H2 – Underwriting Risk Component and Managed Care Credit Calculation in the Health Risk-Based Capital Formula – Final Report

Health Risk-Based Capital (E) Working Group

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Agenda

- Initial Request from NAIC's Health Risk-Based Capital (E) Working Group (HRBC)
- Six Areas of Focus by the Academy's Work Group
- Determination of Work Tracks (3)
    - Track 1: HRBC XR013/XR014 (Experience Fluctuation Risk) Redesign
    - Track 2: Develop Tiered-RBC Factors
    - Track 3: Redesign HRBC Pages XR018/XR019 (Managed Care Credit)
- Overview of Findings and Results
- Next Steps

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Initial Request from NAIC's HRBC

- On April 23, 2021, the NAIC's HRBC requested assistance from the Academy's Health Solvency Subcommittee to perform a **comprehensive review of the H2 – Underwriting Risk component** and the **managed care credit (MCC) calculation** in the health RBC formula.
- While there have been modifications to certain pieces of the H2 – Underwriting Risk Component, there has not been a comprehensive review of the component and the MCC calculation performed since the formula's inception in 1998.
- Because of the evolving and changing health market over the last 23 years, the HRBC believed a review of the lines of business, methodology, and factors for the H2 – Underwriting Risk component was warranted.

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Six Areas of Focus by the Academy

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 MCC 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

Source:
American_Academy_of_Actuaries_H2_Review_Underwriting_Risk_Report_01.21.2022

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Determination of Work Tracks

Three “Work Tracks” were created to support areas of focus #1 through #5:

- **Track 1:** HRBC XR013/XR014 (Experience Fluctuation Risk) Redesign
- **Track 2:** Develop Tiered-RBC Factors
- **Track 3:** Redesign HRBC Pages XR018/XR019 (MCC)

For area of focus #6, the Work Group suggested that an analysis of LTCI be referred to the NAIC’s Life Risk-Based Capital (E) Working Group (LRBC), given LTCI’s prevalence on the Life/Blue Blank.

Overview of Findings and Results

- The final report describes the Work Group's analysis of those recommendations and their findings.

- The Academy's Work Group defers to the NAIC's decision on whether to adopt any of the results presented in the report after it determines the extent to which the results are aligned with its philosophy on health risk and solvency.

Track 1: HRBC XR013/XR014 (Experience Fluctuation Risk) Redesign Recommendations

- Update HRBC forms XR013/XR014 (Experience Fluctuation Risk) by including columns for Commercial Individual, Commercial Group, Medicare, and Medicaid, rather than grouping these lines of business as Comprehensive Major Medical (CMM). This would align with Page 7, "Analysis of Operations," of the Annual Statement.

- Consider adjusting the risk calculation in two ways in the future, consistent with the structure of the Property and Casualty (P&C) premium risk calculation:
  - Display the risk factors in line with how the business is typically measured and managed (e.g., in claims and expense ratio-based terms);
  - Utilize company-specific loss and expense ratio information to refine the risk calculation.

Track 2: Develop Tiered-RBC Factors

- The Work Group analyzed 10 years of reporting data from Health Annual Statements and RBC reporting to generate risk factors at various risk percentiles/safety levels and time horizons.
- The lines of business were expanded to be more granular and consistent with the current health insurance product landscape.
- Premium tier cut-offs were increased, consistent with health trends and growth in the health economy since the 1990s.
- The final generated tiered RBC risk factors were developed at multiple time horizons and risk percentiles/safety levels for review by the NAIC.

Disclaimer: The Academy's Work Group defers the ultimate categorization of line of business/market and selection of risk factors to NAIC regulators and other decision makers, as the final judgment and selection of factors require several additional considerations (e.g., desired risk tolerance) that are outside the purview of this Work Group.

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Track 3: Redesign HRBC Pages XR018/XR019 (MCC)

The Work Group found that the existing MCC categories are not sufficiently detailed:

- The nature of insurer/provider relationships has evolved significantly over the past 25 years since the existing categories were developed.
- While fee-for-service payments are still common, there has been a significant increase in risk-sharing arrangements, particularly for government (i.e., Medicare and Medicaid) lines of business.
- As well, insurance carriers have continued to move providers toward risk-based and value-based contracts as providers' risk tolerances have grown. Frequently, this has led to improvements in member medical management and increasing insurer predictability of claims costs.

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Track 3: Redesign HRBC Pages XR018/XR019 (MCC)(cont.)

- The Work Group proposes changes to Exhibit 7 – Part 1 – “Summary of Transactions with Providers,” which considers emerging provider contracting approaches.
- The Work Group plans to study the impact these arrangements have on claim volatility in future years to develop a revised MCC methodology.

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Next Steps

Immediate next steps, contingent on the NAIC's approval:

- Finalize line of business (LOB)/market categories and determine risk factors at NAIC-desired risk tolerance and time horizon
- Measure LOB and company-specific impact analysis of results
- Determine cadence of future risk factor updates
- Propose a five-year review cycle
- Propose timeline to produce revised MCC methodology

Questions?

For more information, please contact

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