VEHI Health Program Net Position Policy

I. Purpose/Policy Statement: The purpose of the Net Position Policy is to ensure that the Vermont Education Health Initiative's (VEHI) Health Program (Program) maintains a Net Position (reserve balance) that is adequate to meet the Program's current and future expense obligations. In addition, the Policy is intended to ensure annual monitoring of Net Position to allow for an appropriate and timely response to a material change in Net Position.

Adequate Net Position allows the Program, as it deems necessary, to:

a) pay claims above the actuarial estimates that are not covered by individual stop loss;
b) pay unanticipated non-claims expenses, including state and federal fees or assessments, that were enacted after the Program set its rates;
c) maintain a margin above IBNR (claims that have been incurred but not yet reported) to cover all run-out expenses in the event VEHI closes the Program;
d) change the Program's individual stop-loss level;
e) mitigate member rate increases;
f) invest in additional loss control or cost-saving efforts; or
g) add additional benefits or services for members.

II. Definitions:

Net Position – the current year's Health Program Net Position according to VEHI's most recent audited year-end (June 30) financial statement. Current Year Net Position equals Previous Year's Net Position + Current Year's Net Gain (Loss).

Total Expenditures (TE) – total incurred claims plus expenses according to VEHI's most recent audited year-end (June 30) financial statement**.**

Target Net Position – the amount of funds, expressed as a percentage of Total Expenditures that VEHI endeavors to hold at the end of each fiscal year to be in a position to confidently support its Program without disadvantaging its members.

III. Establishing and Reviewing Target Net Position: VEHI will contract with an independent actuary to conduct an analysis and recommend a Target Net Position. **The last analysis was completed in December of 2017 and reaffirmed the Target Net Position at 15%,** which includes 4% for uncertainty. Target Net Position will be subject to actuarial review very five (5) years, or more frequently as determined by the VEHI Board (Board).

IV. If the Net Position <u>**falls below**</u> **the Target level** and meets one of the Action Levels in Section V, VEHI Management (Management) shall take the actions outlined.

V. Action Levels: Action Levels were determined based on an actuarial opinion and shall be subject to actuarial review every five (5) years, or more frequently as determined by the Board. The last review was completed in February of 2019.

Board Action Level – Net Position between 9.0% – 6.1%

If the Net Position falls within this range, Management is required to submit to the Board a written Plan within 45 days of the receipt of the financial audit. The Plan must detail the causes and actions that have led to the deficiency, as well as the strategy to rebuild Net Position to the Target level in an acceptable timeframe. The Board will review and adopt the Plan, or otherwise direct Management to modify the Plan to meet the concerns of the Board. Any modified Plan will be brought back to the Board for review and adoption.

Regulatory Review Level – Net Position at 6.0% <u>or less</u>

If the Net Position is 6.0% or less, Management will submit to the Department of Financial Regulation (DFR) a copy of the written Plan adopted by the Board, detailing the causes and actions that have led to the deficiency, as well as the strategy to rebuild Net Position to the target level in an acceptable time frame.

VI. Rate Setting:

The Board may authorize a planned use of Net Position funds to mitigate rate increases. Alternately, the Board may authorize a planned increase to the Net Position level through an increase in the rates above what is actuarially estimated to be sufficient to cover all program expenses for the applicable year. These actions are subject to the approval of DFR.

VII. Net Position Materially Greater than Target Net Position:

If the Board determines the Net Position is <u>materially greater</u> than the target, the Board may continue to monitor the Net Position Level or, prior to the next rating cycle, based on multi-year projections and subject to the approval of DFR, the Board may authorize other measures, including but not limited to, a mid-year rate decrease, a premium "holiday" where no premiums are collected for a short duration, or surplus distributions to members.

VIII. Implementation Responsibilities: Management is responsible for monitoring and implementing this policy and making recommendations on it to the Board.

Adopted: April 29, 2019

Statement of Actuarial Opinion February 7, 2019

Background

The Vermont Educational Health Initiative (VEHI) has requested an actuarial opinion as to the adequacy of its proposed 9% “Board Action Level” trigger in its Health Program Net Surplus Position Policy Statement. I. John D. Stiefel, Independent Actuary, am a Fellow of the Society of Actuaries and a Member of the American Academy of Actuaries - and I meet the qualification standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Statement of Actuarial Opinion

It is my opinion that VEHI can effectively and responsibility mange its health insurance program with a formal “Board Action Level” trigger at a net position of 9% “surplus ratio”.

