Segal Consulting

116 Huntington Avenue 8th Floor Boston, MA 02116-5744
T 617.424.7300 www.segalco.com

MEMORANDUM

To: Lynda Fraley

From: Andrew D. Sherman
Stephen L. Kuhn

Date: March 5, 2014

Re: Merging Claims Reserve Trust Funds

This memorandum outlines the considerations for merging the City's Trust Funds for its self-funded health plans. Further, this supports the decision to merge the Trust for the plans administered by Harvard Pilgrim Health Care (HPHC) with the Trust for the plans administered by Blue Cross Blue Shield of Massachusetts (BCBSMA). A merged Trust creates more flexibility in building and maintaining reserves, spending surpluses when they occur, and stabilizing future rate changes. The discussion points in this memorandum are consistent with those included in the "Reserves for Self-Funded Health Claims" memorandum dated October 20, 2011 (attached).

Support of Merging Trust Funds on July 1, 2014

- Merging the Trust Funds increases the credibility of the entire group and the ability to assume the risk and volatility of self-funded claims. In other words, the merged Trust allows for the spreading of the risks associated with unknown and unanticipated claims over a larger number of participants and claim dollars and provides the following:
  - More stability in absorbing the claim costs of individuals with large claim dollars. This stability is of greater value to the City with its decision to go without stop loss coverage.
  - More predictability (or less variance) in actual costs compared to projected costs.
- Based on the size of the merged Trust, the City's decision to retain risk for large claims (rather than purchasing stop-loss insurance), the City's desire to manage (stabilize) working rate increases, and the City's overall ability to assume risk, a reserve range of 5% to 15% (exclusive of IBNR reserves) is appropriate for the combined Trust. This range is lower than the current target reserve for the BCBSMA Trust and, as a result, merging the Trusts could create additional reserves to use in stabilizing working rate changes.
- Both the HPHC and BCBSMA Trust Funds, independently, currently have adequate reserves. Since both health trusts have fully funded their respective Trust Fund targeted reserve levels, neither trust would be subsidizing the initial building of reserves for the other trust through the merger.

BCBSMA Trust Reserve Maintenance Plan

As indicated in the attached memo, we recommend the City replenish trust reserves when deficits occur, or spend trust assets during periods where surpluses accumulate, in a manner that is both timely and appropriate in maintaining stability in year-to-year working rate changes. The BCBSMA Trust currently has a surplus and the non-Medicare plans in this Trust have working rates that have been set below the projected costs as a strategy to spend down the surplus over a few years. The City's current BCBSMA multi-year plan to address the existing surplus considers future rate increases and has the objective to avoid excess rate increases once the entire surplus is spent. We recommend the City continue with this multi-year plan whether or not the Trust Funds are merged.

IBNR Reserves

The "incurred but not reported" (IBNR) reserves would be unaffected by the merging of the Trust Funds, as the IBNR reserves are based on the historic claim lag patterns of the health plans and calculated separately for each of the specific benefit plan option. Therefore merging the Trust Funds will not have any impact on IBNR Reserves.

We are available to assist the City with further guidance regarding the Trust Funds.

SLK/ADS/grs

Attachment

cc: Kathleen Green (w/attachment)
Tina Wells (w/attachment)
Daniel J. Rhodes, FSA, MAAA (w/attachment)

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THE SEGAL COMPANY
116 Huntington Avenue 8th Floor Boston, MA 02116-5744
T 617.424.7300 F 617.424.7390 www.segalco.com

MEMORANDUM

To: Lynda Fraley

From: Andrew D. Sherman
Stephen L. Kuhn

Date: October 20, 2011

Re: Reserves for Self-Funded Health Claims

It is critical for self-funded health plans to maintain adequate reserves:

- (1) to account for anticipated claim liabilities; and
- (2) to protect against the risk of unknown expenses.

The first category of reserves cover the anticipated, expected liability of claims that have been incurred but not yet been paid due to lags in claim payments. This reserve is typically referred to as "incurred but not reported" (IBNR).

The second reserve category is needed for unknown and unanticipated costs and claims. The amounts will differ for different plans, depending on a plan's size and its ability to assume risk. This reserve could be referred to as an additional or catastrophic claims reserve. In addition to protecting against future risks, additional claim reserves will also allow for stabilization in rate increases in working rates.

Once a plan determines an appropriate level for the Additional Claims Reserve, the plan may need to take actions to maintain that targeted level. In any given period, it is very likely that actual self-funded claims expenses will vary from those projected and a plan's assets may decrease to lower than the target level (deficit) or increase to greater than the target level (surplus). Therefore, maintaining reserves at target levels is something that needs to be monitored on a regular basis.

This memo provides a brief description of these reserves and suggestions for managing and maintaining the desired level.

Incurred But Not Reported Reserve (IBNR)

The IBNR reserve is recommended to cover claims that are known but not yet paid (pending), as well as unknown claims that have been incurred but not yet submitted (unrevealed). This reserve is typically estimated annually as of the end of a plan or fiscal year. Ideally, given the size of the City's Plan, the IBNR reserve estimate would be based on the Plan's historic claim lag patterns set forth in "triangulation" reports that present claims both by incurred month and by month paid.

Additional Claims Reserve

The City should also hold additional claims reserves to account for the risk and volatility of self-funded claims. The risks to consider in determining these reserves include, but may not be limited to:

- Large claimants – The risk of unexpected increases in the number and/or size of claims incurred by individual participants. Individual stop loss coverage would reduce the Plan's exposure to this risk; however, this risk is mitigated by the size of (i.e., number of participants in) the City's Plan. The City's self-funded plans do not currently have stop loss coverage. If the City continues to be comfortable with assuming this risk (i.e., would be able to cover claims costs) and maintains adequate reserves, we are not recommending the City purchase stop loss coverage at this time.

