

# 2016 Annual Meeting

## Actuaries' Club of the Southwest & Southeastern Actuaries Conference

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### Whispers from the Annual Statement

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# Orange Blank – History & Basics

- Prior to the mid-2000s, companies writing medical/dental coverage might have filed one of several different NAIC blank types, depending on how the company was organized:
  - Orange (HMO)
  - Blue (Life/A&H)
  - White (HMDI, e.g., many BCBS Plans)
  - Red (LHSO, e.g., prepaid dental service organizations)
  - Yellow (P&C, e.g., some BCBS Plans)
- With the introduction of the “Health Statement Test”, all companies whose predominant business is medical/dental file the revised Orange (Health) blank
- This has facilitated the ability to use the Orange Blank as a consistent source of competitive intelligence
- Caveat emptor: Comparability of data (or disclosures) across companies sourced from Orange Blank is far from assured

# Potential Uses of Orange Blank for “Competitive Intelligence” Purposes

- Early-stage M&A
  - Understanding the potential target prior to getting access to a data room
  - Confirmatory source for data room information
- Developing an understanding of a new client
  - Audit actuary
  - Consulting actuary
- Understanding one’s competitors
  - Reported financial results (at a more granular level)
  - Glimpses into their accounting policies

# Sources of General Company Information

- Jurat Page
  - Field for “Licensed as Business Type” (e.g., HMO, Life/A&H)
- Schedule T
  - Lists the states in which company is licensed
  - Lists the written premium by state
  - But, be careful in drawing inferences! Just because a company is licensed in a state and reports premiums in that state doesn’t necessarily mean it is, or ever has, issued products in that state!
- Schedule Y Part 1
  - Corporate organization chart
- Note 3 (Business Combinations)

# Sources of Line-of-Business Financials

- Analysis of Operations by LOB
  - Defined lines of business:

Comprehensive Medical	Medicare Supplement
Federal Employees Health Benefit Plan	Dental Only
Vision Only	Title XVIII (Medicare Advantage)
Title XIX (Medicaid excluding SCHIP)	Other Health (e.g., Part D, stop loss, LTD/LTC)
Other Non-Health (e.g., life/P&C)	

- Choice of lines of business reflects the needs of the early 2000s when the current Health blank was built to replace the existing blanks (and the Health Statement Test was adopted)
- No decomposition here between group and individual
- No decomposition here by geography
- Full income statement down to underwriting gain (so, no allocation of income taxes by LOB)

# Sources of Line-of-Business Financials

- “State Pages” (Exhibit of Premium, Enrollment, and Utilization)
  - Same Health LOBs as the Analysis of Ops, except Comprehensive is split into Individual vs Group
  - Enrollment by quarter
  - Annual premiums, both written and earned
  - Annual claims, both paid and incurred
- Exhibits that might be harder to get one’s hands on:
  - Supplemental Health Care Exhibit
  - Accident & Health Policy Experience Exhibit
  - Medicare Supplement Experience Exhibit
  - Medicare Part D Coverage Supplement

# Risk-Based Capital

- Each company's HRBC Report is filed confidentially with regulators and is not publicly available
- However, the key results from the HRBC filing are reported on the Five-Year Historical Page
  - Total Adjusted Capital
  - Authorized Control Level RBC
- Some ability to reverse-engineer HRBC from data in the Orange Blank, particularly using Exhibit 7 Part 1 (Summary of Transactions With Providers)
  - Decomposition of claims expense into the buckets used in HRBC to determine Managed Care Credit (capitation, FFS, contractual, etc.)
  - How consistent are carriers' approaches for mapping to buckets?

# Limited Insights into ‘Actuarial’ Accounting Policies

- Level of prudence in unpaid claim liabilities
  - Prospective – no relevant disclosure
  - Retrospective –
    - Note 25 – No standardized reporting
    - U&I Exhibit Part 2B
- LAE/CAE liability
  - Liability is found on page 3 line 3
  - Paid-basis CAE & claims over time summarized on Five-Year Historical Exhibit
- Premium deficiency reserve
  - Note 30 lists the PDR (if any) but discloses almost no interesting information about how it was calculated
  - If a company materially changed its PDR policy during the year, might that require an entry on page 5 line 35 (“change in valuation basis of aggregate policy reserves”)?

