



AMERICAN ACADEMY of ACTUARIES

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April 15, 2016

Mr. Patrick McNaughton
Chair, Health Risk-Based Capital Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Recommendation on Credit Risk Factors for Health Care Receivables

Dear Mr. McNaughton:

On behalf of the American Academy of Actuaries'¹ Health Care Receivables Factors Work Group, I would like to provide the following recommendations related to the factors used for health care receivables on page XR020 of the credit risk portion of the health risk-based capital (RBC) formula for year-end 2016:

Line 30.1 Pharmaceutical Rebates Receivables:	continue using the factor 0.050
Line 30.2 Claim Overpayment Receivables:	increase the factor from 0.050 to 0.190
Line 30.3 Loan and Advances to Providers:	increase the factor from 0.050 to 0.190
Line 30.4 Capitation Arrangement Receivables:	increase the factor from 0.050 to 0.190
Line 30.5 Risk Sharing Receivables:	increase the factor from 0.050 to 0.190
Line 30.6 Other Health Care Receivables:	increase the factor from 0.050 to 0.190

These recommendations are a result of the work group's analysis of data provided by the NAIC from the 2013 and 2014 health statutory annual statements. The annual statements for those years provided the data for a follow-up study on the accruals made for health care receivables. Our review of the 2013 annual statement data, which had follow-up data on year-end 2012 accruals, raised data reliability concerns. As a result, we did not use that data in the factor recommendation. We did perform a follow-up study on the 2014 annual statement data, which had follow-up data on year-end 2013 accruals, specifically the amounts collected in 2014.

Annual statements for years 2012 and prior did not provide sufficient granular data for us to perform similar analyses.

¹ The American Academy of Actuaries is an 18,500+ 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.

Our analysis of 2014 annual statement data used companies that filed annual statements for both years. We excluded companies with negative capital and surplus. We also excluded those with no 2013 data, zero 2013 accrual and zero 2014 collection, or negative accruals or collection.

We believe that analyses on additional years of data are needed to verify the levels of average risk. However, because our analysis of the 2014 Annual Statement data shows that a significant increase would be appropriate if the data used is representative of the risk for lines 30.2 through 30.6, we recommend phasing in factor increases beginning with the RBC formula for 2016. The initial recommended increase would start a transition to a likely higher level, with this first recommended factor being one-third of the level adequate to reflect the risk, assuming the one year of data being used approximates the true risk.

We expect to analyze data from the 2015 and 2016 annual statements (when available) and to make subsequent recommendations based on those analyses. We understand that a similar approach was used for the development of the factor on the H2 Underwriting Risk for Standalone Medicare Part D coverage.

The table below shows what the effect on the 2014 RBC results would have been if the above factors had been used for the 2014 annual statement RBC calculations:

	2014 Actual Factors, Which Use 0.050 for All Health Care Receivables)	With 0.190 Factor Used for Health Care Receivables Other Than Pharmaceutical Rebates	Percent Change
Total H3 (Credit Risk)	\$2,063,379,570	\$2,499,363,920	+21.13%
Total RBC Before Covariance	\$49,176,343,504	\$49,612,327,854	+0.89%
Total RBC After Covariance	\$37,495,686,135	\$37,562,424,826	+0.18%
Authorized Control Level RBC	\$18,747,843,291	\$18,781,212,632	+0.18%

Although the proposed factor changes would have a significant effect on the H3 Credit Risk, the effect on Total RBC After Covariance — and, therefore, the Authorized Control Level RBC — is less than a quarter of one percent. The H3 Credit Risk is the smallest of the items subject to the covariance adjustment, so the Total RBC After Covariance is more affected by the larger items subject to the covariance adjustment, namely the H1 Asset Risk – Other, the H2 Underwriting Risk, and the H4 Business Risk.

