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July 13, 2022

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

Re: Request for Comprehensive Review of the H2—Underwriting Risk Component and Managed Care Credit Calculation in the Health Risk-Based Capital Formula

Dear Mr. Drutz:

On behalf of the American Academy of Actuaries (Academy)[1] Health Solvency Subcommittee ("subcommittee"), I am pleased to provide this letter the NAIC Health Risk-Based Capital (E) Working Group ("working group"). The subcommittee drafted this letter in response to the request from the working group after its previous report to provide a timeline to analyze and comprehensively review the H2—Underwriting Risk component and the managed care credit calculation in the health risk-based capital (HRBC) formula.

The subcommittee's January 2022 report included the following six recommendations for the HRBC Working Group's consideration:

1. Refresh factors based on updated insurer data
2. Develop factors at a more granular product level
3. Develop factors specific to more relevant block sizes and consider an indexing factor for cut points to change over time
4. Model risk factors over an NAIC-defined prospective time horizon with a defined safety level that can be refreshed regularly
5. Refresh of managed care credit formula and factors to be more relevant and reflective of common contracting approaches and other risk factors associated with these contracting approaches
6. Analyze long-term care insurance (LTCI) underwriting performance to create a more nuanced set of risk factors that considers pricing changes over time

The subcommittee plans to proceed with an analysis to support recommendations 1-5 above across three work tracks. Concerning recommendation No. 6, the subcommittee suggests that the working group discuss any potential changes to LTCI risk factors with the NAIC Life Risk-

[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.

Based Capital (E) Working Group because most LTCI premium is written on life blanks. Please revisit the previous report for additional detail related to the six recommendations.

The three work tracks that will be needed to support the recommendations are:

1. Redesign HRBC Pages XR013/XR014 (Experience Fluctuation Risk) [2]
2. Develop Tiered RBC Factors
3. Redesign HRBC Pages XR018/XR019 (Managed Care Credit)

As the subcommittee completes each work track, it will share the results with the working group for their consideration and feedback. The remainder of this letter provides more details regarding our proposed analyses.

1. HRBC Pages XR013 and XR014 (Experience Fluctuation Risk) redesign

The current RBC formula for Experience Fluctuation Risk utilizes data from Page 7—Analysis of Operations by Line of Business—then aggregated to six product columns instead of the nine shown on Page 7. Alternatively, the RBC formula could use the Supplemental Health Care Exhibit ("SHCE")—Part 1, the Accident and Health Policy Experience Exhibit ("A&H Exhibit"), or the Exhibit of Premiums, Enrollment, and Utilization. While the SHCE and A&H Exhibits benefit from additional product detail, the limitation is that they are not filed until April 1—after insurers have filed their RBC calculations. The alternative—the Exhibit of Premiums, Enrollment, and Utilization—is limited by the fact that premiums and claims are presented on a gross basis.

Given that the later timing of the supplements would create a mismatch in timing between the RBC calculation and the availability of data, the subcommittee would suggest utilizing Exhibit of Premiums, Enrollment, and Utilization, at least until insurers file the supplements with the rest of the core financial statement pages.

The subcommittee will likely need to make some adjustments during the risk factor development process (e.g., utilizing data from the historical supplements or other sources) to remedy the gross basis presentation. Additionally, for the RBC filing, Company Records may be required to move from gross to net premiums and claims. Lastly, given the significant A&H volume on life blanks, the Analysis of Operations by Lines of Business—Accident and Health would likely need to be utilized.

Additional changes to XR013/XR014 would include:

- Company-specific experience adjustments, based on historical company-specific experience—likely between five and 10 years
- An adjustment for investment income, tailored to the cash flows of health products
- A premium diversification discount factor

[2] Based on the 2021 HRBC formula and layout. Additionally, the subcommittee does not expect to make changes to XR015 as part of this exercise given potential data limitations on the Supplemental pages and the Exhibit of Premiums, Enrollment, and Utilization.

- Adjustments to the tiering thresholds

This work track would produce a brief discussion document with a corresponding workbook with the proposed calculation and health blank data sourcing with mock data. The subcommittee expects this work track to take approximately 18 weeks, given the complexity of the redesign.

2. Tiered RBC factor development

The development of the new Tiered RBC factors would be conceptually similar to the exercise performed by the Academy's Property and Casualty Risk-Based Capital Committee for the P&C RBC formula. That is, the premium risk factors would reflect the risk that the subsequent year[3] of net premium would produce adverse underwriting experience. The Premium Risk Factors for each line of business would be derived from the net loss ratio for each company that has submitted statutory financials over some predefined period (potentially up to 10 years). The premium risk factors would correspond to some percentile confidence level, as determined by the working group.

This work track would ultimately produce a brief discussion document with a corresponding workbook summarizing the data and results for each line of business at various confidence levels. Given the time needed for data collection and analysis, the subcommittee expects this work track to take approximately 28 weeks.

3. HRBC XR018 and XR019 (Managed Care Credit) redesign

As discussed in the previous January 2022 report, the current Managed Care Credit does not reflect the current nature of provider contracts or contractual risk-sharing provisions. As a result, the subcommittee recommended that the Managed Care Credit be updated. Given the limited data collected within Exhibit 7, this exercise would only include the design of a new HRBC page based on company records (or potentially a new health blank exhibit) for the working group's consideration. As the new data is collected, the new Managed Care Credit could eventually be incorporated into the Experience Fluctuation Risk calculation. Alternatively, to accelerate the redesigned Managed Care Credit adoption, the working group could ask that the subcommittee estimate both the effectiveness of each Managed Care mechanism (and the corresponding discount factor) and the industry distribution of claim payment based on Exhibit 7 reporting. This estimation would require some speculation, which may be inaccurate once the NAIC collects and analyzes data in the future.

This work track would produce a brief discussion document with a corresponding workbook with the proposed Managed Care Credit data collection template and calculation. The subcommittee expects this work track to take approximately 18 weeks, given the complexity of the redesign.

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[3] This one-year time horizon would imply that contractual obligations and pricing are generally locked in for a year; however, the NAIC may consider (and request) an alternative time horizon

4. Next Steps

The subcommittee would like to discuss the timing of this work and data availability with the working group. The subcommittee would also like to discuss the approach for factor development—namely:

- Which schedules from the health blanks should be utilized for the Experience Fluctuation Risk calculation? Relatedly, is there any receptivity to either delaying the RBC calculation until the supplemental reports are filed or to accelerating the timing of when the supplemental reports need to be filed?
- Should the Managed Care Credit changes be included as part of this Experience Fluctuation Risk refresh or later, when data becomes available?

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Thank you for the opportunity to provide this response to the request of the working group to provide a work plan to perform an update for the Experience Fluctuation Risk calculations. Members of the subcommittee welcome the opportunity to speak with you in more detail and answer any questions you might have regarding this letter. If you would like to discuss this letter and its recommendations, please contact Matthew Williams, the Academy's senior health policy analyst, at williams@actuary.org.

Sincerely,

Derek Skoog, MAAA, FSA
Chairperson
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