Financial Reporting in Healthcare

Southeastern Actuaries Conference

DANNY MOORE, FSA, MAAA, CERA
Vice President & Principal, Lewis & Ellis, LLC

June 10th – 12th, 2025

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How to become an Appointed Actuary?

Requirement: State DOI's and NAIC require every insurance company to have an assigned Appointed Actuary.

Designation: Board designates an Appointed Actuary

Strict Qualification standards need to be met:

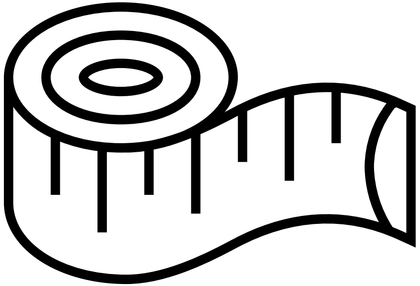
- American Academy of Actuaries membership (Pay dues)
- Credentials and experience in general and specific product lines requiring 6-10 years
- Continuing education requirements
- Good standing with the American Academy of Actuaries
- Compliance with ASOPs and Precepts

Appointed Actuary is responsible for evaluating company's actuarial* assets and liabilities to determine adequacy and sufficiency to meet its obligations to the policyholders.

*Actuarial Nature determined by ASOPs, State DOIs, SOA and NAIC.

How do you know if you are qualified to sign?

- Review the U.S. Qualifications Standards
- Do I have 3 years related experience?
- "Look in the mirror test"
- Internal documentation of qualification standards and CE credits is necessary upon request by AAA, ABCD, auditors, etc.
- State regulations may require further attestation of no adverse professional disciplinary actions, fraud, etc. in the prior 3-5 years



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Sources of guidance and governance

Guidance:

- NAIC guidelines for relevant blank (Blue and Orange)
- Standard Valuation Law (Valuation Manuals)
- Actuarial Standards of Practice (ASOPs)
- American Academy of Actuaries practice notes
- State specific regulation (Holiday letters)
- Precepts (professional code of conduct)
- FASB (Financial Accounting Standards Board)

Governing bodies:

- State Examiners
- Actuarial Standards Board and ABCD
- IRS, SEC
- Society of Actuaries and American Academy of Actuaries
- External Auditors and Internal Auditors

Risks to Actuaries

Actuarial Board for Counseling and Discipline (ABCD) Committee is responsible to work with State DOIs to take any disciplinary actions which may include criminal charges, removing credentials etc.

In 2021, Some of the Material Violations Alleged:

1. *Using unreasonable, overly optimistic assumptions and setting unrealistic reserve*
2. *Using assumptions for loss development factors (Claim reserves) and initial expected loss ratios that were biased toward underestimation in violation of ASOP 43*
3. *Advising actuarial employees to disregard standards of practice and predominantly focusing on financial outcomes when selecting assumptions over utilizing best estimates*
4. *Failure to appropriately document work and identify data, assumptions, and methods.*
5. *Seeking clients' objectives without regard to satisfying applicable laws, regulations, and actuarial standards of practice.*

Dispositions	TOTAL
Dismissed	414
Dismissed With Guidance	105
Counseled	84
Mediated	12
Recommended Private Reprimand	7
Recommended Public Discipline	48
Request for Guidance	1,631
Total	**2,301**

Appointed Actuary responsibility to each authority

Overall accounting rules

GAAP

Reg Body: SEC and FASB

GOAL

Best estimate timing and recognition of future premiums and incurred claims when they accrue.

Risks to Company: <u>Over reserving</u> may prompt additional rates causing <u>SEC, CMS and State intervention, fines, criminal charges and bad news for stocks.</u>

STAT

Reg Body: STAT DOI

GOAL

Requires reserves to be good, sufficient and adequate and that support assets are managed to provide appropriate cash when liabilities are incurred for policyholders.

Risks to Company: <u>Under reserving</u> may cause <u>STATE DOI Board finding, Penalties, Management changes or Takeover.</u>

TAX

Reg Body: IRS

GOAL

Defines unpaid losses and reserves to be fair and reasonable based on facts and company experience for higher taxes. Typically set as % of GAAP.