# Other Financial Statement Notes that May (or May Not) be Useful/Interesting

- Note 1 – Summary of Significant Accounting Policies
- Note 2 – Accounting Changes and Corrections of Errors
- Note 10 – Information Concerning Parent/Subs/Affiliates
- Note 22 – Subsequent Events
  - ACA Health Insurer Fee disclosure here
- Note 24 – Retrospectively Rated Contracts and Contracts Subject to Redetermination
  - 24E – disclosures related to ACA 3Rs
- Note 28 – Health Care Receivables
- Note 31 – Anticipated Salvage and Subrogation

# Use of Annual Statement Information – Regulatory Examination Actuary’s Perspective



# Regulatory Actuary's Use of Annual Statement Information

- Financial monitoring
  - Annual / quarterly analysis
  - Periodic financial examination (3 to 5 years)
    - Risk-focused approach
    - Actuary is part of examination team with focus on reserving risk, underwriting risk and reinsurance issues
    - Approach: identify areas of significant residual risk and determine if further action is warranted (recalculation/restatement of reserves, other regulatory action)
- Rate Review
  - Check reasonableness of rate filing information
    - MLR, Supplemental Health Care Exhibit
- Review of company's license application

# Information Used from Annual Statement Blank?

Assets page	Liabilities, Capital and Surplus
Statement of Revenue and Expenses	Cash Flow
Analysis of Operations by line of business	Underwriting and Investment Exhibit – Part 1, 2, 2A, 2B, 2C, 2D, 3
Exhibit 1 – Enrollment by Product Type for Health Business Only	Exhibit 2 – Accident and Health Premiums Due and Unpaid
Exhibit 3, 3A – Healthcare Receivables	Exhibit 4 – Claims Unpaid and Incentive Pool, Withhold and Bonus
Exhibit 7 – Summary of Transactions with Providers and Intermediaries	Notes to Financial Statement
General Interrogatories – Part 1, General; Part 2 - Health	Five-Year Historical Data
Exhibit of premiums, enrollment and Utilization (state page)	Schedule S – Reinsurance
Schedule T – Premiums and other considerations	Statement of Actuarial opinion and accompanying actuarial memorandum

# Supplemental Information Used

## Annual Statement Supplements:

- Supp 12: Medicare Supplement Insurance Experience Exhibit
- Supp 18-21: Long-Term care experience reporting forms
- Supplemental Health Care Exhibit
- Accident & Health Policy Experience Exhibit
- Medicare Part D Coverage Supplement
- Management's Discussion and Analysis (MD&A)

## Other Information:

- Business plan – includes budget projections
- Risk-based capital (RBC) report
- Rate filing

# Understanding the Landscape : Company Overview

- Review company experience:
  - *Five Year Historical Data*
  - *Analysis of Operations by Lines of Business(ANOPS), Statement of Revenue and Expenses*
    - New lines of business, changes in distribution of business by line?
    - Significant changes in experience for specific lines?
    - Calculate loss ratios, expense ratios, premiums PMPM, claims PMPM
      - Compare to prior years, industry averages, peer company averages
  - *Exhibit 1 – Enrollment by Product Type for Health Business Only*
    - Major changes in products offered?
  - *Exhibit of premiums, enrollment and utilization*
    - Significant changes in membership, premiums, inpatient admissions?
      - By LOB, individual vs group.
- RBC report – look for changes in relative weight of RBC charges by category

# Actuarial Assets

Concern/risk: Assets included in the scope of actuarial opinion are materially overstated

- Assets – Page 2, Contra liabilities, Page 3
- Includes:
  - Healthcare receivables – *Exhibit 3, 3A*
  - Medicare Pt D, Medicare Advantage risk-sharing receivables – *U&I Exhibit, Part 2D*
  - ACA receivables - *Note to Financial Statements # 24*
- Consider:
  - Potential variability of each asset
  - Materiality - Potential impact on surplus position, RBC
  - Collectability
  - Reasonableness of actuarial methods and assumptions - *Actuarial Memorandum*

# Actuarial Reserves

Risk: Actuarial liabilities/reserves are materially understated

- Page 3: *Liabilities, Capital and Surplus*, includes all reserves/liabilities included in *Statement of Actuarial Opinion*:
  - Claims unpaid
  - Accrued medical incentive pool and bonus payments
  - Unpaid claims adjustment expenses
  - Aggregate Health Policy Reserves - *U&I Exhibit, Part 2D*
  - Aggregate Life Policy Reserves
  - Property/Casualty Unearned Premium Reserve
  - Aggregate Health Claim Reserves
  - Any Other Loss Reserves, Actuarial Liabilities, or Related Items Presented as Liabilities in the Annual Statement

# Actuarial Reserves, Cont'd

- Are the actuarial reserves appropriately calculated?  
Consider:
  - Comparison to state, peer company, national averages
  - Historical estimates vs. actual (hindsight analysis)
  - Inherent volatility of liability
  - Recent change in product offerings, lines of business – *ANOPS*, *MD&A*
  - Change in company experience: loss ratios, claims PMPM
  - Operational changes
  - Change in external environment, e.g., regulatory changes
  - Reasonableness of actuarial methods and assumptions in the Actuarial memorandum
- Are all appropriate reserves established?
  - Premium deficiency reserve
  - Future contingent benefits

# Unpaid Claims Reserves

Reasonableness of unpaid claims – retrospective review

- *Five Year Historical Data* – total deficiency/redundancy of unpaid claims reserve for the last 5 years
- *U&I Exhibit – Part 2B*
  - Review deficiency/redundancy by LOB over time
  - Are there deficiencies in specific LOBs even if there is an overall redundancy?
  - Must be careful when using for companies with significant healthcare receivables (e.g. Medicare Advantage)
- *U&I Exhibit – Part 2A*
  - Review history of unpaid claims by LOB, broken down by:
    - In process of adjustment – may indicate change in backlog levels
    - IBNR
    - Amounts withheld from paid claims and capitations
  - Does the current year's unpaid claims estimate reflect adjustments made based on prior years' experience?

