



AMERICAN ACADEMY *of* ACTUARIES

June 11, 2005

To: Mr. Louis Felice, Chair, NAIC Capital Adequacy (E) Task Force

From: Mr. John Fritz, Chair, American Academy of Actuaries'¹ Health RBC Subgroup

RE: Status Report on RBC Formula and Instruction Changes for Medicare Part D Coverage

Dear Mr. Felice,

This status report is to update the Task Force on the work of the Academy's Health RBC Subgroup. The Subgroup was created in response to your charge for recommendations of changes to the 2006 RBC Formulas and Instructions, in order to address the risks of Medicare Part D Prescription Drug coverage.

We believe that we will provide three distinct aspects for your review by the September 2005 deadline. These aspects, along with the current status and expected delivery date, are as noted below.

1. Proposed changes to the RBC Formula worksheets and to the instructions

The Academy Subgroup is reviewing very early drafts of proposed changes to lines and columns in the Life & Health RBC Formula. It is important to note that while similar changes would also be incorporated into the Health Formula, the Life Formula is more complex. We expect to use an existing unused column in the Underwriting Experience Risk worksheet so that managed care offsets can reflect the risk reductions of various federal reinsurance options.

We anticipate providing an initial draft to the Task Force by the end of June. Doing so will allow for possible exposure prior to the September meeting, enabling the Task Force to review any comments in September.

2. Proposed factors for Part D coverage

The Academy Subgroup has three recruited volunteers who are willing to provide claims experience for seniors. It is expected that this experience data can then be used to provide the

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necessary inputs for the existing model. The Subgroup has a member who will be able to run the existing model as soon as all of the experience data is available.

As the Subgroup begins to work with the data, we will be better equipped to provide a timeline for when the proposed factors will be available. Keeping the deadline of September 2005 in mind, we will keep the Task Force updated of our progress.

3. A report on the risks presented by this new approach to insurance, which are not incorporated into the Academy's model to produce the proposed factors

In terms of Part D coverage, which introduces substantial federal risk involvement and regulatory oversight, the Subgroup anticipates providing a report in late July 2005. This report would provide input to the discussion surrounding the need to review the underlying assumptions of the RBC Model by the NAIC. Since 1994, the same model has been used to develop RBC factors for almost all types of health coverage, with appropriate adjustments for key differences. The model assumes that historical loss ratios of companies writing the business exist and that companies can adequately price for expected costs. The focus of the RBC factors (C-2 and H-2) then becomes the variance from the expected and the recovery time to effectuate premium rate increases.

Should the Task Force prefer to defer this report to a later date, the Subgroup will focus on the remaining two aspects of the charge.

We appreciate the opportunity to provide this status report and look forward to your feedback. If there are any questions regarding these comments, I invite you to contact Geralyn Trujillo, staff liaison to the Subgroup, at (202) 785-6924 or trujillo@actuary.org.

Very truly yours,

John F. Fritz
Chair, Health RBC Subgroup
State LTC Task Force
American Academy of Actuaries

CC: Julia Philips, Chair, Health RBC Subgroup of the Capital Adequacy (E) Task Force
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Alan Ford, Chair, Academy Task Force on Health RBC
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