Rationale

1. VEHI’s experience shows that VEHI has been able to manage its business toward a surplus ratio of 15%. (See attached spread sheet prepared by VEHI.)
   a. At the start of the program in 1996, VEHI held a letter of credit as it built its reserves. By 6/30/2002, VEHI’s health program had a surplus ratio of 10.6%.

   b. Only twice after 2002 did VEHI’s health program surplus ratio fall close to or below 9%.
      i. The first time was the result of a confluence of factors, including the advent of the federal PPACA fees and increasing state fees at a time when VEHI increased its investment in wellness (loss control) programming. In response, VEHI added additional internal controls to better monitor and adjust to both internal and external factors that impact expenditures.
      ii. The second time VEHI reduced its surplus at the request of DFR and Green Mountain Care Board, predicated on the expected move to Green Mountain Care and the close of the program in the near future.
      iii. In each case, the surplus ratio was brought back to around 15% within a couple of years.

2. VEHI contractual rights and membership stability. VEHI needs less surplus than the typical insurer using risk based capital or any other means of calculating it.

   a. Can increase rates in the middle of the policy year if experience is trending unfavorably.
   b. Can assess member districts to generate additional income, even after the year has ended.
   c. VEHI has not needed to exercise this authority at any time since the organization was formed in 1996.
   d. VEHI’s membership is stable, with all public schools included, and school districts are not in danger of going bankrupt or leaving the state.
   e. Over the past decade VEHI saw its covered lives rise in number from 39,146 as of January 1, 2009 to 42,613 as of January 1, 2019.
   f. The typical insurer does not have these rights or membership stability.

3. VEHI has specific stop loss protection at the $750,000 level.
    a. This mitigates the biggest risk of claim fluctuations; i.e. catastrophic claims.

4. A statistical analysis shows that the “minimum ballpark” estimate of required surplus is only 1.5%.
    a. VEHI’s annual report for FYE 6/30/18, shows VEHI had claims totaling $244,382,324 and an average annual claim of $5,880 ($490 per month). So VEHI had 41,562 claims ($244,382,324 divided by $5,880).
    b. Each claim event is independent of every other claim event.
    c. Let E(X) = 41,562, the expected value of the total number of claims. Then, using a “Poisson distribution” formula, V(X), the variance of expected claims also equals 41,452 and D(X), the standard deviation of expected claims is the square root of V(X) or 204 (square root of 41,562).
    d. If claims follow a “normal distribution” then, per c. above, 3 standard deviations above the number of expected claims is 43,173 claims. Based on the average of $5,880, this is $247,978,532 which is 101.5% of actual claims.
    e. VEHI’s claims don’t follow a “normal distribution” (the distribution is actually “skew-symmetric” with more claims < the mean than > the mean). So there will be more than “normal distribution variability”; but this analysis shows us a “minimum ballpark” estimate of how much surplus is needed.
    f. This same statistical analysis shows minimum surplus of 2.3% for a $100,000,000 block of business, 3.7% for a $10,000,000 block, 23.0% for a $1,000,000 block and 72.7% for a $100,000 block.

5. Industry standard
    a. In the health insurance industry, a “premium stabilization” reserve (PSR) of 9% is considered conservative for a client with more than $100,000,000 in assets.
    b. The typical PSR includes a provision for IBNR, just like VEHI’s net surplus position does. VEHI’s IBNR is $8,392,603 (including an offset of $6,500,000 for pharmacy rebates expected to be paid by 4/1/19).
    c. The IRS has long considered PSR’s in excess of 20% to be “unreasonable” – even for a small client (e.g. $100,000).