History of Factors for Health Care Receivables and Data Sources

The 1998 RBC formula for HMOs used a factor of 0.050 for health care receivables; they were not divided into categories. This factor was used for many other non-invested assets, including reinsurance receivables. At the time the RBC formula for Hospital, Medical, Dental Service or Indemnity (HMDI) corporations did not have a charge for health care receivables, because health care receivables were not recognized as admitted assets. In the 2002 RBC formula for health insurers, the health care receivables were divided into the six categories currently in use, with the factor for each category being 0.050. For more detailed information, readers may refer to the

following Academy report dated April 2000 to the NAIC Health Organizations Risk-Based Capital (E) Working Group: http://www.actuary.org/pdf/naic/HORBC_assetrpt_1200.pdf.

In 2009, the Academy formed the Health Care Receivables Factors Work Group with an objective to recommend changes to the factors for the health care receivables for consideration by the NAIC based on a review of reported actual experience in collecting these receivables. The work group reviewed the available follow-up data on health care receivables, which consisted of data reported in the Notes to Financial Statements on two of the six categories of health care receivables — pharmaceutical rebates receivables and risk sharing receivables. We found that the data in the Notes to Financial Statements was not completed consistently by health insurers, as outlined in Statement of Statutory Accounting Principles No. 84, “Certain Health Care Receivables and Receivables Under Government Insured Plans.”

Accordingly, the NAIC Health Risk-Based Capital Working Group decided to augment the Health Annual Statement to include follow-up study data on all six categories of health care receivables. Existing Exhibit 3 – Health Care Receivables shows the details on the accrued amounts for each of the six categories, including the split between admitted and nonadmitted amounts. The new Exhibit 3A – Analysis of Health Care Receivables Collected and Accrued first appeared in the year-end 2013 Annual Statement. Exhibit 3A is similar in design to the Underwriting and Investment Exhibit (U&I Exhibit) Part 2B – Analysis of Claims Unpaid – Prior Year – Net of Reinsurance. For each of the six categories of health care receivables, Exhibit 3A shows the amount collected during the year, split between those on amounts accrued prior to the current year and those accrued during the prior year. It also shows the health care receivables accrued as of December 31 of the current year, split between amounts accrued as of December 31 of the prior year and those accrued during the current year. The sum of amounts collected against the prior year’s accrual plus any such amounts still accrued at the end of the current year is then compared to the accrual made as of December 31 of the prior year. The Academy’s work group provided input on the design of Exhibit 3A and on updates to the instructions for the Health Annual Statement for Exhibit 3A and related issues on the U&I Exhibit Part 2B and on Exhibit 3.

Analysis of Exhibit 3A Data

The work group analyzed the data from both 2013 and 2014 Annual Statements, comparing health care receivables reported on Exhibit 3, Exhibit 3A, and the U&I Exhibit Part 2B. The chart below shows the comparison between amounts shown on Exhibit 3 and those shown on Exhibit 3A:

HealthCare Receivables Shown on Exhibits 3 and 3A	2013 Annual Statements	2014 Annual Statements	Difference = 2014 minus 2013
Are both zero (and therefore match)	44.71%	40.06%	-4.64
Are both non-zero and match	54.75%	59.40%	+4.64
Do not match	0.54%	0.54%	0.00
Total	100.00%	100.00%	

We found the 4.64–percentage-point increase in the portion of annual statements in which accruals shown in Exhibit 3 and Exhibit 3A were both non-zero and match to be larger than we

would have reasonably expected from one year to the next if the data for both years were being filed accurately. The 2013 Annual Statement was the first that included Exhibit 3A (the follow-up study for the health care receivables accrued at year-end 2012). When companies filed their 2012 annual statement they did not know then that the December 31, 2012, health care receivables would be subject to the follow-up study on the 2013 annual statement Exhibit 3A. Because Exhibit 3A was new for the 2013 annual statement, there may have been companies that did not complete it. Because of the differences noted and because 2013 was the first year for Exhibit 3A data, the work group decided to base recommendations for factor changes on follow-up data from the 2014 Annual Statement and subsequent years.

