Reserving for Commercial Risk Adjustment Payment Transfers

ROWEN B. BELL, FSA MAAA

2017 Valuation Actuary Symposium

August 28, 2017

SOCIETY OF ACTUARIES®

Presentation Disclaimer

Presentations are intended for educational purposes only and do not replace independent professional judgment. Statements of fact and opinions expressed are those of the participants individually and, unless expressly stated to the contrary, are not the opinion or position of the Society of Actuaries, its cosponsors or its committees. The Society of Actuaries does not endorse or approve, and assumes no responsibility for, the content, accuracy or completeness of the information presented. Attendees should note that the sessions are audio-recorded and may be published in various media, including print, audio and video formats without further notice.

SOCIETY OF ACTUARIES
Antitrust Notice for Meetings

Active participation in the Society of Actuaries is an important aspect of membership. However, any Society activity that arguably could be perceived as a restraint of trade exposes the SOA and its members to antitrust risk. Accordingly, meeting participants should refrain from any discussion which may provide the basis for an inference that they agreed to take any action relating to prices, services, production, allocation of markets or any other matter having a market effect. These discussions should be avoided both at official SOA meetings and informal gatherings and activities. In addition, meeting participants should be sensitive to other matters that may raise particular antitrust concern: membership restrictions, codes of ethics or other forms of self-regulation, product standardization or certification. The following are guidelines that should be followed at all SOA meetings, informal gatherings and activities:

- DON'T discuss your own, your firm's, or others' prices or fees for service, or anything that might affect prices or fees, such as costs, discounts, terms of sale, or profit margins.
- DON'T stay at a meeting where any such price talk occurs.
- DON'T make public announcements or statements about your own or your firm's prices or fees, or those of competitors, at any SOA meeting or activity.
- DON'T talk about what other entities or their members or employees plan to do in particular geographic or product markets or with particular customers.
- DON'T speak or act on behalf of the SOA or any of its committees unless specifically authorized to do so.
- DO alert SOA staff or legal counsel about any concerns regarding proposed statements to be made by the association on behalf of a committee or section.
- DO consult with your own legal counsel or the SOA before raising any matter or making any statement that you think may involve competitively sensitive information.
- DO be alert to improper activities, and don't participate if you think something is improper.

If you have specific questions, seek guidance from your own legal counsel or from the SOA's Executive Director or legal counsel.

Agenda

- An audit actuary's perspective
- Study of 2016 RA results

An audit actuary's perspective

The audit actuary’s role

- Understand the company’s basis for making its risk adjustment estimate
- At a high level, assess the reasonableness of inputs to the company’s estimate
  - Core audit team may do additional procedures around data
- In conjunction with auditors, and taking materiality into account, assess reasonableness of estimate
  - Consider offsets that may exist elsewhere in balance sheet

Assets versus liabilities

- As actuaries, we tend not to distinguish between assets and liabilities, other than the sign!
- Accountants generally have a higher bar to justify recording an asset versus recording a liability, particularly when (as in the case of risk adjustment) the asset equates to recognizing additional revenue
- Statutory accounting conservatism, as well

Commonly observed methodologies

- Wakely studies, without adjustment
  - Generally "scenario 6" (best estimate transfer), but sometimes see "scenario 5" (unadjusted)
- Wakely studies, with adjustment
  - Formulaic adjustment, e.g., a 20% haircut on Wakely asset
  - Client judgment to reflect factors not contemplated by Wakely, e.g., client efforts in process to improve coding, competitors not participating in Wakely study

Commonly observed methodologies (cont’d)

- Non-Wakely external studies
  - Some states (e.g., Massachusetts) had a non-Wakely firm perform a market-level study
  - When no market study available, an external actuarial firm has developed estimates using client’s own data plus assumptions on year-over-year state PLRS change
- Prior year PMPM and/or %-of-premium transfers
  - Perhaps with judgment applied to reflect changes in market

What we'd like to see

- Clear articulation of the company's thought process behind deciding what to book
  - If you're booking straight Wakely, explain why that is your best estimate
  - If you're not booking straight Wakely, explain why you've made the adjustments you're making
  - How did last year's actuals impact your thought process?
- Documentation is key

Other issues

- Accounting guidance (SSAP 107)
  - Current NAIC activity re: high-cost risk pooling in 2018 RA
- Revisions to ASOP 42 coming?
- Subsequent event considerations (for companies whose audit reports are issued in May)
- Anticipating failures of competitors who owe money
- Massachusetts carriers in 2017
- Private exchange risk adjustment

Study of 2016 RA results

SOCIETY OF ACTUARIES®

Introduction

- Study spans all EY audit clients participating in CMS-administered commercial risk adjustment in 2016
  - Massachusetts is out of scope
  - Private exchange risk adjustment is out of scope
- Comparing “actual” 2016 results (from 6/30/17 CMS report) against “recorded” results (what the client booked at 12/31/16, from audit workpapers)

Study demographics

- 29 different insurance holding companies
  - 13 of the 29 are BCBS Plans
  - All 29 participated in Individual market
  - 23 of the 29 participated in Small Group market
- Defining a “cell” as a state / legal entity combination:
  - 78 Individual cells, spanning 39 states
  - 69 Small Group cells, spanning 35 states

Overview of actual results

- Netting at the cell level:
  - Indiv – $980M of transfers to issuers, $976M of payments by issuers
    - 36 out of 78 cells received transfers
  - SG – $551M of transfers to issuers, $181M of payments by issuers
    - 43 out of 69 cells received transfers

Overview of actual results (cont'd)

- Netting at the holding company level:
  - Indiv – $811M of transfers to, $807M of payments by
    - 15 net recipients, 14 net payors (split across BCBS Plans was 11-2)
    - Size distribution of net absolute magnitude: >$100M = 4, $10-100M = 15, <$10M = 10
  - SG – $511M of transfers to, $140M of payments by
    - 13 net recipients, 10 net payors (split across BCBS Plans was 11-2)
    - Size distribution of net absolute magnitude: >$100M = 2, $10-100M = 7, <$10M = 14

Did issuers get the sign right?