Risks to Company: <u>Over reserving</u> may cause IRS fines and backdating, potential to stop new business due to under payment of taxes.

Best Estimate (BE) = **Ensure compliance with all, have documentation and balance BE with adequacy and sufficiency** = Best Estimate (BE)

Four types of opinion and impacts

Unqualified Opinion

- Reserves are sufficient, all good!

Qualified Opinion

- Cashflow testing scenarios are concern or retrospective analysis show deficiency with no explanation
- Reserves for certain items are in question –cannot be reasonably estimated or unable to render opinion on those items.
- IMPACT: State DOI intervention and finding to the board

Adverse

- Reserves are deficient and additional reserves were not added.
- IMPACT: State DOI takeover, Management changes, Actions prescribed for the board

No Opinion or Inconclusive

- Deficiency or limitation of data, assumptions and analysis
- IMPACT: State DOI takeover, Management changes, Actions prescribed for the board

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OPINION SECTION - CONSIDERATIONS

- Usual for the actuary to discuss the process leading to the conclusion that the amounts being opined upon (including any $0 items) are reasonable, and when viewed in aggregate, are good and sufficient.
- Might include support, such as an exhibit with best estimates and booked amounts to demonstrate the overall provision for adverse deviation, or margin, across the amounts opined upon, or a volatility analysis.
- Might describe the thought process behind the good and sufficient conclusion, including discussion of what the range of the assets and liabilities could be under moderately adverse conditions, including a discussion of any interactions.
- The actuary should provide enough details to convince the reviewer that it is a reasonable conclusion that the amounts booked will be sufficient under moderately adverse conditions.

RELEVANT COMMENTS

Explain a zero or non-zero that is not obvious to the intended audience.

Clearly state items that cause the opinion to be qualified.

Reasons for not following prescribed language

Language required by state law or regulation.

Description of any material changes in methodology.

Description of major uncertainties (e.g., risk adjustment)

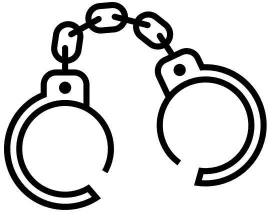
Factors that had a significant impact on your opinion.

Significant data issues.

Address topics of regulatory importance.

Subsequent events

NAIC ANNUAL STATEMENT INSTRUCTIONS – ACT MEMO



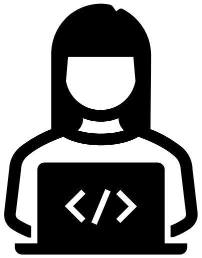
- **Instruction Limitations:**
  - Instructions are general in nature.
  - Not detailed enough to ensure consistency across actuaries.
  - Focus of the instructions is Unpaid Claims Liabilities
  - They do not adequately address all actuarial liabilities and assets that could be included in the SAO.
  - Actuaries must determine what should be included in the Actuarial Memorandum.
- **The Actuarial Memorandum should contain BOTH narrative and technical components.**
  - Narrative Component - Intended for non-actuaries, such as company management, the Board, and regulators with non-technical backgrounds
  - Technical Component - Intended for health actuaries, and regulators with more technical and/or financial backgrounds.

NARRATIVE COMPONENT

- Per ASI, "should provide ***sufficient*** detail to clearly explain to company management, the regulator, or other authority the findings, recommendations and conclusions, as well as their ***significance***."
- Sufficient – Includes a qualitative aspect to it requiring judgment by the actuary.
- Significance – Might take into consideration:
  - The magnitude of an actual recorded amount.
  - Potential for significant variability in the amount.
  - Complexity with determining any amount.
  - Importance to financial position.

NARRATIVE COMPONENT

- **Findings should be explained for each of the Scope items of the Opinion.**
  - Could be necessary to explain an amount of $0, e.g. PDRs
  - Explain a zero or non-zero that is not obvious to the intended audience.
  - Noting materiality of changes could be beneficial and notable in the Scope/Significance section.
- **Might consider including a detailed explanation of any estimate:**
  - That requires substantial judgment.
  - That is difficult to estimate.
  - For which the probable variance in the actual outcome versus the estimate has significant implications on reported income or company solvency/surplus.



