Session 99PD, Suggested Approach to Preparing Actuarial Memos in Support of Actuarial Opinions (Orange Blank)

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SOA Antitrust Disclaimer
SOA Presentation Disclaimer
Session 99: Suggested Approach to Preparing Actuarial Memos in Support of Actuarial Opinions (Orange Blank)

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Active participation in the Society of Actuaries is an important aspect of membership. While the positive contributions of professional societies and associations are well-recognized and encouraged, association activities are vulnerable to close antitrust scrutiny. By their very nature, associations bring together industry competitors and other market participants.

The United States antitrust laws aim to protect consumers by preserving the free economy and prohibiting anti-competitive business practices; they promote competition. There are both state and federal antitrust laws, although state antitrust laws closely follow federal law. The Sherman Act, is the primary U.S. antitrust law pertaining to association activities. The Sherman Act prohibits every contract, combination or conspiracy that places an unreasonable restraint on trade. There are, however, some activities that are illegal under all circumstances, such as price fixing, market allocation and collusive bidding.

There is no safe harbor under the antitrust law for professional association activities. Therefore, association meeting participants should refrain from discussing any activity that could potentially be construed as having an anti-competitive effect. Discussions relating to product or service pricing, market allocations, membership restrictions, product standardization or other conditions on trade could arguably be perceived as a restraint on trade and may expose the SOA and its members to antitrust enforcement procedures.

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- **Do not** discuss prices for services or products or anything else that might affect prices
- **Do not** discuss what you or other entities plan to do in a particular geographic or product markets or with particular customers.
- **Do not** speak on behalf of the SOA or any of its committees unless specifically authorized to do so.
- **Do** leave a meeting where any anticompetitive pricing or market allocation discussion occurs.
- **Do** alert SOA staff and/or legal counsel to any concerning discussions
- **Do** consult with legal counsel before raising any matter or making a statement that may involve competitively sensitive information.

Adherence to these guidelines involves not only avoidance of antitrust violations, but avoidance of behavior which might be so construed. These guidelines only provide an overview of prohibited activities. SOA legal counsel reviews meeting agenda and materials as deemed appropriate and any discussion that departs from the formal agenda should be scrutinized carefully. Antitrust compliance is everyone’s responsibility; however, please seek legal counsel if you have any questions or concerns.
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Poll: What is your experience with Statements of Actuarial Opinions (SAOs) and Actuarial Memorandums (AMs)?
What is your experience with Statements of Actuarial Opinions (SAOs) and Actuarial Memorandums (AMs)?

- 36% Appointed Actuary preparing SAOs and AMs
- 46% On the supporting team preparing SAOs and AMs
- 11% Hope to get into this work
- 7% New to me
- 0% Regulator auditor - reviewing SAOs AMs
Session Roadmap

1. Actuarial Memorandum guidelines
2. Case studies
3. Summary
4. Additional resources
“Actuarial Memorandum” means a document or other presentation prepared as a formal means of conveying the appointed actuary’s professional conclusions and recommendations, of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the appointed actuary’s opinion or findings and that documents the analysis underlying the opinion.

- NAIC Annual Statement Instructions – Health
- The Actuarial Memorandum is an actuarial communication and must comply with ASOP 41
- Retain for seven years
- Must be available by May 1, or earlier if requested
- Contains proprietary information and will be held confidential
- Conform to the documentation and disclosure requirements of the ASOPs
- Contains both narrative and technical components
Narrative Component

Who is the audience?

• Regulators

• Company management

Should provide sufficient detail to clearly explain

• Findings

• Recommendations

• Conclusions
Technical Component

Who is the audience?

