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Correspondence Memorandum

Date: August 28, 2017

To: Group Insurance Board

From: Lisa Ellinger, Director
Office of Strategic Health Policy

Subject: Board Reserve Policy

Staff recommends Board approval of the attached Health Insurance Reserve Policy.

Staff and Segal Consulting will be available at the Board meeting to respond to questions.

Attachment: Segal Memorandum – Health Insurance Reserve Policy

Board	Mtg Date	Item #
GIB	8.30.17	7E

Segal Consulting

MEMORANDUM

To: Lisa Ellinger

From: Kenneth C. Vieira

Date: August 25, 2017

Re: Health Insurance Reserve Policy

The Department of Employee Trust Funds (ETF) has asked Segal Consulting (Segal) to review the Health Insurance Reserve Policy being administered by the Group Insurance Board (GIB). The current policy was recommended by Deloitte in a memo to Lisa Ellinger dated August 11, 2011. There have been some programmatic changes since 2011 and ETF/GIB are interested to see if any modifications should be made to the policy.

Current Policy

The general policy of the GIB is to hold reserves that range from 15% to 25% of "Benchmark Claims" for the upcoming year. "Benchmark Claims" are defined as 100% of expected claims for self-insured coverage and 20% of the estimated claims for fully-insured coverage (premiums). There is no explanation in the memo as to why the 20% component was utilized for fully-insured coverage.

The reserve is solely meant to cover program contingencies and provide adequate rate stabilization. The runout for claims Incurred But Not Paid (IBNP) or Incurred But Not Reported (IBNR) has already been factored into the net fund balance or cash available. The reserve calculation is on top of that funded IBNR.

The calculation and policy revolves around what level of fluctuation and/or risk is present in the year and setting an adequate level to hedge an adverse year.

Given the current policy and prior recommendation, the GIB is holding:

- Fully-Insured Coverage – 20% of premiums multiplied by the 15% to 25% range, or 3% to 5% of total premiums for the year.

- Self-Insured Coverage – 15% to 25% of total projected claims

There appear to be some inconsistencies between the two levels. Segal recognizes that different programs, like Medical, Pharmacy or Dental, will have different trend variances and risk, necessitating higher reserves, but the difference between the two may be overly conservative. We could understand if the IBNP or IBNR was built into the 15% to 25% level, but that is not the case.

Recommended Policy

We believe there needs to be consistency between the calculation of the reserve levels for fully-insured and self-insured programs. The reserve levels are more dependent on the benefit type vs. the insured arrangement. The level of reserves for the fully insured medical program is intended to offset any high trend year and provide overall premium stabilization. This is true as well for self-insured pharmacy and dental programs, but we recognize a slightly higher variance in pharmacy historical trend that would suggest a higher level of risk and associated reserve. The challenge is coming to a prudent level for the State. We suggest setting this level looking at historical trend variances, marketplace conditions and industry comparisons.

The prior recommendation points to Risk Based Capital (RBC). This is a method developed by the National Association of Insurance Commissioners (NAIC) to measure the minimum amount of capital that an insurance company needs to support its overall business operations. We agree that it is not totally applicable to ETF, but provides a reasonable benchmark to follow. The Deloitte memo does not specifically address the reserve level that RBC produces but seems to imply that this would be in the 15% to 25% range recommended. Our actuarial team ran the RBC numbers and found that reserving approximately 4.5% of claims is sufficient at a 100% RBC target. A couple states have implemented RBC based reserve levels (Delaware & Virginia). Both are primarily self-insured plans covering medical and pharmacy benefits. These states target approximately 200% of the RBC level – ranging from 8% to 10% of projected claims.

Our recommendation is designed to cover excessive trend variation and provide premium stabilization if needed. Looking at our Segal Trend Survey – the variance on the medical plan has been significantly less than the variance on pharmacy. Over the last 13 years, actual trends for HMOs had a variance of 5%, while pharmacy variance was nearly 10% and dental was close to 4%. Note that these variances are over time and are much less year over year. Given the variances and emerging costs in the program, we believe it is prudent to provide additional reserves for the pharmacy program when compared to medical and dental.

