Year-End 2020 Statements of Actuarial Opinion: Considerations for Health Carriers and State Regulators

By

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Estimating and reviewing 2020 year-end accruals to be included in the financial statements of carriers with health business will be challenging for appointed actuaries preparing NAIC[1] Statements of Actuarial Opinion ("Opinion") and for state regulators reviewing these estimates and financial statements. The COVID-19 pandemic has disrupted all aspects of life in the United States and around the world as our social and economic structures have been shaken. The impact on the overall healthcare system and on health insurance is still evolving. Health actuaries preparing year-end financial statement Opinions will need to consider many factors when determining the net impact of the pandemic on the items included in the scope of the Opinion.

Additionally, the ACA market has experienced low premium increases and significant growth over the last two years. A new study[2] by the Kaiser Family Foundation indicated that on average, 2021 benchmark premiums in the ACA Marketplace declined by more than 2% across the country compared to 2020 benchmark premiums, and 30 insurers are entering the Marketplace in 2021 across 20 states with another 61 expanding their service area in states that they already serve.

The impact of either one of these events on year-end financials could be significant; the combination may be even more so, and the net impact depends on factors affecting the state, the market, as well as company-specific factors such as business mix and surplus position. To make prudent decisions in the best interest of the consumers of health insurance products in their state, regulators will need to understand the many moving parts of actuarial estimates and their impact on the financial health of the companies under their jurisdiction.

The following provides a high-level discussion of some of the potential impacts on actuarial liabilities and assets included in the Opinion, the type of Opinion issued, and the minimum risk-based capital ("RBC") requirements.

[1] National Association of Insurance Commissioners

[2] Kaiser Family Foundation "Insurer Participation on the ACA Marketplaces, 2014-2021", November 23, 2020.

Impact on Actuarial Liabilities and Assets

Unpaid claim reserves

Due to the unusual claim and billing patterns experienced due to the COVID-19 pandemic, appointed actuaries may not be able to rely on historical claims payment patterns to calculate incurred claims. While the impact of the pandemic in the second quarter of 2020 has generally subsided, the surge in COVID-19 cases and related hospitalizations in many states during the fourth quarter of 2020 will make it particularly difficult to estimate the level of incurred but unreported claims as of the end of the calendar year. The impact on year-end unpaid claims estimates would depend on the recent incidence of hospitalized COVID-19 cases in the state, the carrier's mix of business, and the extent to which the state enacted "stay-at home" or other policies, which would tend to suppress utilization of other more routine medical services. Appointed actuaries would be well served to utilize all possible sources of internal data related to claims processing and lags, as well as hospitalization pre-certification and admission data, broken down by ICU/non-ICU admissions to inform their assumptions related to the calculation of unpaid claims. It may be prudent for the appointed actuary to use different approaches to the calculation of incurred claims, perform sensitivity testing to determine a reasonable range of the estimate, and carefully consider the appropriate provision for adverse deviation or margin that should be used. The impact of certain risk-sharing arrangements with providers may also need to be considered if the carrier's obligation is increased in the event of the insolvency of such a provider. In some cases, COVID-19 has increased the risk of insolvency of certain providers, due to the loss of revenue when medical services were either deferred or forgone, particularly in the second and fourth quarters of 2020. If the company's use of provider risk-sharing arrangements is material, the appointed actuary should consider the likelihood of such providers' insolvency and may establish a separate liability to reflect the additional obligation that may become due or incorporate such additional obligation into the calculation of the carrier's unpaid claims liability. ASOP No 5, *Incurred Health and Disability Claims*[3], provides authoritative guidance for actuaries calculating and reviewing incurred health insurance claims.

Additionally, many states saw an increase in the number of health carriers providing coverage, in the individual ACA market. Often, companies entering new states may experience delays in claims payments due to the logistics of establishing new provider networks, expanding, or establishing their claims processing systems, or working with the claims systems of third parties in rental network situations. These issues may be exacerbated with the influx of COVID-19 cases during 2020 and again at the end of 2020.