- Regulators – DOI Actuary and support staff
- Reviewing actuary (practicing in the same field)

Should provide sufficient documentation and disclosure

- To evaluate the work
- Show the analysis from starting from data to the conclusions
- Not a data dump – sufficient detail with reader friendly formatting
- Use clear and accurate language and business writing best practices
Additional Required Components

The Memorandum must also include:

• An exhibit that ties to the Annual Statement.
• Reconciliation of the data used for analysis to the Underwriting and Investment Exhibit, Part 2B.
• Other follow-up studies documenting the prior year’s claims liability.
• Documentation of the assumptions used for contract reserves:
  • Material changes to those assumptions
  • Studies which support the adequacy of any margin
Suggested Components

Other suggested items:
• Identification and analysis of assets within scope.
• Review of Loss Adjustment Expense and how it compares to actuals.
• Lookback on other actuarial items, like risk adjustment accruals, MLR.
• Document changes from prescribed wording.
Case Study 1
Case Study 1

“This memorandum has been prepared for ABC’s internal purposes only, and is not intended for use by any other parties or for any other purposes. This memorandum may be shared with the company’s auditors in the process of auditing these reserve calculations and may be shared with the Department of Insurance upon their request.”
Case Study 1 – Improvement Suggestions

• According to the NAIC’s orange blank is a regulatory requirement.
  • There are at least two audiences: the company’s board of directors and the regulator.

• The memorandum is not prepared for internal purposes.
Case Study 2
Case Study 2

• This entity writes significant ACA business.
• In the previous year, a large risk adjustment payable was reported.
• This year, a large risk adjustment receivable was reported.
• The swing in risk adjustment transfer payment amounts results in a 30% change in the company’s surplus.
• The actuary issued an unqualified opinion and did not address the type of opinion issued in the Actuarial Memorandum.
Case Study 2 – Improvement Suggestions

• The Actuarial Memorandum should clearly state the type of opinion and an explanation as to why that opinion is appropriate.
• A large swing in a material actuarial item should be explained and the actuary should be prepared to explain why the opinion is valid, given the apparent volatility of that item.
Case Study 3
Case Study 3

The Table of Key Indicators indicated prescribed wording was used in all sections. The following opinion section was included in an annual statement filed in Ohio:

In my opinion, the amounts carried in the balance sheet on account of the items identified above:

A. Are in accordance with accepted actuarial standards consistently applied and are fairly stated in accordance with sound actuarial principles;

B. Are based on actuarial assumptions relevant to contract provisions and appropriate to the purpose for which the statement was prepared;

C. Meet the requirements of the Insurance Laws and regulations of the state of Michigan and are at least as great as the minimum aggregate amounts required by the state in which this statement is filed;

D. Make a good and sufficient provision for all unpaid claims and other actuarial liabilities of the organization under the terms of its contracts and agreements;

E. Are computed on the basis of assumptions and methods consistent with those used in computing the corresponding items in the annual statement of the preceding year-end; and

F. Include appropriate provision for all actuarial items that ought to be established.
Case Study 3 – Improvement Suggestions

• Pay attention to the details.
• Start with prescribed wording and make edits as necessary.
• Document material changes from prescribed wording.
Case Study 4
Case Study 4

Incurred But Not Paid Claims for Medical Expenses

The Incurred But Not Paid (IBNP) Claims liability for medical claims includes provision for all claims incurred prior to January 1, 2017 but paid on or after January 1, 2017. These include:

- Claims incurred but not reported
- Claims pending
- Claims denied that ultimately will become payable

IBNP reserves are determined separately for each line of business to reflect the different payment patterns. The Company provided monthly incurred and paid claims data for non-capitated covered lives by line of business through December 2016.

- Due to the size of the groups, the final incurred claims were determined by taking a weighted average of actual (unsmoothed) claims and estimated (smoothed) claims experience.

- Estimated payments (smoothed) are determined by applying completion factors to the average per member claim. A 6 to 12 month average is used depending on circumstances. A medical inflation of 8% inflation per annum is used in the calculation.

- The smoothed claims are compared with the actual unsmoothed claims and a weighted average paid and incurred payment stream by month is developed.

- Based on the triangular data, completion factors are developed then applied to the assumed monthly paid and incurred payments to determine ultimate incurred claims by month.

