National Association of Insurance Commissioners

The Center for Insurance Policy and Research

MEMORANDUM

TO: Patrick McNaughton, Chair, Health Risk-Based Capital (E) Working Group

FROM: Stephen Wiest, Chair, Operational Risk (E) Subgroup

DATE: February 26, 2019

RE: **Referral for Further Work on Health Growth Operational Risk**

The operational Risk (E) Subgroup believes that there is an opportunity to improve the assessment of growth risk in the Health Risk-based Capital (HRBC) formula. While alternatives to the existing growth risk methodology that have been tested by the Subgroup have not proved to be better indicators of risk, there are reasons to consider whether the existing methodology is working as intended. The Health RBC (E) Working Group is best positioned to continue the review. The Operational Risk (E) Subgroup recommends that the review focus on the existing growth risk by forming an ad hoc subgroup of regulators and interested parties familiar with the HRBC formula similar to what was utilized to review the existing growth risk methodology and factors in the Property RBC formula. This document should be used as a starting point for that review. That ad hoc group would provide suggestions for potential enhancements to the existing growth charge to the HRBCWG. The review could include:

- Given the current array of company types that now file Health RBC, should the variables used in the application of the 10% threshold be reversed (i.e., the charge is assessed if risk revenue is increasing faster than RBC)?
- Determine if a 10% threshold is still reasonable.
- Should the normal growth risk calculation (existing or as adjusted) apply to start-up companies? If not, what adjustments should be applied to the calculation for start-ups?
- Should the Health RBC growth risk methodology (existing or as adjusted) be adopted into the Life RBC formula for companies that write a material amount (e.g. > X%) of their premiums in health business, where such business would be subject to the growth risk calculation in the Health RBC formula?

Background

How the Existing Growth Risk Charge Works:

- Growth in Underwriting Risk RBC year over year is measured against growth in underwriting risk revenue year over year. Thus, the formula recognized that as risk was added, revenue should respond accordingly.
- If growth Underwriting Risk RBC exceeds growth in underwriting risk revenue by greater than 10%, growth risk is triggered.
- A factor of 50% is applied to the excess of growth in Underwriting Risk RBC above the 10% threshold.

Considerations in Developing the Existing Methodology:

- The risk of growth, while included in H-4, is most related to increased pricing risk caused by growth rather than increased operational risk that that may be caused by rapid growth.
- The methodology is better designed to capture change in product mix or introductions of new managed care products with differing levels of managed care features.
- At the time that the HRBC formula was being developed, there were significant issues around transfer of risk to providers which were driving a change from capitated arrangements and HMO products to greater use of contractual fee-for-service and withholds / incentives in provider agreements and PPO and POS products.
- The developers of the HRBC formula considered the potential for premium rate impact related to increasing competition from national carriers into local markets, and consolidation in the market.

Reasons to Consider a Change to the Existing Methodology:

- The original Health Organizations RBC (HORBC) formula applied primarily to HMOs and Not-for-profit health plans (e.g., hospital and medical indemnity plans). In the early 2000s, with the adoption of Statutory Accounting Principles and the Health financial reporting blank (and the addition of a health test to that reporting blank), insurers became subject to the renamed Heath RBC (HRBC) formula.
- Relatively few entities triggered the current growth risk charge, even during recent periods of rapid growth caused by the ACA.
- The application of growth risk to new entities is unclear. A number of entities that were new to the market and which grew rapidly in 2014 and 2015 ultimately failed regardless of original projections. If sufficient capital was put in place during the licensing process based on reasonably accurate projections, then there should be little impact from growth risk. If not, perhaps growth risk should be recognized as an early warning indicator. The growth should smooth out over time and the charge removed.
- For various reasons, neither the informational approach nor other alternatives explored thus far by the Operational Risk (E) Subgroup have indicated a significantly improved ability to identify companies that are not sufficiently capitalized to absorb the impact of rapid growth.
- Companies that file the Life RBC formula, but write the same type of health business written by companies that are required to file the Health RBC formula are not currently subject to a growth risk capital requirement.