The table below shows the size of the various health care receivables in the 2014 Annual Statement data:

2014 Annual Statement Exhibit 3 Health Care Receivables	Dollar Amounts Across All Filers	Portion of Total Health Care Receivables
Pharmaceutical Rebates Receivables	\$4,393,125,461	48.16%
Claim Overpayment Receivables	\$1,806,641,022	19.80%
Loans and Advances to Providers	\$832,157,807	9.12%
Capitation Arrangement Receivables	\$520,015,922	5.70%
Risk Sharing Receivables	\$282,420,895	3.10%
Other Health Care Receivables	\$1,288,192,021	14.12%
Total	\$9,122,553,130	100.00%

The work group separately analyzed the data for each of the six categories of health care receivables. Based on the sizes of the various health care receivables, the work group decided to develop recommended factors for (1) Pharmaceutical Rebates Receivable and (2) the aggregation of all other health care receivables, herein labeled the Other Five Receivables. These two groups are of similar size. We considered the development of a factor solely for Claim Overpayment Receivables, the second-largest category. The work group noted that the gathering of data by insurers on collected amounts of pharmaceutical rebates was straightforward, because the data is a limited number of separate payments received from pharmacy benefit managers or pharmaceutical manufacturers. In contrast, the amount collected against accrued claim overpayment receivables may include numerous amounts “collected” by offsetting amounts that would otherwise have been paid to the affected providers. Because of this, the overpayments collected could effectively be imbedded in the amounts shown routinely as paid claims. Therefore, the work group decided to include Claim Overpayment Receivables in the Other Five Receivables category and performed its analysis on that basis.

Pharmaceutical Rebates Receivable Factor Development

The work group analyzed the follow-up data on Exhibit 3A from the 2014 Annual Statements to determine a recommended factor for Pharmaceutical Rebates Receivable. This information showed the following:

348	Count of companies for which pharmaceutical rebates collected in 2014 on amounts accrued as of Dec. 31, 2013, exceeded the <i>admitted asset</i> for pharmaceutical rebates receivable accrued as of Dec. 31, 2013
35	Count of companies for which pharmaceutical rebates collected in 2014 on amounts accrued as of Dec. 31, 2013, exactly matched the <i>admitted asset</i> for pharmaceutical rebates receivable accrued as of Dec. 31, 2013 (both amounts not zero)
39	Count of companies for which pharmaceutical rebates collected in 2014 on amounts accrued as of Dec. 31, 2013, were less than the <i>admitted asset</i> for pharmaceutical rebates receivable as of Dec. 31, 2013
422	Total count of companies that had a Dec. 31, 2013, pharmaceutical rebate receivable of interest (excludes those with no 2013 data, zero 2013 accrual and zero 2014 collection, or negative accruals or collection)

The work group initially targeted a factor that would provide 90 percent confidence that the collected rebates would exceed the sum of the admitted accrual plus the amount added to the H3 credit risk calculation. For this data, that would be $90\% \times 422 = 380$ companies that the factor would need to cover. This number of companies is exceeded by the $348 + 35 = 383$ companies in the first two categories, so that the 2014 data shows that the 90 percent confidence target would have been met by a zero factor. We then looked at what factor would provide 95 percent confidence. For that level of confidence, the factor would need to cover $95\% \times 422 = 401$ companies. This would be the 383 companies in the first two categories plus another 18 companies from the other 39 companies, specifically the 18 companies that had the smallest absolute value percentage difference between collection and accrual. For that 18th company, the difference was 8 percent, so a 0.080 factor would have provided the amount added to the credit risk to cover the difference between accrual and collection. We are not recommending that the Pharmaceutical Rebates Receivable factor be based on a 95 percent confidence level. Neither are we recommending a zero factor based on the single year's data at the 90% confidence level. Instead, we recommend continuing the use of the current 0.050 factor, which would represent a confidence level between 90 percent and 95 percent. As additional years of data become available, those can be used to adjust the factor as needed.