Risk Adjustment for ACA business

Estimating risk adjustment transfer payment accruals for ACA business is challenging under the best of circumstances because the amount of the accrual depends on the company's own risk level relative to

[3] http://www.actuarialstandardsboard.org/asops/incurred-health-and-disability-claims_186/

that of the rest of the market. Additionally, the recent changes[4] to the error rate calculation and the application of the results of the risk adjustment data validation ("RADV") program adds greater uncertainty to the estimation of 2020 risk adjustment accruals. Due to the economic impact of COVID-19, many individuals lost their employer-sponsored health coverage due to layoffs and business closures so there was a higher than usual level of movement of participants from the group market and into the individual and Medicaid markets. Additionally, due to the pandemic, some state exchanges established special enrollment periods to allow mid-year enrollment without requiring demonstration of a usual qualifying event. These factors may have a significant impact on the risk scores of specific health carriers, as well as the overall average risk score of the state. Combined with the uncertainty of the risk associated with the claims incurred in November and December and reported after the end of the year, the calculation of the risk adjustment transfer accrual as of December 31, 2020 may be even more challenging.

Additionally, as stated above, several states experienced an increase in the number of carriers offering ACA products. In some states, where new carriers have entered the market, risk scores of existing companies may be significantly different from prior years, which means that existing companies as well as new companies may have a hard time estimating risk adjustment accruals based on historical data in that state or in other states with similar demographics.

Premium Deficiency Reserves

Companies are required to establish a premium deficiency reserve ("PDR") whenever "the expected claims payments or incurred costs, claim adjustment expenses and administrative costs exceed the premiums to be collected for the remainder of the contract period…"[5]. Since 2021 premiums for Medicare Advantage and ACA products were finalized in the Spring and summer of 2020, the potential impact of the pandemic on claims was largely uncertain and many did not adjust premiums to reflect additional claims due to COVID-19. Additionally, as stated above, ACA premiums decreased nationwide between 2020 and 2021. Additionally, with the current surge in COVID-19 cases emerging in the fourth quarter of 2020 and expected to last into 2021, the 2021 premiums may be deficient, particularly in the Medicare Advantage market, which has felt the brunt of the claims since the virus affects a disproportionate number of older persons. However, depending on its availability and efficacy in vulnerable populations, the impact of the newly approved vaccine may dampen the increase in claims, particularly in the second quarter of 2021.

As stated above, the impact of risk adjustment on net premiums is difficult to estimate and may have a significant impact on projected premiums used in the PDR formula.

[4] The final rule, issued by the Centers for Medicare and Medicaid ("CMS") on November 24, 2020 can be found here: https://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/CMS-9913-F.pdf
[5] Statement of Statutory Accounting Principles (SSAP) No. 54, Paragraph 19

Additionally, in some states, new entrants in the ACA market may have gained significant market share from returning carriers, which may result in actual enrollment for 2021 being significantly different from the estimates used in pricing. For some returning carriers, lower enrollment may result in deficient premiums and a PDR would need to be established. New carriers generally experience deficient premiums until their enrollment has grown to support fixed expenses. As stated earlier, a recent study from the Kaiser Family Foundation indicated that benchmark premiums declined by more than 2% nationwide. Therefore, it is prudent for carriers to perform a comprehensive analysis to determine if a PDR is indicated as of year-end 2020. ASOP No 42, *Health and Disability Actuarial Assets and Liabilities Other Than Liabilities for Incurred Claims*[6], provides guidance for actuaries developing or reviewing premium deficiency reserves. The American Academy of Actuaries Discussion paper on premium deficiency reserves is also a good resource.[7]

Due to the current uncertainty relating to the adequacy of 2021 premiums in the ACA and Medicare Advantage markets, it is also prudent for companies to update the PDR calculation at least quarterly during 2021 and maybe into 2022, so that the appropriate level of PDR can be established and or maintained.

