

Southeastern Actuaries Conference

Codification and other NAIC
Health Topics

June 22, 2001

James P. Galasso, FSA, MAAA

Actuarial Services & Financial Modeling, Inc.

Topics

- Overview/Reference Documents
- NAIC Health Reserves Guidance Manual
- Statutory Accounting Principles (SAP) Working Group

Overview / Selected Resource Documents

- NAIC's Statutory Accounting Principles (SAP)
 - NAIC's SAP Working Group (SAPWG)
 - NAIC's Emerging Accounting Issues Working Group (EAIWG)
- NAIC Accounting Practices and Procedures Manual (March, 2001)
- NAIC Health Reserves Guidance Manual
 - The Primary Source Document (for this presentation)
 - Available from the NAIC
- SAPWG (3/26/2001 Hearing Agenda)
 - Topics of concern/discussion
 - Health Care Receivables (Issue Paper #107)

NAIC Health Reserve Guidance Manual

- Manual is specific to statutory accounting (i.e. not necessarily GAAP)
- Addresses the following areas:
 - Claim Reserves
 - Contract Reserves
 - Provider Liabilities
 - Premium Deficiency Reserves
- Excellent source for reference materials

Claim Reserves

- Definition = “...an entity’s contractual obligation to pay benefits, as of a specified date (the ‘valuation date’)”
- Reserve/Contract Types (Covered by Manual)
 - Medical Insurance Contracts
 - Stop Loss Contracts
 - Disability Income Contracts
 - Long Term Care Contracts
 - Extension of Benefits
 - Loss Adjustment Expenses

Claim Reserves – Calculation Methodologies

- Development Methods
- Tabular Methods
- Exposure Methods
- Loss Ratio Methods
- Case Reserve (or, Direct Enumeration) Methods

Claim Reserves - Conservatism

- The NAIC Guidance Manual supports the position that varying degrees of conservatism may be appropriate and that such conservatism may be explicit or implicit.
- The Securities and Exchange Commission (and, thus, many accounting firms) is beginning to question the appropriateness of reserve margins.
- Theoretically, Statutory Reserves may differ from GAAP Reserves (but, in practice, differences for one-year term medical insurance contracts are quite rare)

Contract Reserves

- Definition = “...a reserve set up when a portion of the premium collected in the early years is meant to help pay for higher claim costs arising in later years.”
- Where Required (Covered by Manual)
 - Individual Disability Income
 - Long Term Care
 - Issue age-rated medical policies
- NAIC’s Health Insurance Reserves Model Regulation specifies minimum standards

Provider Liabilities

- Definition = an “...obligation to make future payments to providers under some form of risk-sharing arrangement.”
- “Risk-sharing arrangement” is further defined as:
 - “...payment not related to a specific service performed by that provider, and
 - “...payment is contingent upon certain financial or operational goals being achieved.”
- Manual currently limited to medical insurance, but other coverages will be added.

Provider Liabilities – Calculation Methodologies

- Can calculate on seriatim or aggregate basis
- Follow-up studies should test adequacy
- Consider Impact of claim reserve estimates (i.e. “reverse margin correlation”)
- Consider stop-loss provisions
- Alternative calculation methods include:
 - Use pricing assumptions to estimate expected provider payments
 - Use Loss Ratios to estimate financial target incentives
 - Reserve withholds based on historical experience

Provider Liabilities – Various Risk-Sharing Provisions

- Payments contingent on financial results – usually based on a target cost per member or a loss ratio
- Stop-loss – when a portion of a catastrophic claim remains with the carrier, the associated liability estimate should be included in the carrier's claim reserves
- Payments contingent on operational goals – such goals are often expressed as the number of hospital days per 1,000 members per year
- Withholds – Note: statutory guidelines may require that withhold associated liabilities be held as part of the claim reserves
- Liability for settlement admin expenses – Manual suggests that the admin expenses associated with accrued but unpaid provider liabilities should be established as a liability

Premium Deficiency Reserves (“PDRs”)

- Definition = “...a reserve that is established when future premiums and current reserves are not sufficient to cover future claim payments and expenses for the remainder of a contract period.”
- “Contract period” may involve judgment as to such items as lapsation and regulatory rating limitations.

PDRs – Sources for Help (Confusion?)

- NAIC Health Insurance Reserves Model Regulation (NAIC Model 010)
- Individual and Group Accident and Health Contracts (NAIC SSAP No. 54)
- When to Do Cash Flow Testing for Life and Health Insurance Companies (ASOP No. 14)
- Financial Accounting and Reporting by Providers of Prepaid Health Care Services [AICPA Audit and Accounting Guide: Health Care Organizations (5/1/99, Chapter 13)] – **NOTE:** This presents GAAP vs STAT standards

PDR – The Basic Components

The PDR calculation can be expressed as the present value* (as of the valuation date) of:

$$C_p + (V_{\text{end}} - V_{\text{beg}}) + \text{Exp} - P_e$$

Where:

C_p = Claims paid during deficiency period

V_{end} = Total reserves at end of deficiency period

V_{beg} = Total reserves at beginning of deficiency period

Exp = Admin expenses charged to deficiency period

P_e = Premiums earned during deficiency period

* Interest rate used for present value should reflect that appropriate to the business for the time period under review.

PDR – Other Considerations

- PDRs should be reviewed at least annually with interim adjustments as deemed appropriate and necessary
- PDRs should be determined for distinct contract groupings which may reflect product type, case size, geographical rating area, etc.
- Surpluses from one contract grouping may not offset the deficiencies of another contract grouping
- The Guidance Manual leaves open (but slightly discourages) the application of future expected rate increases during the deficiency period as an offset to prior losses incurred during the deficiency period
- The Guidance Manual suggests that documentation of the actuaries analysis be available even if a PDR is not required

PDR – Other Considerations (Cont'd)

Administrative expense considerations include:

- Admin expenses should represent a “reasonable” allocation of an entity’s expenses
- Certain expenses (e.g. new business installation) may not be applicable to a particular contract grouping
- If other business segments can cover overhead, the admin expense allocation can reflect only direct costs

SAP Working Group
Issue Paper No. 107

- The Issue – Codification states that only assets specifically identified as admissible shall be “Admitted” for Statutory Accounting. All other assets must be treated as “Non-Admitted”
- But . . . for example, government plan receivables and provider receivables are not specifically identified as admissible

SAP Working Group
Issue Paper No. 107 (Cont'd)
Government Receivables

- Insured Programs (e.g. Medicare Risk, Medicaid Risk, CHAMPUS, FEHBP)
- Uninsured Programs (e.g. Medicare intermediary)

SAP Working Group
Issue Paper No. 107 (Cont'd)
Provider Receivables

- Pharmacy Rebates
- Claim Overpayments
- Coordination of Benefits
- Capitation receivables
- Risk sharing receivables
- Right to offset liabilities with provider loans/advances