Other Five Receivables Factor Development

The work group analyzed the follow-up data on Exhibit 3A from the 2014 Annual Statements to determine a recommended factor for the Other Five Receivables. Note that there are fewer companies that had any receivables in the Other Five Receivables categories compared to the number of companies with pharmaceutical rebates receivable. This information showed the following:

220	Count of companies for which the sum of the other five receivables collected in 2014 on amounts accrued as of Dec. 31, 2013, exceeded the <i>admitted asset</i> for the sum of the other five receivables accrued as of Dec. 31, 2013
56	Count of companies for which the sum of the other five receivables collected in 2014 on amounts accrued as of Dec. 31, 2013, exactly matched the <i>admitted asset</i> for the sum of the other five receivables accrued as of Dec. 31, 2013 (both amounts not zero)
142	Count of companies for which the sum of the other five receivables collected in 2014 on amounts accrued as of Dec. 31, 2013, was less than the <i>admitted asset</i> for the sum of the other five receivables receivable as of Dec. 31, 2013
30	Count of companies with non-zero other five receivables accrued as of Dec. 31, 2013, but with amounts collected in 2014 of zero or blank
69	Count of companies with an adverse difference of less than \$1 million between the other five receivables accrued at Dec. 31, 2013, and amount collected in 2014
43	Count of companies with an adverse difference of \$1 million or more between the other five receivables accrued at Dec. 31, 2013, and amount collected in 2014
418	Total count of companies that had a Dec. 31, 2013, other five receivables of interest (excludes those with no 2013 data, zero 2013 accrual and zero 2014 collection, or negative accruals or collection)

We originally attempted to use the same approach for the Other Five Receivables as we used for the Pharmaceutical Rebates Receivables, but we found problems with using the data in that manner. Of the 418 companies with Other Five Receivables, 142 companies (or 34 percent) showed an unfavorable development of accrual amounts. Of those 142 companies, 30 of them showed non-zero Other Five Receivables accrued at December 31, 2013, but showed a zero or blank amount collected during 2014. The work group had concerns about the reliability of the data, specifically that there may have been collections that were not reported on Exhibit 3A. We decided not to include the data from these 30 companies in the initial determination of the Other Five Receivables factor. For these 30 companies, the admitted amount of Other Five Receivables was small—an average amount of \$0.60 million, with the largest being \$2.91 million. We then looked at the remaining companies, noting that there were 69 companies with an adverse difference of less than \$1 million, with the average difference being \$0.16 million. For the development of the initial year's recommendation, we decided not to use the information from these 69 companies.

For the 43 companies with adverse differences of at least \$1 million, the average difference is 57 percent of the December 31, 2013, accrued amount. For the initial factor for the Other Five Receivables, we recommend 0.190, which is one-third of the amount of the 57 percent average

difference for these companies. This recommended factor is a transition to what may in future years be a final factor. The recommended factor of 0.190 would cover 44 of the 142 companies that showed an unfavorable development of accrual amounts compared to the admitted portion of the accrual. When these 44 are added to the 276 companies with favorable development, the total of 320 companies is 77 percent of the 418 companies. A factor of 0.570 would cover 81 of the 142 companies; $276 + 81 = 357$ is 85 percent of the 418 companies, which would be a little less than the 90 percent to 95 percent coverage provided by the recommended 0.050 factor for the pharmaceutical rebates receivable.

When data from the 2015 annual statements is available, we would review that data along with the data from 2014 annual statements to develop a recommended factor (a second transition factor) for use in the 2017 RBC formula. When data from the 2016 annual statements is available, we would review that data along with the data from 2014 and 2015 annual statements to further develop a recommended factor for the 2018 RBC formula.

Because the factors for the Other Five Receivables for later RBC formulas may turn out to be smaller or larger than the recommended 0.190 factor for the 2016 RBC formula, we have shown in an attachment the impact of factors of 0.150, 0.250, and 0.500 if they had been used in the 2014 RBC formula.

We appreciate the opportunity to provide these recommendations and would welcome the opportunity to discuss them with you in more detail. If you have any questions or would like to discuss further, please contact David Linn, the Academy's health policy analyst, at 202-785-6931 or linn@actuary.org.