- Incurred but unpaid claims are developed from the assumed ultimate incurred claims.

- A margin is applied to the reserves to cover potential unknown events and fluctuations.
Case Study 4 – Improvement Suggestions

• Describe IBNP calculation using well defined terms. “Smoothing” is vague.
  • The reason for the smoothing process is vague – “due to the size of the groups”... Why is group size a consideration for the method used? Explain.

• Expand the IBNP calculation description to fully document the process.

• Document why 8% trend is chosen.

• How is the 8% trend used in the calculation?

• How is the margin determined? What were the considerations?

• What adjustments were made for large claims, seasonality, etc.?

• Is this process different from last year? If yes, why was a new process needed?

• Has hindsight testing been done to evaluate the appropriateness of the methodology?
Case Study 5
Case Study 5

Expected Reinsurance Recoveries

The IBNP reserves determined above are reduced by reinsurance recoveries expected to be made after the measurement date for claims incurred prior to the measurement date. These amounts are estimated to be 5% of the IBNP reserve.
Case Study 5 – Improvement Suggestions

• Explain how reinsurance estimate of 5% is developed.
• Consider past reinsurance experience.
• Have there been any change in the large claims experience or the terms of the reinsurance contract(s) that may impact the expected recoveries?
• Has the actuary formed an opinion regarding whether or not the credit for reinsurance is appropriate or is he/she relying on others for that determination? The Actuarial Memorandum should make it clear.
Case Study 6
Case Study 6

An actuary files an unqualified opinion for a company with significant historical losses for each of the last 4 years and $0 premium deficiency reserve (PDR).

• An examination as of 12/31/2015 results in adjustments that lead to a material PDRs for 2013, 2014, and 2015.

• For 2016 and 2017, the company again records a $0 PDR.

• No documentation was provided in the Actuarial Memorandum for the determination of the PDRs for any of the years.
Case Study 6 – Improvement Suggestions

• The existence of a PDR for prior years does not necessarily imply a PDR for future years. However, it increases the need for a thorough explanation of the methodology and assumptions used to determine the PDR estimates.

• Documentation of the PDR calculation is provided regardless of the value of the PDR.
Case Study 7

This entity writes significant ACA business on and off the exchange.

This is the scope section of the Actuarial Opinion and the same items are discussed in the Actuarial Memorandum:

I have examined the assumptions and methods used in determining loss reserves, actuarial liabilities and related items listed below, as shown in the annual statement of the organization as prepared for filing with state regulatory officials, as of December 31, 2017.

A. Claims unpaid (Page 3, Line 1) $160,000,000
B. Accrued medical incentive pool and bonus payments (Page 3, Line 2) $1,000,000
C. Unpaid claims adjustment expenses (Page 3, Line 3) $2,500,000
D. Aggregate health policy reserves (Page 3, Line 4) including unearned premium reserves, premium deficiency reserves and additional policy reserves from the Underwriting and Investment Exhibit, Part 2D $0
E. Aggregate life policy reserves (Page 3, Line 5) $0
F. Property/casualty unearned premium reserves (Page 3, Line 6) $0
G. Aggregate health claim reserves (Page 3, Line 7) $0
H. Any other loss reserves, actuarial liabilities, or related items presented as liabilities in the annual statement $0
I. Specified actuarial items presented as assets in the annual statement $0
Case Study 7 – Improvement Suggestions

• Document the $0 PDR, $0 risk adjustment, and $0 MLR liabilities in Actuarial Memorandum.

• $0 is a number that you need to document.

