Date: 12/10/21

Virtual Meeting

HEALTH RISKED-BASED CAPITAL (E) WORKING GROUP
Thursday, December 16, 2021
2:00 – 3:00 p.m. ET / 1:00 – 2:00 p.m. CT / 12:00 – 1:00 p.m. MT / 11:00 a.m. – 12:00 p.m. PT

ROLL CALL

Steve Drutz, Chair Washington Michael Muldoon Nebraska
Jennifer Li Alabama Tom Dudek New York
Wanchin Chou Connecticut Kimberly Rankin Pennsylvania
Carolyn Morgan/Kyle Collins Florida Mike Boerner/Aaron Hodges Texas
Tish Becker Kansas

NAIC Support Staff: Crystal Brown

AGENDA

1. Discuss Comments Received on Proposal 2021-18-H—Steve Drutz (WA) Attachment One
   • UnitedHealth Group (UHG) Comment Letter—Jim Braue (UHG) Attachment Two
2. Consider Exposure of a Health Test Language Proposal—Steve Drutz (WA) Attachment Three
3. Discuss Any Other Matters Brought Before the Working Group—Steve Drutz (WA)
4. Adjournment
### Agenda Item # 2021-18-H

**Year 2022**

<table>
<thead>
<tr>
<th>DISPOSITION</th>
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<td>ADOPTED</td>
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<td>OTHER (SPECIFY)</td>
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**DESCRIPTION OF CHANGE(S)**

Incorporate benchmarking guidelines for the Working Group to follow in updating the investment income adjustment in the underwriting risk factors for Comprehensive Medical, Medicare Supplement and Dental & Vision.

**REASON OR JUSTIFICATION FOR CHANGE **

The reason for the change is to clearly identify the frequency and parameters to use in adjusting the underwriting risk factors for investment income in the Comprehensive Medical, Medicare Supplement and Dental & Vision lines.

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**Additional Staff Comments:**

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**This section must be completed on all forms.**

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**UNDERWRITING RISK - L(1) THROUGH L(21)**

**XR013**

**Line (12) Underwriting Risk Claims Ratio.** For Columns (1) through (5), Line (11) / Line (6). If either Line (6) or Line (11) is zero or negative, Line (12) is zero.

**Line (13) Underwriting Risk Factor.** A weighted average factor based on the amount reported in Line (6), Underwriting Risk Revenue. The factors for Column (1) through (3) have incorporated an investment income yield of 0.5%.

<table>
<thead>
<tr>
<th>Line of Business</th>
<th>$0 – $3 Million</th>
<th>$3 – $25 Million</th>
<th>Over $25 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comprehensive Medical &amp; Hospital</td>
<td>0.1493</td>
<td>0.1493</td>
<td>0.0893</td>
</tr>
<tr>
<td>Medicare Supplement</td>
<td>0.1043</td>
<td>0.0663</td>
<td>0.0663</td>
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<tr>
<td>Dental &amp; Vision</td>
<td>0.1195</td>
<td>0.0755</td>
<td>0.0755</td>
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<tr>
<td>Stand-Alone Medicare Part D Coverage</td>
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<td>0.251</td>
<td>0.151</td>
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<tr>
<td>Other Health</td>
<td>0.130</td>
<td>0.130</td>
<td>0.130</td>
</tr>
<tr>
<td>Other Non-Health</td>
<td>0.130</td>
<td>0.130</td>
<td>0.130</td>
</tr>
</tbody>
</table>

The investment income yield was incorporated into the Comprehensive Medical & Hospital, Medicare Supplement and Dental & Vision lines of business. The purpose was to incorporate an offset to reduce the underwriting risk factor for investment income earned by the insurer. The Working Group incorporated a 0.5% income yield that was based on the yield of a 6-month US Treasury Bond. The Working Group will evaluate the yield of the 6-month Treasury bond as of January 1st each year and determine if further modifications to the 0.5% adjustment are needed. Any adjustments will be rounded up to the nearest 0.5%.