There was also a reference in the prior memo related to enrollment variances between the programs causing additional risk. The memo notes that plans possibly leaving the program could impact renewals. In our experience, the program typically loses higher cost plans and therefore receives a moderate savings from the process. Also with the statewide vendor being fully-insured, the risk is minimized further.

We believe the current 3% to 5% level on the fully insured medical program is adequate, but would recommend changing the self-insured pharmacy and dental levels. Below is a summary of our proposed reserve levels:

Program	Insured	Current	Recommended
Medical	Fully-Insured	3% to 5%	3% to 5%
Pharmacy	Self-Insured	15% to 25%	8% to 10%
Dental	Self-Insured	15% to 25%	3% to 5%

We would recommend drawing down to the midpoint of these levels over a 4-year period, reaching the target level in 2021. This would minimize a large premium increase in any given year when coming out of the stabilization period.

The policy the GIB has followed was a reasonable and prudent approach. We are recommending some modifications to the self-insured reserve be made which are less conservative and closer to industry standards.

Available Funds

Using the recommendations, a midpoint target reserve would be $73.7 million for the State and $11.7 million for Locals. Prior policy produces a mid-point level of $117.5 million and $17.2 million respectively.

Below is the calculation of the reserve at 12/31/2017. This would allow the GIB to pull $111.1 million from the State Reserve and $5.4 million from the Local Reserve.

	State				Local			
	Med	Rx	Dental	Total	Med	Rx	Dental	Total
Projected Net Fund Balance 12/31/2017	$ 85.5	$ 100.9	$ (1.5)	$ 184.9	$ (0.4)	$17.5	$ -	$ 17.0
Self Insured								
Projected 2018 Claims	$ -	$ 314.5	$ 57.1	$ 371.6	$ -	$47.8	$ 1.3	$ 49.2
Fully Insured								
Projected 2018 Premiums	$1,078.9				$184.6			
Total Claims & Prem	$1,078.9	$ 314.5	$ 57.1	$1,450.5	$184.6	$47.8	$ 1.3	$ 233.8
Target Reserve % - Min	3%	8%	3%	4.1%	3%	8%	3%	4.0%
Target Reseve % - Max	5%	10%	5%	6.1%	5%	10%	5%	6.0%
Target Reserve - Min	$ 32.4	$ 25.2	$ 1.7	$ 59.2	$ 5.5	$ 3.8	$ 0.0	$ 9.4
Target Reserve - Max	$ 53.9	$ 31.5	$ 2.9	$ 88.2	$ 9.2	$ 4.8	$ 0.1	$ 14.1
Target Reserve - Midpoint	$ 43.2	$ 28.3	$ 2.3	$ 73.7	$ 7.4	$ 4.3	$ 0.1	$ 11.7
Surplus at Minimum Target	$ 53.1	$ 75.7	$ (3.2)	$ 125.7	$ (5.9)	$13.7	$ (0.0)	$ 7.7
Surplus at Maximum Target	$ 31.6	$ 69.4	$ (4.3)	$ 96.6	$ (9.6)	$12.8	$ (0.1)	$ 3.1
Surplus at Midpoint Target	$ 42.3	$ 72.6	$ (3.8)	$ 111.1	$ (7.8)	$13.2	$ (0.1)	$ 5.4

Multi-Year Reserve Draw Strategy

We recommend drawing down the reserve to the current reserve target over 2018-2019. Then over the following two years, 2020-2021, draw the reserve down to the midpoint of the recommended policy. The table below illustrates this approach for the State Reserve. We feel this approach best minimizes premium fluctuations.

State Reserve Multi-year Strategy						
	Balance*	Target**	% of Claims/FI Prem	Surplus***	Draw	Surplus after Draw
2018	$184.9	$117.5	8.1%	$67.4	$29.0	$38.4
2019	$155.9	$117.5	8.1%	$38.4	$38.4	$0.0
2020	$117.5	$73.7	5.1%	$43.8	$21.9	$21.9
2021	$95.6	$73.7	5.1%	$21.9	$21.9	$0.0

* Assumes there are no future gains or losses that would impact the fund balance.
** New Reserve Target Policy in 2020. No trend was applied.
*** The Surplus refers to the money in the fund that exceeds the midpoint Target Reserve.