• Make sure that every item included in the scope of the Actuarial Opinion is covered in the Actuarial Memorandum.
Case Study 8
Case Study 8

“In forming my opinion on the ACA risk Adjustment payable (part of the aggregate write-ins for other liabilities), I relied upon data prepared by Reliable Actuarial Consulting, Inc., as certified in the attached statements.”
Case Study 8 – Improvement Suggestions

• Explain what information was used from the consultants.
• Explain what level of review was done, including any reasonableness tests conducted.
• If consultants provided a range of results, how did you choose from the range and what, if any adjustments were made to reflect specific circumstances that may have emerged since the consultant’s estimate was determined?
Case Study 9

“ABC company established a liability for a premium deficiency reserve (PDR) on its individual block of business as of the statement date. I relied on ABC’s projections and, upon review, found their methods and assumptions to be reasonable.”
Case Study 9 – Improvement Suggestions

• The PDR is an actuarial calculation.
  • Was the company’s calculation performed by a qualified health actuary?
  • Whether or not, it is not appropriate to accept the company’s estimate unless the
    opining actuary did an independent calculation or reviewed the work papers.

• Document the level of review that was performed to determine the
  appropriateness of the estimate.
Case Study 10
A reliance letter was included that stated “the Underwriting and Investment Exhibit of the Annual Statement was prepared consistent with the claim incurral dates and claim payment dates of the data provided to support determination of the liability for unpaid claims.”
Case Study 10 – Improvement Suggestions

• The actuary must reconcile to the Underwriting and Investment Exhibit, Part 2B. A reliance letter is not sufficient.

• Prescribed language in the Actuarial Opinion includes the statement:
  • “The Underwriting and Investment Exhibit - Part 2B was reviewed for reasonableness and consistency with the applicable Actuarial Standards of Practice.”
  • Follow this requirement and document any deviation.
Summary
Best Practices

• Most of the analysis that is included in the Actuarial Memo should be done in February, coinciding with the Opinion.

• Include enough detail in the technical component that a practicing actuary could follow your process.

• When using other’s work, make sure you have reviewed their analysis in detail as if it was your own.

• Specify what items need or do not need margin and why you believe this. Don’t forget aggregate margin.

• Add in additional components in the list of items within scope of the Actuarial Opinion, even if the value is $0. Examples include PDR, MLR, and ACA risk adjustment.
Resources - ASOPs

- ASOP 1: Introductory Actuarial Standard of Practice
- ASOP 5: Incurred Health and Disability Claims
- ASOP 7: Analysis of Life, Health, or P&C Insurer Cash Flows
- ASOP 8: Regulatory Filings for Health Benefits, Accident and Health Insurance, and Entities Providing Health Benefits
- ASOP 11: Treatment of Reinsurance Transactions
- ASOP 22: Statements of Opinion Based on Asset Adequacy Analysis by Actuaries for Life or Health Insurers
- ASOP 23: Data Quality
- ASOP 28: Statements of Actuarial Opinion Regarding Health Insurance Liabilities and Assets
- ASOP 41: Actuarial Communications
- ASOP 42: Determining Health and Disability Liabilities Other than Liabilities for Incurred Claims
- ASOP 45: The Use of Health Status Based Risk Adjustment Methodologies
Resources – SSAPs*

- SSAP 54 – Individual and Group Accident Health Contracts
- SSAP 55 – Unpaid Claims, Losses, and Loss Adjustment Expenses
- SSAP 84 – Health Care and Government Insured Plan Receivables
- SSAP 61 – Life, Deposit-type and Accident Health Reinsurance

* Statement of Statutory Accounting Principles
Other Resources

• Practice Note – Revised Actuarial Statement of Opinion Instructions for the NAIC Health Annual Statement Effective December 31, 2010
• NAIC Health Annual Statement Instructions 2017
• NAIC Health Reserves Guidance Manual – February 2007
• Premium Deficiency Reserve Discussion Paper – AAA March 2007
• Practice Note – Large Group Medical Insurance Reserves, Liabilities, and Actuarial Assets
• Practice Note – Small Group Medical Insurance Reserves and Liabilities
• Practice Note – Practices for Preparing Health Contract Reserves
• The Plain English Approach to Business Writing - Edward Bailey/Larry Bailey
Questions?

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Live Content Slide

When playing as a slideshow, this slide will display live content

Social Q&A
Thank You