

PROJECT HISTORY - 2009

RISK-BASED CAPITAL FOR HEALTH ORGANIZATIONS MODEL ACT (#315) TO INCORPORATE THE HEALTH TREND TEST

1. Project Description

To establish a trend test wherein the RBC company action level is triggered when the combined ratio is greater than 105% and the RBC is between 200-300%.

The trend test has been established within the RBC formula but would be considered "Information Only" until states adopt legislation that conforms their statutes to the modifications included in this change to the RBC for Health Organizations Model Act. The major change to the Model Act is to cite the health trend test as a way for the company action level to be triggered.

2. Group Responsible for Drafting Model and States Participating

The Health Risk-Based Capital (E) Working Group was responsible for drafting the revisions of the model. Dennis Julnes (Washington) chaired the Working Group. The following states were members: Alabama, Minnesota, New York, Pennsylvania, and Texas.

3. Charge Authorizing Project

The Capital Adequacy (E) Task Force originally charged the Health Risk-Based Capital (E) Working Group in 2006 with the creation of the health trend test and to consider refinements to the RBC calculations and to maintain the Risk-Based Capital for Health Organizations Model Act.

4. Description of Drafting Process

During a March 5, 2008, conference call of the Health Risk-Based Capital (E) Working Group, the American Academy of Actuaries (AAA) and the Working Group began work to create the Health Trend Test. The AAA worked with blinded data from the NAIC and the default proposal consisted of a HRBC ratio between 200-300% and a combined ratio greater than 105%. The AAA submitted a report containing three proposed tests to the Health Risk-Based Capital (E) Working Group on August 26, 2008. The report proposed three different trend tests, they were:

Trend Test 1: If $200 \text{ percent} < \text{HRBC}_{\text{base year}} \leq 300 \text{ percent}$ and $\text{combined ratio}_{\text{base year}} > 105 \text{ percent}$
(straw man benchmark trend test)

Trend Test 2: If $\text{net income before FIT} / (\text{TAC} - 2 * \text{ACL}) \leq -1$, where
TAC = total adjusted capital in the base year
ACL = authorized control level (100 percent RBC)

Trend Test 3: If $\text{net income before FIT} / (\text{TAC} - 1.5 * \text{ACL}) \leq -1$

Lou Felice (NY) noted that a change would also need to be made to the RBC for Health Organizations Model Act for the trend test to be enforceable.

5. Description of Due Process

The Health Risk-Based Capital (E) Working Group discussed the report on an October 10, 2008, conference call. The Trend Test 1 proposal for the health RBC formula was released for comment for a 30-day period. A comment letter was received from America's Health Insurance Plans (AHIP) to create a trend test that looks at trends over a time period and not only at one point in time.

The changes to the Health RBC formula for trend test 1 were adopted at the November 12, 2008, conference call of the Health Risk-Based Capital (E) Working Group. At the same time, a model review request to make changes to the RBC for Health Organizations Model Act was also approved. The Capital Adequacy (E) Task Force and Financial Condition (E) Committee adopted the health RBC trend test formula changes and Request for RBC for Health Organizations Model Act changes at the 2008 Winter National Meeting.

Authorization to consider changes to the RBC for Health Organizations Model Act was given by the Executive (EX) Committee at the 2009 Spring National Meeting. The revised RBC for Health Organizations Model Act language was released for comment on a March 31, 2009, conference call of the Health Risk-Based Capital (E) Working Group. No comments were received, and the Health Risk-Based Capital (E) Working Group adopted the model act changes at the May 7, 2009, Working Group conference call. The Capital Adequacy (E) Task Force and Financial Condition (E) Committee adopted the RBC for Health Organizations (E) Model Act changes at the 2009 Summer National Meeting.

6. Significant Issues Raised

There were no serious issues raised with the Model Act.

There were some concerns of the trend test only looked at only one point in time and not at trends over a time period. There were also concerns expressed about the test producing false positive results. The Working Group found that an RBC action level had not resulted in the next year for those companies because of capital infusions.