TECHNICAL COMPONENT

- Per ASI, "should provide ***sufficient*** documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component ***must*** show the analysis from the ***basic data***, (e.g., claim lags) to the conclusions."
- Sufficient – Could mean that after reading the Act Memo, the reviewer has no more questions and the Act Memo has made it clear how the appointed actuary has come to his or her conclusions.
- Significance – Interpretation might be required. However, the language states an expectation that significant detail will be provided with regard to the basic data, along with how that data is used in drawing conclusions in order to allow for another actuary practicing in the same field to evaluate the work. (could provide both PDFs and XLS files)

Actuarial in Nature Assets and Liabilities

Liabilities

- Incurred but not reported reserves (Lag triangles)
- Non-Lag (Below The Line) items (capitation, bonus etc.)
- Provision for Adverse Deviation
- Premium Deficiency Reserve testing
- Pharmacy Rebates
- ACA, Medicare and Medicaid Liability accruals:
  - Risk Adjustment Accruals
  - Risk Corridor
  - MLR Rebates
- Other State liabilities (LICS, Federal reinsurance etc.)

Action Items

- ✓ Retrospective study
- ✓ Assumption development and review
- ✓ Reconciliation against ledger
- ✓ Margin study and appropriateness
- ✓ Sensitivity and adverse deviation testing and comments
- ✓ Source of assumption development and documentation
- ✓ Articulation of methodology and compliance
- ✓ Presentation of results

Assets

- ACA, Medicare and Medicaid Asset accruals:
  - Risk Adjustment Accruals
  - MLR Rebates
- Asset adequacy testing and reinsured business review
- Gross Premium valuation as required by states
- Asset/investment review including duration, quality of assets and type of assets.

Claims Unpaid

Importance of Claims Liability Estimates

- **One of the Largest Balance Sheet Entries**
  - Annual Statement Balance Sheet – Unpaid Claims Liability
  - Well-documented industry standards and modeling practices
  - Auditor/Examiner concerns due to degree of “actuarial judgement”
- **Affects observed level of Incurred claims that lead to decisions in**
  - Pricing
  - Care Management
  - Product Portfolio
  - Incentive metrics
- **Used to settle contractual and Statutory obligations**
  - Provider incentives
  - Minimum Loss ratios

Claims Unpaid
Aggregation

1. Combine Business with Similar Experience
   a. Payment Patterns (Completion Factor)
   b. Cost and Utilization (PMPM)

2. Reporting Requirements

3. Credibility

Claims Unpaid

Methods used in Calculation

- **Development Method**
  - Infers future payments for a given service date from observed level of claims paid so far
  - Most common approach referred to as “triangle”, completion, chain-ladder models
  - Works best with a high volume of relatively uniform ***claims payment patterns*** for which we have historical data to populate models
  - Often used for later duration months, with more “run-out”
- **Trended PMPM (Per Member Per Month) Method**
  - Independent of claims already paid, assumes an ultimate level of claims based on past experience
  - Used to supplement Development method for early duration months
  - Works best with a high population of relatively ***consistent morbidity*** for which we have historical data to populate models
- **Case Rate**
  - Often used with high-cost, low volume claims
  - Seriatim case listing with an estimated cost per case applied
  - Works well with DRGs, authorizations, and large case management
  - Pitfalls – claims listing can be incomplete, case estimates are variable
  - Strength – better for claims too variable for lag-based development
- **Loss Ratio or Book-to-Budget**
  - Often used when there is limited historical data or pattern
  - Applying a pricing or budgeted LR against premiums or exposure
  - Pitfalls – if revenue turns out insufficient, so is liability….. self-perpetuating error
  - Strength – often the only information available early in a program