Medical Loss Ratio Rebate Liability

Many carriers experienced favorable claims experience through the third quarter of 2020 due to a deferral of routine or non-emergency care in the first and second quarters of 2020 when the impact of COVID-19 caused some state and local governments to limit medical services as well as the level of social interaction in public areas. This led some carriers to provide early premium credits to their members during 2020. The recent surge in COVID-19 cases during the fourth quarter of 2020 reduces the likelihood and magnitude of state or federal medical loss ratio rebates as of year-end 2020. The net impact of all experience during 2020 needs to be carefully evaluated when determining the appropriate level of rebate liability that needs to be reflected in year-end 2020 financial statements.

Type of Opinion

Depending on the combination of factors impacting a company in a particular state, the level of uncertainty surrounding the estimation of the actuarial assets and liabilities may be sufficient for an appointed actuary to determine that an unqualified opinion may not be appropriate. We recommend that appointed actuaries consider the cumulative impact of the COVID-19 and other market forces identified above when determining the type of opinion to issue for year-end 2020. Depending on the situation, an unqualified opinion may not be appropriate. That is, depending on the level of uncertainty associated with the determination of actuarial assets and liabilities included in the scope of the actuarial

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[6] http://www.actuarialstandardsboard.org/asops/health-and-disability-actuarial-assets-and-liabilities-other-than-liabilities-for-incurred-claims/

[7] https://www.actuary.org/sites/default/files/files/publications/Health_Discussion_Paper_on_Premium_Deficiency_Reserves_0703.pdf

opinion, a qualified, inconclusive, or adverse opinion may be indicated. ASOP No. 28, *Statements of Actuarial Opinion Regarding Health Insurance Liabilities and Assets*[8], provides guidance for health actuaries preparing statements of actuarial opinions with respect to health insurance liabilities and health insurance assets, and it also serves as a blueprint for regulators evaluating financial statements of health carriers.

Minimum Risk-Based Capital Requirements

The establishment of additional reserves, such as a PDR would directly reduce a company's surplus, which lowers RBC percentage. Companies growing quickly by expanding into other states may be subject to an additional growth charge in the RBC formula, which would lower the RBC percentage. Companies that are marginally capitalized and face these types of changes to their balance sheet or to the RBC charge, may need additional cash infusions before the end of the year to ensure they meet minimum capital and surplus requirements. Therefore, carriers may want to estimate their year-end RBC percentage and make plans for any needed additional funding as soon as possible to avoid triggering a regulatory event. It may also be prudent for companies to contact the regulators in their state of domicile to discuss the timing of any additional funding amounts applicable to the 2020 reporting year.

Final Notes

This article provides an overview of some of the considerations that health actuaries working on behalf of carriers and state regulators need to be aware of regarding the preparation and review of Opinions and financial statements for year-end 2020. Appointed actuaries would be well advised to contact their state regulator to discuss these issues if they are concerned that the combined impact of COVID-19 and market changes in the ACA market may have a significant impact on their year-end actuarial estimates. Regulators should be aware of the interactions of the various market and company-specific factors impacting the calculation of the actuarial assets and liabilities, the variability of the estimates, and the potential impact on the financial health of the carriers under their jurisdiction. A new actuarial practice note[9] provides information relating to the type of documentation that a regulator may expect to be provided in the actuarial memorandum prepared in support of the Opinion, which may help to evaluate the actuarial estimates in the context of financial viability.

Please contact the author at annette@NovaRest.com (775)343-2322 if you want further information about addressing or evaluating any of these issues.

[8] http://www.actuarialstandardsboard.org/asops/statements-actuarial-opinion-regarding-health-insurance-liabilities-assets/

[9] Actuarial Memorandum Practice Note, American Academy of Actuaries, October 2020 https://www.actuary.org/sites/default/files/2020-10/Academy%20Actuarial%20Memorandum%20Practice%20Note.pdf