6. Risk Based Capital (RBC) Model as a guide to establishing trigger ratios for VEHI
    a. DFR has accepted VEHI’s 15% “surplus ratio” target as reasonable for VEHI’s health program.
    b. When reviewing commercial carriers such as BCBSVT and MVP, DFR utilizes the National Association of Insurance Commissioners RBC model and accepts a ratio between 500% and 700% as reasonable for insurance carriers.
    c. Therefore, VEHI’s current 15% “surplus ratio” can reasonably be deemed analogous to 500% of RBC, and action trigger levels can be calculated using the mathematical relationship of this correlation.
    d. If VEHI were to consider their 15% “surplus ratio” as analogous to the higher end of the RBC range, it would mathematically lower the percent at which action is triggered.

e. The RBC model has 200% of RBC (6% surplus ratio for VEHI) as the “no action required” level.
f. The Joint Fiscal Office Issue Brief of 9/3/17 indicates “In Vermont, a company action level event can be triggered at 300% of RBC.” (This is a 9% surplus ratio for VEHI)
g. So (d) and (e) above show that a 9% surplus ratio as a trigger for VEHI Board action is sufficient for VEHI. Further, a 6% surplus ratio as a trigger for a “Regulatory Review Level” is also sufficient.

Sincerely,

John D. Stiefel, FSA,MAAA

John D. Stiefel, FSA, MAAA
Independent Actuary
860-563-0722

Fiscal Year Ending	A Total Revenue	B Total Expenditures (TE)	C Gain from Investment Activity	D = A - B + C Net Gain	E Previous Year's Net Surplus Position	F = D + E Current Year's Net Surplus Position	G = F/B Surplus as a % of TE
6/30/2001	$ 92,313,847	$ 85,233,314	$ 496,230	$ 7,576,763	$ (5,027,163)	$ 2,549,600	3.0%
6/30/2002	$ 105,601,358	$ 98,084,605	$ 345,867	$ 7,862,620	$ 2,549,600	$ 10,412,221	10.6%
6/30/2003	$ 116,634,859	$ 112,151,176	$ 257,525	$ 4,741,208	$ 10,412,221	$ 15,153,429	13.5%
6/30/2004	$ 138,711,045	$ 130,134,536	$ 202,025	$ 8,778,535	$ 15,153,429	$ 23,931,964	18.4%
6/30/2005	$ 151,870,452	$ 144,775,684	$ 827,550	$ 7,922,318	$ 23,931,964	$ 31,854,282	22.0%
6/30/2006	$ 168,728,331	$ 160,957,103	$ 1,495,187	$ 9,266,415	$ 31,854,282	$ 41,120,697	25.5%
6/30/2007	$ 181,878,325	$ 175,390,865	$ 2,957,679	$ 9,445,139	$ 41,120,697	$ 50,565,836	28.8%
6/30/2008	$ 195,521,725	$ 186,037,596	$ 3,262,850	$ 12,746,979	$ 50,565,836	$ 63,312,814	34.0%
6/30/2009	$ 205,052,996	$ 205,347,530	$ 1,528,521	$ 1,233,986	$ 63,312,814	$ 64,546,801	31.4%
6/30/2010	$ 210,176,149	$ 214,621,950	$ 1,644,386	$ (2,801,414)	$ 64,546,801	$ 61,745,386	28.8%
6/30/2011	$ 217,823,698	$ 227,712,542	$ 1,154,180	$ (8,734,665)	$ 61,745,386	$ 53,010,722	23.3%
6/30/2012	$ 227,420,579	$ 245,922,656	$ 1,136,343	$ (17,365,734)	$ 53,010,722	$ 35,644,988	14.5%
6/30/2013	$ 237,238,077	$ 251,352,697	$ 320,849	$ (13,793,772)	$ 35,644,988	$ 21,851,216	8.7%
6/30/2014	$ 260,375,044	$ 254,628,310	$ 663,286	$ 6,410,020	$ 21,851,216	$ 28,261,236	11.1%
6/30/2015	$ 269,071,555	$ 271,487,230	$ 302,096	$ (2,113,579)	$ 28,261,236	$ 26,147,657	9.6%
6/30/2016	$ 277,686,297	$ 270,872,224	$ 608,073	$ 7,422,146	$ 26,147,657	$ 33,569,803	12.4%
6/30/2017	$ 298,480,550	$ 285,613,569	$ 216,289	$ 13,083,271	$ 33,569,803	$ 46,653,074	16.3%
6/30/2018	$ 259,873,402	$ 267,139,924	$ 419,284	$ (6,847,239)	$ 46,653,074	$ 39,805,835	14.9%