patrick McNaughton
Chair, Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners (NAIC)

Re: Draft Bond Structure and Instructions

Dear Mr. McNaughton:

The American Academy of Actuaries[1] Health Solvency Subcommittee is pleased to provide this response letter to the NAIC Health Risk-Based Capital (HRBC) Working Group. This letter is in response to the HRBC Working Group comment letters received on the exposure of the Draft Bond Structure and Instructions.

United Health Group (UHG) sent two comment letters which comprised comments on:

Treatment of Investment Income

Investment income is utilized in the development of the underwriting risk in the property and casualty (P&C) Risk-Based Capital Formula. Therefore it would be redundant to include as an offset to the default risk within the bond factor development. It is unclear whether the Health Risk-Based Capital Formula used a similar consideration in the development of the underwriting risk. The HRBC Working Group should consider the implications of investment income already included in the formula.

As stated in UHG's second letter dated November 13, 2018, the bond factors would require a number of considerations and assumptions in order to accommodate the impact of investment income in the model. An alternative approach could be considered if determined appropriate.

Investment-Grade Bonds

As noted in the UHG comments, the Joint P&C/Health Bond Factors Analysis Work Group's (PCHWG) report[2] suggests a minimum risk factor of 0.1%, which UHG has stated it views as being too conservative. In considering the minimum risk charge, it's important to recognize the risk charge associated with cash. If cash has a risk charge, then bonds should have a charge at

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

[2] *An Update to the Property & Casualty and Health Risk-Based Capital Bond Factors*, Joint P&C/Health Bond Factors Analysis Work Group, July 30, 2018.

least as great. Related to bond risk, there may be other risks outside of the modeled risk of misuse or loss that should be taken into consideration.

<u>Speculative-Grade Bonds</u>

While the UHG comments expressed some general concerns with the approach, UHG also acknowledged that given the limited amount of information available, there was no superior alternative.

<u>Other Asset Classes</u>

UHG has stated it concurs with the PCHWG report on page 13—that all factors based upon bond factors should be updated.

America's Health Insurance Plans (AHIP) provided comments on:

<u>Speculative Grade—Size Adjustment</u>

The AHIP comments surround the use of a bond size factor in the development of the speculative grade bond factors. It's important to note that both life and P&C utilize a bond size adjustment factor on speculative-grade bond factors in their respective formulas. Therefore from a consistency standpoint, health incorporated a similar type of adjustment on the speculative-grade bond factors.

It's important to note that footnote 74 in the PCHWG report acknowledged that the modeled approach was simplified and identified potential inconsistencies. However, the last sentence outlines why the approach was reasonable overall: "*However, as the bond size factor is based on the total number of issuers (excluding US government issuers), rather than issuers by rating class, and as the proportion of* [speculative-grade] *bonds is not large for either life or P&C, we believe this approach is reasonable.*"

If the HRBC Working Group decided to adjust the speculative-grade modeling to remove the size adjustment factor, then the investment-grade bonds would also need to be adjusted to account for a lower number of issuers on this asset class. This would lead to an increase in the proposed size adjustment and resulting factors.

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We appreciate the opportunity to provide these comments and would welcome the opportunity to speak with you regarding these comments in more detail and answer any questions you might have. If you have any questions or would like to discuss further, please contact David Linn, the Academy's senior health policy analyst, at 202-223-8196 or linn@actuary.org.

Sincerely,

Tim Deno, MAAA, FSA
Chairperson, Health Solvency Subcommittee
American Academy of Actuaries