Sincerely,

F. Kevin Russell, MAAA, FSA
Chairperson, Health Care Receivables Factors Work Group
American Academy of Actuaries

Impact of changing the factors for Health Care Receivables– 2014 Annual Statement Data

	2014 Annual Statement - 0.050 Factor for all Health Care Receivables	0.150 for Health Care Receivables Other than Rx Rebates	0.190 for Health Care Receivables Other than Rx Rebates	0.250 Factor for Health Care Receivables Other than Rx Rebates	0.500 Factor for Health Care Receivables Other than Rx Rebates
Total H0 -Asset Risk - Affiliate	\$3,624,793,667	\$3,624,793,667	\$3,624,793,667	\$3,624,793,667	\$3,624,793,667
Total H1 - Asset Risk - Other	7,582,407,471	7,582,407,471	7,582,407,471	7,582,407,471	7,582,407,471
Total H2 - Underwriting Risk	30,692,854,824	30,692,854,824	30,692,854,824	30,692,854,824	30,692,854,824
Total H3 - Credit Risk	2,063,379,570	2,374,796,956	2,499,363,920	2,686,214,367	3,464,757,895
Total H4 - Business Risk	5,212,907,972	5,212,907,972	5,212,907,972	5,212,907,972	5,212,907,972
Total RBC Before Covariance Adjustment	49,176,343,504	49,487,760,890	49,612,327,854	49,799,178,301	50,577,721,829
Total RBC After Covariance Adjustment	37,495,686,135	37,539,484,935	37,562,424,826	37,601,734,681	37,816,525,631
Total Adjusted Capital	115,338,709,263	115,338,709,263	115,338,709,263	115,338,709,263	115,338,709,263
Authorized Control Level RBC	18,747,843,291	18,769,742,468	18,781,212,631	18,800,867,572	18,908,263,041
Aggregate RBC Percentage	615.2%	614.5%	614.1%	613.5%	610.0%
Median RBC Percentage	623.0%	622.6%	617.5%	616.0%	614.5%
Maximum Dollar Change in H3	N/A	\$36,820,952	\$51,549,333	\$73,641,905	\$165,694,285
Maximum % Change in H3	N/A	200%	280%	400%	900%
Maximum Dollar Change in RBC	N/A	\$11,507,293	\$17,727,933	\$28,145,558	\$78,518,499
Maximum % Change in RBC	N/A	96%	146%	228%	593%

883 companies were included in the NAIC’s database of 2014 Health Annual Statement filers. However, 6 companies with a negative surplus were removed from the data used in this analysis to avoid distortion of the results. The exhibits reflect the remaining 877 companies.

Impact on Action Levels

	2014 Annual Statement - 0.050 Factor for all Health Care Receivables	0.150 for Health Care Receivables Other than Rx Rebates	0.190 for Health Care Receivables Other than Rx Rebates	0.250 Factor for Health Care Receivables Other than Rx Rebates	0.500 Factor for Health Care Receivables Other than Rx Rebates
No Action	832	832	832	832	830
Company Action Level - Trend Test	21	21	21	21	21
Company Action Level	13	13	13	13	15
Regulatory Action Level	7	7	7	7	7
Authorized Control Level	2	2	2	2	2
Mandatory Control Level	2	2	2	2	2
Total No. Companies	877	877	877	877	877

Impact on RBC Percentages

	2014 Annual Statement - 0.050 Factor for all Health Care Receivables	0.150 for Health Care Receivables Other than Rx Rebates	0.190 for Health Care Receivables Other than Rx Rebates	0.250 Factor for Health Care Receivables Other than Rx Rebates	0.500 Factor for Health Care Receivables Other than Rx Rebates
# of Companies with an RBC Ratio of > 10,000%	80	80	80	80	80
# of Companies with an RBC Ratio of < 10,000% & > 1,000%	204	203	203	201	201
# of Companies with an RBC Ratio of < 1,000% & > 500%	259	259	259	260	256
# of Companies with an RBC Ratio of < 500% & > 300%	237	237	237	238	240
# of Companies with an RBC Ratio of < 300% & > 200%	73	74	74	74	74
# of Companies with an RBC Ratio of < 200%	24	24	24	24	26
Total # of Companies in Database	877	877	877	877	877