AMERICAN ACADEMY of ACTUARIES

MEMORANDUM

TO: NAIC Life RBC and HORBC Working Groups

FROM: American Academy of Actuaries HORBC Task Force
Chair: Burt Jay

RE: American Academy of Actuaries Comments and Recommendations to the NAIC Life RBC and HORBC Working Groups

DATE: April 20, 1999

The American Academy of Actuaries Health Organizations Risk-Based Capital Task Force met by conference call on April 16 to discuss several issues that are on the agenda of the NAIC joint conference call scheduled for April 26. Other issues discussed will be covered in a report to the NAIC prior to the June meeting in Kansas City.

The Task Force agreed to recommend the paragraph defining stop-loss that was supplied to the NAIC in March by Bill Weller after making several changes. The revised definition follows:

> "Stop-Loss Coverage - Coverage for a self-insured group plan, a provider/provider group or non-proportional reinsurance of a medical insurance product. Coverage may apply on a specific basis, an aggregate basis or both. Specific coverage means that the stop loss carrier's risk begins after a substantial amount of claims for any one covered life has been covered by the group plan, provider/provider group or direct writer. Aggregate coverage means that the stop loss carrier's risk begins after the group plan, provider/provider group or direct writer has incurred a specified percentage of expected claims."

The Academy's Task Force believes that a more precise definition of "substantial amount" and "specific percentage" is needed in the longer term. Any such definition would need to be based upon a scientific study of risk with the intent of associating higher risk coverage with higher RBC factors. The Academy anticipates that our current on-going review of the stop-loss factors will assist the NAIC in enhancing the definition of stop-loss. Until that study is completed later this year, we do support the inclusion of some definition of stop-loss in the RBC instructions.

The Academy's Task Force also recommends that the MCO-RBC formula include only a single excess growth term that contains all coverages written by an MCO. The Academy does have concerns that the current form of the excess growth term does not respond to real higher risks resulting from growth as

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well as it might[1]. If the NAIC wishes, the Academy will study the issue and make a recommendation at a later date to improve the responsiveness of this term to real changes in risk.

The Joint Life RBC and MCO-RBC Working Groups also requested input on several changes proposed by others at the March NAIC meeting. In particular, several issues were raised by Dan Swanson.

His first issue deals with the treatment of Federal Employee Health Benefit Plan (FEHBP) business. The Comprehensive Medical Premium in LR015 should be reduced by the FEHBP premium. The Academy HORBC Task Force agrees that a new line for FEHBP should be added to LR015 and that the instructions be revised to clarify this.

His next issue is whether companies with very little health premium should be subject to the $1.5 million minimum RBC. This minimum is consistent with previous Academy HORBC Task Force proposals. It is believed that there is a disproportionate level of risk associated with small blocks of health business. If the NAIC would like the Academy to review to the 1998 submissions of companies with less than $10 million of health premium to determine the impact of the minimum RBC, we would be happy to be of assistance.

His third item is a set of three questions on extended rate guarantees in LR016. The first question deals with which health lines the additional RBC factors for extended rate guarantees should apply. The Academy's HORBC Task Force believes that these factors should only apply to lines with continuing medical trend (comprehensive medical, med-sup, etc.). Therefore, revised instructions should provide that the extended rate guarantee factor apply to lines included in LR015.

The second question deals with the premium base to be included with the factor for extended rate guarantees. The Academy's previous HORBC proposals would have been consistent with having the factor apply to the earned premium, rather than the premium for the entire rate guarantee period.

The third question relates to reinsurance. In our opinion, the premium reported for the extended rate guarantee factor should be net of reinsurance. However, the instructions should be revised to state: "Premium amounts should be shown net of reinsurance only when the reinsurance premium is also subject to similar rate guarantees."

The Academy has reviewed the proposal to revise the instructions for handling ASC business. It has generally been assumed that the risks related to ASC business are more similar to ASO business than normal "full risk" business. Therefore, we believe that the premium for ASC, if reported as revenue for annual statement purposes, should be excluded from risk premium for purposes of the MCO-RBC formula (both by reducing the premium in line 1 of MR010 by any amounts of ASC "premium" which is reported in line 6 of MR017 and excluding ASC business from the calculation in MR013).

The last sentence in the instructions for Comprehensive Medical and Hospital should be deleted. We believe that it would be appropriate to add a sentence as follows: "If ASC contracts are reported in the

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[1] The current MCO-RBC growth risk compares the percentage increase in RBC to the percentage increase in premium. Thus only changes in the distribution of business from low RBC factors to higher RBC factors (or less managed care credits) can produce a growth risk. These are much less likely than a higher than industry average rate of premium growth which has greater potential for increasing solvency risk. As an example, an MCO with a substantial amount of stop-loss coverage, which will now be subjected to the 25% factor, might, when combined with existing medical coverage, generate a very large increase in its RBC/Premium ratio that exceeds any increase in the real risk.

annual statement as risk revenue, that amount should be eliminated in the calculation for both Underwriting Risk and the Managed Care Credit calculation."

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