



# AMERICAN ACADEMY *of* ACTUARIES

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November 26, 2003

To: Philip Barlow  
Chair, NAIC Life Risk-Based Capital Working Group

From: Alan Ford  
Chair, American Academy of Actuaries<sup>1</sup> Task Force on Health Risk-Based Capital

Re: BCBS Florida's Proposal on Active Life Reserves

As you are aware, the American Academy of Actuaries (Academy) Life Capital Adequacy Subcommittee has forwarded to the Academy's Task Force on Health Risk-Based Capital your working group's request for input on the proposal made by Blue Cross Blue Shield of Florida regarding the treatment in Life and Health risk-based capital (RBC) of certain health insurance policies where active life reserves are required to be held. The purpose of this letter is to provide the NAIC with an update on our analysis of this issue to date and our intended future progress.

The original RBC factors for health insurance products assumed implicitly that all actuarial reserves held by the reporting entity were appropriate and adequate. The RBC factors for medical insurance products were developed under this assumption without regard as to whether or not active life reserves were held. The more recent Academy projects developing updated RBC factors for disability income products and long-term care products have taken active life reserves into account.

In general, we believe it would be inappropriate to suggest that products for which active life reserves are required should automatically receive some form of relief within RBC relative to similar products for which active life reserves are not required. We also believe it would be inappropriate to draw an analogy between premium stabilization

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<sup>1</sup> The American Academy of Actuaries is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the actuarial profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice and the Code of Professional Conduct for all actuaries practicing in the United States.

reserves, which reflect client funds that the reporting entity can draw upon to cover underwriting losses, and active life reserves, which are a requisite consequence of the premium rating structure in place.

However, we also believe that there may be merit to BCBS Florida's proposal in the limited context of those health insurance products having active life reserves and for which there is an expectation at issue that regular premium increases will be necessary, such as major medical and Medicare Supplement policies, as opposed to disability income, specified disease or hospital indemnity policies, which are generally not priced anticipating rate increases.

The existing RBC factors for major medical and Medicare Supplement products were determined by modeling that assessed the capital needed to protect against ruin in adverse scenarios. It may be possible that including an active life reserve in that modeling would have resulted in a lower factor. For example, it may be the case that in the scenarios leading to ruin, the reporting entity would see a partial release of active life reserves into surplus, owing to differences between actual experience in the adverse scenarios and the assumptions underlying the calculation of those reserves. This would ameliorate the financial position of the reporting entity in the adverse scenarios, implying that the probability of ruin is less than it would be if active life reserves were not held.

To this end, BCBS Florida has agreed to perform new modeling work in conjunction with external actuarial consultants and provide our task force with the results thereof. The intent of this modeling would be to first replicate the modeling that led to the original RBC factors for major medical and Medicare Supplement products, and then integrate an active life reserve into that model to determine the impact on the factor. Our task force intends to review this modeling and use it to make a recommendation to the NAIC.

We understand that this modeling is to be completed early in the first quarter of 2004. Hopefully, this will provide our task force with sufficient time to review the methodology and results of the modeling and develop a recommendation prior to the March 2004 NAIC meeting.

I will not be attending the December 2003 NAIC meeting, but a representative of our task force will be present to answer any questions.

Cc: Julia Philips (Chair, NAIC Health Risk-Based Capital Working Group)  
Larry Gorski (Chair, AAA Life Capital Adequacy Subcommittee)  
Randy Kammer (BCBS Florida)