



SOCIETY OF ACTUARIES

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# Health Section News

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## Considerations in the Development of Area Factors

By David Reichlinger

Adjustments based on geographic location cause more variability in rates than any other factor except age. Whether they are developed internally or externally, a number of issues should be considered. Unfortunately these considerations are often subjective and may even be in conflict with each other. As a result, the process is both an art and a science.

This article presumes that an initial set of area factors is already available. Before making any modifications, it is important to understand how these area factors were developed.

It is a good idea to review your block of business for any circumstances that may require a special adjustment. For example, there may be a concentration of business in the fringes of a metropolitan area. This could result in a lower factor. If you specialize in a particular industry or affinity group, it could also impact the area factor.

Adjustments should also be made for any demographic differences. Rural areas

are more likely to have larger families. Census data is a good source for this information. Depending on the nature of your business, there may be other demographic considerations.

Legislation and the regulatory environment must be reviewed carefully. The impact will vary considerably depending on the product and jurisdiction.

Consideration must be given as to the location and composition of the services. The most expensive procedures are generally confined to major hospitals in large metropolitan areas regardless of where the patient is located. As the deductible increases, hospital stays generate a greater percentage of the cost. In pricing high deductible business or any form of excess reinsurance, the impact of the shift in location and composition of services must be carefully considered.

Competitive pressures play a role. If possible, avoid rapid increases in area factors. It is a good idea to carefully examine the factors in key markets.

As indicated above, this is an art and a science. Therefore it is necessary to rely on instinct. Don't be afraid to make adjustments if you feel they are appropriate. If possible, have an associate review your work.

If your pricing is based on your own experience, the application of area factors should have a neutral impact. Develop a composite area factor by taking a weighted average of the area factors against your block of business. If the composite isn't near 1.00, an adjustment is needed. If you rely on external sources for your pricing, this step isn't necessary.

In developing the process outlined above, consideration was given to a wide variety of products. You may find that some steps are not needed or have additional issues.

*David L. Reichlinger, FSA, MAAA, is owner of Reichlinger Consulting Group in Ft. Wayne, Ind. He can be reached at dreichlinger@fwi.com.*

### Chairperson's Corner

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customers with quality healthcare, create the necessary information systems, and still perform traditional insurance functions.

Although actuaries perform important technical risk functions, are we still the major force in the industry? I believe that to be the major force we have to be regarded as the MBAs of the healthcare industry. As the famous British actuary Frank Redington once said, "An actuary who is only an actuary is not an actuary." Questions that therefore come to mind are:

- What do we need to know?
- How do we learn it?
- How should this relate to our current education program?

Please let me know your thoughts, comments, and ideas on this challenge. These will be incorporated in a discussion

paper for further comment and ultimately for submission to the Society's health practice and E&E committees, if appropriate. Please contact me by e-mail at BRabinowitz@radixhealth.com.

Currently MCOs are earning inadequate returns on capital; more providers are in financial difficulty than ever before; political and litigation threats against managed care are gaining momentum; prescription drug costs are rapidly increasing; there are 44 million uninsured plus many underinsured; the population is aging; medical claim cost trend has now reached double digits. Where is our healthcare system headed?

For answers read *Institute for the Future: Health and Healthcare, The Forecast, The Challenge 2010*. The Robert Wood Johnson Foundation has placed a copy of this 217-page book on its Web site

[www.rwjf.org](http://www.rwjf.org). Just click on libraries. This book may also be ordered from Jossey-Bass Publishers at [www.josseybass.com](http://www.josseybass.com).

The Health and Pension Spring Meeting in Las Vegas (May 22-24, 2000) was a great success with about 1,100 attendees. All 39 sessions sponsored by the Health Section were well attended.

The success of the meeting was due in large part to the efforts of many volunteers including our program representatives Bob McGee and Dan Skwire, Section Council members, moderators and the panelists. Also thanks to the Society staff for their dedication and hard work.

*Bernie Rabinowitz, FIA, ASA, MAAA, is executive vice-president and chief actuary of Radix Health Connection LLC in Chicago. He can be reached at BRabinowitz@radixhealth.com.*