



July 13, 2023

Steve Drutz
Chair, Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners (NAIC)

Re: Request for Comprehensive Review of the H2—Underwriting Risk Component and Managed Care Credit Calculation in the Health Risk-Based Capital Formula

Dear Chair Drutz:

On behalf of the Health Underwriting Risk Factors Analysis Work Group of the Health Solvency Subcommittee of the American Academy of Actuaries (Work Group),¹ I appreciate the opportunity to provide these updates to the National Association of Insurance Commissioners (NAIC) Health Risk-Based Capital (E) Working Group in response to the request to comprehensively review the H2—Underwriting Risk Component and the Managed Care Credit Calculation in the Health Risk-Based Capital (HRBC) formula.

As part of the work group's review of the H2—Underwriting Risk Component, we identified several components of the current formula that merit discussion within the NAIC HRBC Working Group. We have described the issues below and would appreciate the opportunity to discuss them with the Working Group at the July 25, 2023, NAIC HRBC Working Group meeting.

For background, the critical source of the Experience Fluctuation Risk (EFR) formula within Underwriting Risk is the Analysis of Operations by Lines of Business (page 7 of the annual statutory financial statements). The page includes a buildup of underwriting gain/(loss), starting with net premium income, adding various other sources of revenue, then subtracting claims and administrative expenses. Some lines within the exhibit, including Fee-for-service and Risk revenue, are not broadly applicable, and the proportion of filers that utilize these fields is relatively small. Still, they often make up a material portion of revenue for those filers.

Those smaller components of the Analysis of Operations by Lines of Business have nuanced treatment within the current EFR formula that is likely not broadly understood. This nuanced treatment includes:

Nuance #1: Fee-for-service revenue is netted against incurred claims for Comprehensive Major Medical but not Medicare or Medicaid.

- The RBC instructions do not include the rationale for the distinction between lines of business.
- We do not see an intuitive rationale for the distinction and believe it may have been an inadvertent drafting error.

¹ The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Nuance #2: The fee-for-service revenue netting can result in erratic net loss ratio experience for health plans with significant fee-for-service revenue levels.

- After investigating several instances of health plans reporting fee-for-service revenue, it appears that filer understanding of the field is mixed.
- Additionally, if health plans report a significant amount of fee-for-service revenue, the net loss ratio may look problematic:
 - For example, we observed a health plan with an approximately 100% gross loss ratio and a 140% net loss ratio; the gross loss ratio is more likely to resemble the “priced” loss ratio.
 - The risk charge is effectively applied to the net claims level, which is tantamount to a managed care credit discount of 1.0.

Nuance #3: Other Health Risk Revenue is included in the revenue calculation for Comprehensive Major Medical but not for Medicare or Medicaid.

- The RBC instructions do not include a rationale for the distinction between lines of business.
- We do not see an intuitive rationale for the distinction and believe it may have been an inadvertent drafting error.

Nuance #4: Aggregate write-in revenue (health and non-health) is excluded from the calculation.

- “Aggregate write-ins for other health care related revenues” is commonly populated and often represents pass-through revenue related to Aggregate write-ins for other hospital and medical (line 14), which is included in line 17.
- “Aggregate write-ins for other non-health care revenues” are infrequently populated and generally immaterial.

These nuances may need to be addressed within the existing formula but should be considered as part of any significant change to the EFR formula. For simplicity, one option to change the formula may be to use lines 7 and 17 for revenue and claims for each applicable line of business; however, we welcome additional suggestions based on feedback from the Working Group.

If you have any questions or would like to discuss further, please contact Matthew Williams, the Academy’s senior health policy analyst, at williams@actuary.org.

Sincerely,

Derek Skoog, MAAA, FSA
 Chairperson, Health Solvency Subcommittee, Health Underwriting Risk Factors Analysis Work Group
 American Academy of Actuaries

Cc: Crystal Brown, Senior Health RBC Specialist & Education Lead, Financial Regulatory Affairs, NAIC