Risk Adjustment

ASOP 45

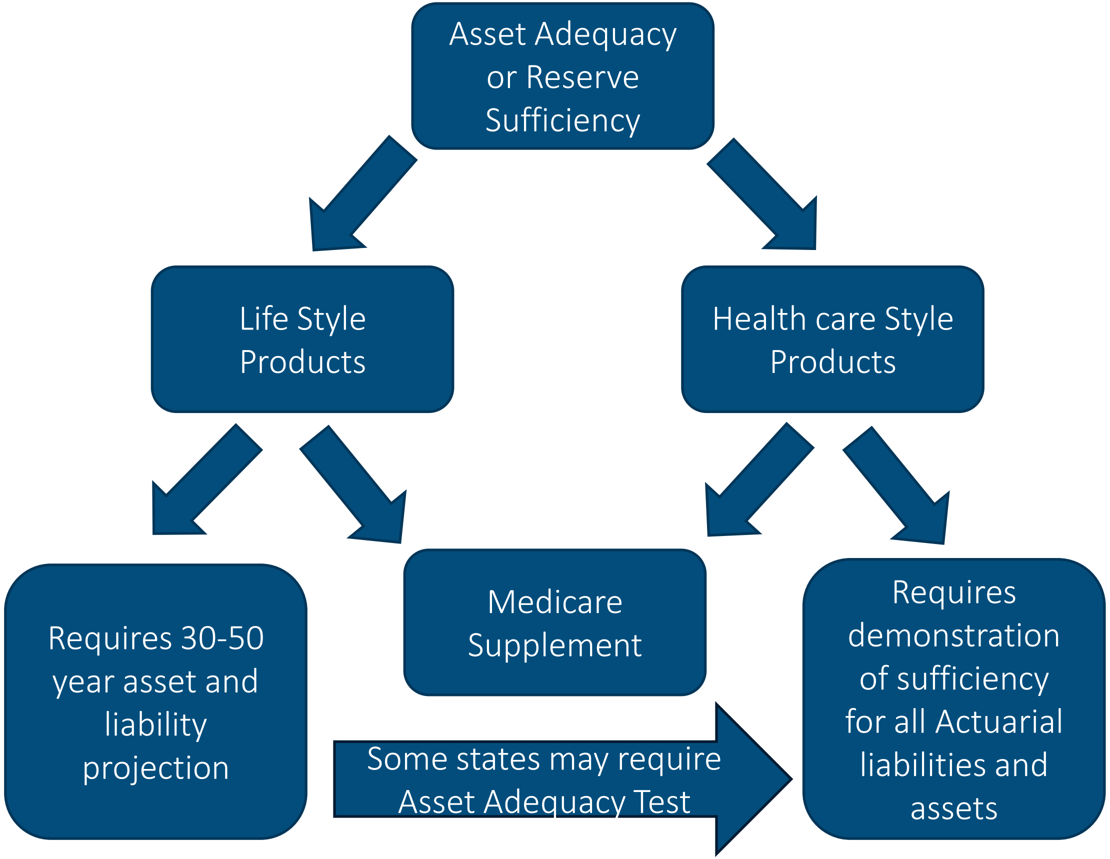
- "Risk Adjustment [is] the process by which relative risk factors are assigned to individuals or groups based on expected resource use and by which those factors are taken into consideration and applied."

- In ACA and some Medicaid Markets, funds are transferred from insurers with lower-risk, lower-utilizing, populations to insurers with higher-risk, higher-utilizing populations.
  - Goal is to stabilize the market and allow for healthy market competition
  - The transfers are budget neutral overall
- In Medicare Advantage, government populations are based on risk level of the population which has a delay in data collection to ensure all diagnosis data is collected; This results in revenue settlements after the year-end valuation date

Asset Adequacy

To demonstrate that sufficient reserves are set for liabilities, below are methods used:

1. Determine Reserves and Assets are good sufficient – Orange blanks
2. Asset Adequacy Analysis- Both orange and blue blanks
   a. Cashflow testing method
   b. Gross Premium Valuation Method
   c. <u>Demonstrate degree of conservatism</u>
   d. Loss Ratio Method
   e. Risk Theory Techniques (disability and other short-term liabilities)



PREMIUM DEFICIENCY RESERVES (PDRS)

SSAP #54: Section 19 Additional Reserves

- “When the expected claims payments or incurred costs, claim adjustment expenses and administration costs exceed the premiums to be collected for the remainder of a contract period … For purposes of determining if a premium deficiency exists, contracts shall be **grouped in a manner consistent with how policies are marketed, serviced and measured**…Deficiencies shall not be offset by anticipated profits in other policy groupings. Such accruals shall be made for any loss contracts, even if the contract period has not yet started.”