# Unpaid Claims Reserves, Cont'd

Reasonableness of current year's unpaid claims

- Review changes since the prior year which may impact the calculation
  - Provider agreement types: *Exhibit 7 – Summary of Transactions with Providers and Intermediaries*
  - LOBs, type of products offered: *ANOPS, Exhibit 1 – Enrollment by product type for health business only*
  - Backlog: Estimate average number of days of claims in process. Compare to national, state, peer company averages
- Reasonableness checks:
  - History of unpaid claims as % of total incurred claims, by quarter
  - Loss ratios - paid and incurred basis
- Offsets
  - Reinsurance – is magnitude appropriate?
    - Collectability issues- schedule S
    - Recovery PMPM – schedule S
  - Actuarial assets/contra liabilities

# Premium Deficiency Reserve (PDR)

*Page 3, line 4; U&I Exhibit – Part 2 D; Note to Financial Statement # 30*

- Indication of underpricing
- Hints that a PDR may be needed
  - History of significant total underwriting losses
  - History of significant underwriting losses for specific LOBs
  - History of regular cash infusions to maintain RBC levels
  - Lower PMPM premiums compared to state, peer company averages
  - History of high loss ratios compared to state, peer company averages
- May be established/re-valued mid-year

# Actuarial Memorandum

- Arguably the most important part of the annual statement filing from an examination actuary's perspective
- Contains proprietary information and is held confidential
- Must include both narrative and technical components which conform to the documentation and disclosure requirements of ASOP 41 and other applicable ASOPs
  - Excellent documentation could avoid costly, time-consuming recalculation of actuarial items

# Asset Adequacy for Health Company Using Information from the Orange Blank



# Asset Adequacy Testing for a Health Company?

- Actuarial Opinion and Memorandum Regulations (AOMR) - revised
- Life, Accident & Health Insurers that file the Blue Blank – States where revised AOMR adopted
- Health Insurers that file an Orange Blank – varies by state (e.g., Illinois, Florida, Alaska, etc.)

# Guidance to Review

- Statutory Accounting Principles
  - SSAP #54 – Individual and Group Accident and Health Contracts
    - Section 25 (b)– Additional reserves required based on asset adequacy analysis as discussed in Appendix A-822
- Actuarial Standards of Practice
  - No. 28 – Statements of Actuarial Opinion Regarding Health Insurance Liabilities and Assets (3.12)
    - “This standard does not obligate the actuary to undertake evaluation of the adequacy of the assets supporting the stated liability amount except as may be needed to comply with any applicable law, regulatory requirement, or other ASOP.”
    - “Guidance on statements of opinion based on asset adequacy analysis is provided in ASOP No. 22”
  - No. 22 – Statements of Opinion Based on Asset Adequacy Analysis by Actuaries for Life or Health Insurers (pg. v)
    - “Actuaries performing work for health benefit plans such health insurers, health service plans, and HMOs should note that this standard potentially applies to each of these types of plans. Applicable law will determine for which of these types of plans an appointed or qualified actuary is required to submit a statement of actuarial opinion based on asset adequacy analysis subject to this standard.”

# Methods

- ASOP No. 22 - 3.3.2 Analysis Methods
  - “A number of asset adequacy analysis methods are available to, and used by, actuaries. The most widely used method is cash flow testing (see ASOP No. 7). Cash flow testing is generally appropriate where cash flows of existing assets, policies, or other liabilities may vary, or where the present value of combined asset, liability, or other cash flows may vary under different economic or interest-rate scenarios.”
  - “Asset adequacy analysis test methods other than cash flow testing may be appropriate in other situations... *These methods would test moderately adverse deviations in the actuarial assumptions, except for the investment rate-of-return assumptions.*”

# Methods

- ASOP No. 22 - 3.3.2 Analysis Methods
  - Gross Premium Valuation
    - A gross premium valuation may be appropriate where the policy and other liability cash flows are sensitive to moderately adverse deviations in the actuarial assumptions underlying these cash flows, but are not sensitive to changes in interest rates.
  - Loss Ratio Methods
    - For short-term health insurance business that tends to be supported by short-term assets, loss ratio methods may be appropriate.
  - Demonstration of Extreme Conservatism
  - Risk Theory Techniques
  - Product Design Limitations

# Questions & Contact



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