**Line (14) Base Underwriting Risk RBC.** Line (6) x Line (12) x Line (13).
November 30, 2021

Mr. Steven Drutz, Chair
Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO  64106-2197

Via electronic mail to Crystal Brown.

Re: Proposal 2021-18-H.

Dear Mr. Drutz:

I am writing on behalf of UnitedHealth Group in regard to Proposal 2021-18-H, as exposed for comment on 11/4/21. As we have stated in previous comment letters, we are supportive of investment income being reflected in the Health Risk-Based Capital formula, and we appreciate the work that your Working Group has done to implement that concept.

Proposal 2021-18-H bases the investment income adjustment on “the yield of the 6-month Treasury bond as of January 1st each year.” We will comment on two aspects of this proposal: the 6-month maturity assumption and the January 1 reference period.

Six-month maturity assumption.

As explained in our comment letters of 1/6/21 and 4/16/21, we believe that a longer maturity assumption than 6 months is warranted. In particular, we have suggested that a 5-year maturity assumption would be reasonable, given that the bond risk factors were based on an assumed 5-year maturity. The same portfolio that generates the bond risk is also generating the investment income that is being reflected in the underwriting risk factors.

Two objections have been raised to using a 5-year maturity: a concern about asset/liability mismatch; and a concern about consistency with premium rate filings. We will address both concerns below.

1. Asset/liability mismatch.

Considerable emphasis has been placed on the fact that most claims are paid within a few months of when they were incurred. The analysis that the American Academy of Actuaries
performed to determine the investment income adjustment indicated that the average lag until payment for a comprehensive medical claim is less than two months. However, as we noted in our 1/6/21 letter, the run-out period of a single incurral date’s claims is not really relevant from an investment standpoint. As a going concern, a health entity does not repeatedly run its assets down to zero as claims are paid; there is a continual inflow of cash from premiums and other revenues, and investments are held for a longer term. Generally speaking, investment maturities would not be needed for as long as the entity’s business is stable or growing, except in cases where cash outflows exceeded cash inflows because of abnormally high levels of claims or other expenses.

Over what period might we assume that an entity’s volume of business will remain stable? For purposes related to the underwriting risk charges, we can look at what the Academy assumed in developing those charges. In the December 1994 report (as revised) of the Academy’s Health Organizations Risk Based Capital Task Force to the NAIC’s Health Organizations Risk-Based Capital Working Group, the Academy explained the following about the model used in determining the underwriting risk charges:

The purpose of this model is to simulate the financial results of a block of business over a five year period. … The block of business that is simulated is assumed to represent a stationary population. This means that as old business lapses, new business is written, and the characteristics of the inforce remains steady over time.

This, by itself, would suggest that a five-year investment maturity is indeed consistent with the assumptions underlying the development of the underwriting risk factors. It might be legitimately objected that, while the Academy may have evaluated risk assuming five years of steady volume, the modeled entity would not necessarily have made that same assumption in its investment strategy. That is true, but likewise the entity would not necessarily assume the imminent termination of all of its business. The use of a six-month maturity assumption could mean, as an example, that the entity expected more than 50% of its business to be terminated immediately, and the remainder to be terminated in one year. (The percentage is “more than” 50% because the run-off of the claims would add, as noted above, something more than a month to the average maturity.) While some entities, with concerns about the stability of their business, might make such an assumption, it does not seem like a reasonable assumption for the broad majority of entities covered by the Health RBC formula.

During a previous discussion, one regulator pointed out that, while immediate termination of most or all of an entity’s business might not be a reasonable assumption, in some markets a 30% termination rate would be quite reasonable. Consider that, if 30% of an entity’s business terminated immediately (net to any new business added), and another 30% of the remaining business terminated at the beginning of each subsequent year, on average the business would be on the books for about 2.3 years. If we wanted to be more conservative than to assume that the 30% annual termination continued indefinitely, and instead assumed that all remaining business would terminate at the end of the third year, the average life of the business would still be more than 1.5 years. Because that number represents an average, and because the yield curve is currently convex upwards, the resulting interest rate might
correspond to a maturity somewhat less than 1.5 years, but still more than one year. To reduce that rate further, to represent a six-month maturity, seems overly conservative.