ASOP #42: Section 3.5

- “…the actuary should use ***reasonable*** assumptions that are appropriate for the intended purpose, and also reasonable in the aggregate.”
- Blocks of Business—”…a manner consistent with applicable financial reporting requirements…The actuary may need to estimate a premium deficiency reserve for a block of business where a premium deficiency exists ***even if the contract period has not started.***”

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Premium Deficiency Reserves

- Reserve Equals
  - Sum of:
    - PV of future claims, including claim and contract reserves
    - PV of future non-benefit expenses
  - Less the sum of:
    - PV of future earned premiums and investment income
    - Current accrual for future claims and non-benefit expenses, including claim and contract reserves

PDRS - CONSIDERATIONS

- Analysis should be done to determine if it is necessary to establish a PDR.

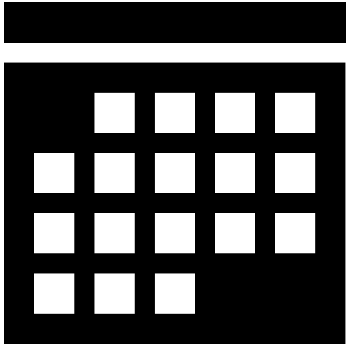
Calculation Methodology

- Describe the overall approach used to determine the PDR.
- Note special circumstances that warrant specific considerations, e.g. a new carrier or a significant new block.

Grouping Methodology

- Describe the groupings used for both the analysis and reporting.
- Basis and reasoning for the groupings.
- Explain any changes since prior PDR.

PDRS - CONSIDERATIONS



The Projection Period

- Include rationale for the choice of the projection period.
- Explain any changes versus prior PDR.
- It is important to discuss the inclusion or exclusion of cash flows from policies effective after the valuation date but contracted on or before the “as of” date.
    - SSAP #54, Section 19
    - ASOP #42, Section 3.5

PROVISIONS FOR ADVERSE DEVIATION (MARGIN)

ASOP #5: 3.3.1d Provision for Adverse Deviation

- “Recognizing that the estimation of liabilities for incurred but unpaid health and disability claims involves an estimate of the true obligations that will emerge, the actuary should consider what explicit provision for adverse deviation, if any, might be appropriately included. If a provision for adverse deviation is included, the unpaid claims liability should be appropriate, in the actuary’s judgment, for the intended use.”

ASOP 28: 3.7 Liability and Asset Valuation

- “When the actuary opines that the liabilities make ***good and sufficient*** provision, the actuary should include a provision for adverse deviation. The provision should result in amounts that, in the actuary’s professional judgment, are sufficient to cover obligations under ***moderately adverse*** conditions.”

ASOP 28: 3.9 Adverse Deviation

- “In general, when establishing a provision for adverse deviation, the provision should increase as the level of uncertainty increases.”

ASOP 28: 3.11.a Unqualified Opinion

- “The actuary should be satisfied that the liabilities, assets, and related items opined on make reasonable provision to cover obligations under moderately adverse conditions.”

WHAT IS AN APPROPRIATE MARGIN?

- Issues of excessive margin
  - Timing of excessive/adequate margin
- Implicit versus explicit margin
  - Does your method (without margin) always produce excessive margin?
- How was margin determined?
  - Is there an official margin policy? Who sets the margin? How was it established? Different by LOB?
- Has the level of uncertainty increased or decreased?
- Are there company-specific or external factors that may require an “extraordinary” margin to be applied?

Questions

Thank You!

Danny Moore, FSA, MAAA, CERA
VP & Principal, Lewis & Ellis
dmoore@lewisellis.com

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