- Yes!
- At holding company level:
  - Indiv – 28 of 29 correctly predicted whether they'd be a net recipient or a net payor
    - 1 recorded liability but received a payment
  - SG – 21 of 23 correctly predicted whether they'd be a net recipient or a net payor
    - 1 recorded liability but received a payment; 1 recorded asset but owed

Did issuers get the sign right? (cont'd)

- At the cell level:
  - Indiv – 74 of 78 correctly predicted whether they'd be a net recipient or a net payor
    - 3 recorded liability but received a payment; 1 recorded asset but owed
  - SG – 63 of 69 correctly predicted whether they'd be a net recipient or a net payor
    - 4 recorded liability but received a payment; 1 recorded asset but owed; 1 recorded zero but owed

How accurate were asset estimates?

- Individual
  - 44 cells recorded $842M of assets, and received $976M
  - Weighted average R-to-A = 87%; median also 87%
  - [25^{th},75^{th}]%ile R-to-A range = [54%, 99%]
  - 7 out of 44 cells over-estimated asset by >0.5%
  - 3 out of 44 cells over-estimated asset by >5%

How accurate were asset estimates? (cont'd)

- Small Group
  - 40 cells recorded $463M of assets, and received $546M
  - Weighted average R-to-A = 85%; median = 79%
  - [25^{th},75^{th}]%ile R-to-A range = [63%, 101%]
  - 10 out of 40 cells over-estimated asset by >0.5%
  - 8 out of 40 cells over-estimated asset by >5%

How accurate were liability estimates?

- Individual
  - 34 cells recorded $963M of liabilities, and owed $963M
  - Weighted average R-to-A = 100%; median = 97%
  - [25^{th},75^{th}]%ile R-to-A range = [75%, 117%]
  - 15 out of 34 cells over-estimated liability by >5%
  - 12 out of 34 cells under-estimated liability by >20%

How accurate were liability estimates? (cont'd)

- Small Group
  - 28 cells recorded $184M of liabilities, and owed $174M
  - Weighted average R-to-A = 106%; median = 100%
  - [25th,75th]%ile R-to-A range = [62%, 134%]
  - 12 out of 28 cells over-estimated liability by >5%
  - 8 out of 28 cells under-estimated liability by >20%

Wakely vs. Non-Wakely

- Three cases:
  1. Company participated in Wakely study, and directly recorded a Wakely-calculated number (I=28, SG=15)
  2. Company participated in Wakely study, but made adjustments to Wakely-calculated number (I=26, SG=27)
  3. Company did not participate in Wakely study (I=24, SG=27)
- Deviations from Wakely estimates were more common when Wakely estimated an asset

Wakely values available - Individual

- Across 54 cells:
  - Wakely estimated $729M assets, $815M liabilities
  - Issuers recorded $706M assets, $823M liabilities
  - Actuals were $816M assets, $840M liabilities
- Wakely value was within 10% of actual in 19 of 54, and within 20% of actual in 29 of 54
- Issuer deviations from Wakely value tended to detract from quality of estimate (possibly by design, for assets)

Wakely values available – Small Group

- Across 42 cells:
  - Wakely estimated $429M assets, $46M liabilities
  - Issuers recorded $402M assets, $45M liabilities
  - Actuals were $458M assets, $36M liabilities
- Wakely value was within 10% of actual in 15 of 42, and within 20% of actual in 23 of 42
- Issuer deviations from Wakely value tended to detract from quality of estimate (possibly by design, for assets)

Wakely values unavailable - Individual

- Across 24 cells:
  - Issuers recorded \$127M assets, \$130M liabilities
  - Actuals were \$158M assets, \$133M liabilities
- Median R-to-A was 69% for assets, 82% for liabilities
  - Weighted average for liabilities is distorted because largest cell in sample significantly over-estimated its liability
- Only 3 of 24 recorded estimates were within 10% of actual value; only 9 of 24 within 20%

Wakely values unavailable – Small Group

- Across 27 cells:
  - Issuers recorded $61M assets, $139M liabilities
  - Actuals were $91M assets, $143M liabilities
- Median R-to-A was 62% for assets, 100% for liabilities
- Only 5 of 27 recorded estimates were within 10% of actual value; only 9 of 27 within 20%

Study conclusions

- Overall tendency towards conservative recording of assets, but realistic recording of liabilities
- Even 3 years in, we see much greater volatility in risk adjustment development than we do for other actuarial balances (e.g, claim liabilities)
- Existence of Wakely studies enhances average accuracy of estimates, but significant volatility still remains even when Wakely studies are available

Closing thoughts

- We hadn't done similar formal studies of our clients' risk adjustment results in prior years – however, subjectively we feel like risk adjustment accuracy improved from 2015 to 2016 (after having improved significantly from 2014 to 2015)
- Significant changes to CMS RA model for 2018 will likely produce additional confusion

SOCIETY OF ACTUARIES®