Another potential objection is that the RBC formula does in fact assume that there will be losses, and that therefore cash outflows might indeed be assumed to exceed cash inflows, resulting in a need for shorter maturities. However, two things should be considered: first, that the underwriting risk charges (approximating the excess outflows) will in most cases be less than the claim reserves; and second, that the underwriting risk charges represent a cumulative loss over five years, which would not necessarily all need to be funded in the first year or two. Therefore, the capital that covers the excess outflows would not necessarily be invested to a shorter horizon than the claim reserves themselves, and accordingly would not significantly impact the average maturity of the investment portfolio.

In summary, even rather conservative assumptions about business volume would lead to an assumed maturity in the range of one to two years. Less conservative assumptions could easily justify a maturity above two years, since, for example, an entity experiencing a 30% loss of business might adjust its pricing and/or marketing to reduce further losses, rather than allow the 30% to continue or worsen.

2. Consistency with premium rate filings.

Regulators have raised the concern that the assumption of any non-trivial amount of investment income would be inconsistent with the assumptions that they have seen in premium rate filings, where, they state, investment income is typically dismissed as being immaterial. First, we must note that there may legitimately be differences between what is assumed for RBC purposes and what is assumed for rate filings, because of, for instance, differing standards of materiality.

However, even if we suppose that the same assumption should be used for both purposes, it does not follow that the rate filings should be driving the RBC outcome. RBC should be based on the best available data and reasoning. If those data and rationales seem at odds with what is being assumed elsewhere, it is those other assumptions that should be considered suspect.

Further, we point out that the RBC formula is applied to a broad population of health entities, whereas rate filings are entity-specific. If a regulator is concerned about whether an entity has appropriately reflected investment income in its rate filing, that entity can be required to provide further justification for its assumptions. RBC, on the other hand, must be appropriate for a wide variety of circumstances, and there is a practical limitation on how much it can be tailored to individual entities.

In summary, it does not seem appropriate to base RBC assumptions on what is depicted in premium rate filings.

We recognize that the proposal to round the investment income rate up to the next higher multiple of 0.5% was intended, at least in part, to effectively lengthen the maturity assumption.
However, while a fix of that sort might produce a reasonable result at a given point in time, it is unlikely to work properly in the long term. When the yield curve has a steep positive slope, the adjustment will be inadequate. When the yield curve is flat or, especially, inverted, the adjustment will be excessive. To avoid such outcomes, the maturity assumption should be set appropriately, and a lesser degree of rounding should be used.

In regard to that rounding convention, we will also note that the proposal states, “Any adjustments will be rounded up to the nearest 0.5%.” We suggest that, to avoid confusion, the sentence should begin, “The investment income yield will be rounded …” The word “adjustment” might be construed to mean the change in the underwriting risk factor, rather than the yield assumption underlying that change.

January 1 reference period.

Proposal 2021-18-H provides, “The Working Group will evaluate the yield of the 6-month Treasury bond as of January 1st each year …” We have some concerns regarding the phrase “as of January 1st.” To begin with, the fixed income markets typically will not be open on January 1, and many rate sources (e.g., the U.S Treasury department’s Daily Treasury Yield Curve Rates) will not supply a value for that date, leaving open to question what value should be used. More importantly, it may be inadvisable to use any single date as the basis for the yield determination, because the rate on a single date may be anomalous, e.g., because of overreactions to certain news items. It would be better to use the average yield over a somewhat longer period, such as the first ten business days of the year, or even the first month of the year. This would tend to minimize the impact of any one anomalous rate, while still allowing the determination to be made early in the calendar year.

*     *     *     *     *

We would be happy to discuss these comments with you and the Working Group.

James R. Braue
Director, Actuarial Services
UnitedHealth Group

cc: Crystal Brown, NAIC
     Randi Reichel, UnitedHealth Group