- Unfavorable claims – The risk related to overall claims experience developing at a variance from the expected cost per participant. This variance is often attributed to the lack of credibility of a plan's claims experience. We note that as the size of the City's self-funded health plan increases, the level of this risk decreases.

- Trend and regulatory environment – The risk inherent in a projection that uses a forecast of the overall increase in price and utilization of health care services and the influence of government (state and federal) regulations on these trends. We note that this risk is constant regardless of the size of the plan.

As previously stated, the additional claim reserves can also be used to stabilize required rate increases in working rates. If surpluses are retained in lower cost years to fund reserves to an even greater extent, the reserves can also be used in subsequent higher cost years to limit required rate increases.

We note that plans typically set additional claims reserves as a percent of total annual plan costs, and base that percentage in part on the size of the group, as noted above. We further note that if a greater portion of the City's health plan membership (*e.g.*, Harvard Pilgrim Health Care members) moves from fully-insured to self-funded, these reserves as a percentage of total annual plan costs could be lowered.

City of Boston Recommended Reserves

We note that as of June 30, 2011, based on the City plan's historic lag patterns, Segal estimates the IBNR reserve to be approximately 8% of annual paid claims or, expressed another way, approximately one month of paid claims.

In regards to additional claims reserves, a range of 10% to 20% of total annual plan costs is appropriate. This range is based on the current size of the City's self-funded plans, the City's assumption of the large claimant risk (i.e., no stop loss coverage), the City's desire to manage (stabilize) working rate increases, and the City's overall ability to assume risk. As the City continues to monitor claims experience and evaluate its stability, especially if the size of the self-funded plans increases significantly, a lower additional claims reserve expressed as a percent of total plan costs will likely be appropriate (e.g., a range of 5% to 15%). If the City plans to use the reserve to stabilize annual working rate increases, the City may want to consider funding the reserves at the higher end of the suggested range, in years when that is possible.

Reserve Maintenance

As a result of actual annual claims experience varying from the projected cost, plan assets may be in a deficit or surplus in comparison to target reserve levels. The City can make necessary adjustments to reserves through adjustments to the working rates. Large one-time deposits or withdrawals will not necessarily be required.

For reserve deficits, we recommend the City replenish the plan reserves in a manner that is both timely and appropriate in maintaining stability in year-to-year working rate changes. For instance, replenishing reserve levels may be done over multiple years of setting working rates with additional margin to increase plan assets.

For reserve surpluses, the City can reduce plan assets using a rate holiday or adjusting working rates in a similar manner (albeit opposite manner) as utilized for reserve deficits. A rate holiday would entail not funding the Plan account and not collecting employee contributions for a set period of time (e.g., a month) to allow the absence of revenue to decrease or eliminate the surplus. When using adjustments to working rates to "spend down" a surplus, the City should also consider future rate increases that may result from the working rate reductions. Here as well, a multiyear strategy may be used to reduce reserves to the target level while maintaining stability in year-to-year rate changes. A multiyear strategy should be reviewed on an annual basis and adjusted (as necessary) for the Plan's current reserve position.

If the reserve is also used to stabilize rate increases, annual decisions to replenish or spend down the fund to adjust a certain year's rates must also be made in consideration of the same broader multiyear strategy.

City of Boston Reserve Maintenance Plan

We have reviewed the City's reserve maintenance plan as of October 2011 (attached) and it is reasonable and appropriate, reflecting the guidelines outlined above.

We are available and prepared to assist the City with its ongoing review and management of reserve levels and their appropriateness.

Attachment

cc: Eugene Pastore, City of Boston
Margaret Houy, Bailit Health Purchasing

Guiding Policies for
City of Boston Health Claims Trust Fund

The City of Boston Health Claims Trust Fund ("the Fund") was established pursuant to M.G.L. Chapter 32B, Section 3A. The Fund allows the City to "self-fund" certain health plans by paying actual claims and other expenses, as opposed to paying estimated insurance premiums. Below are the guiding policies for management and operation of the Fund.

1. **Expenditures**
   The Fund's expenditures include the following:
   a. **Claims.** Actual health care claims incurred by the City's subscribers (and their dependents) payable under the terms of the applicable health plans, are paid from the fund to third party administrators.
   b. **Service Charges of Third Party Administrator.** Third party administrators are responsible for adjudicating and paying claims under the terms of the designated health plans. Charges for these services are periodically renegotiated or rebid, and service quality is periodically audited.
   c. **Other Service Charges.** Payments are made from the Fund for other professional services, such as consultants, actuaries and auditors who perform services that maximize the effectiveness of health plans administered through the Fund.

2. **Revenues**
   a. The Fund's primary revenues are the premium payments (technically termed "working rate" payments) that are received from the City and from subscribers. Those payments are made on a shared basis according to predetermined ratios.
   b. The actual "working rates" for each self-funded health plan are set annually by a credentialed actuary. The actuary's calculations take into account projected health claims as well as the maintenance of an appropriate Fund balance, following (4) below.
   c. Annual interest earned on the Fund balance will be added to the Fund balance.

3. **Accounting**
   Accounting for the Fund will be in accordance with generally accepted accounting principles, and will ensure that all contributions and actual costs are shared between employers and their subscribers according to predetermined ratios.

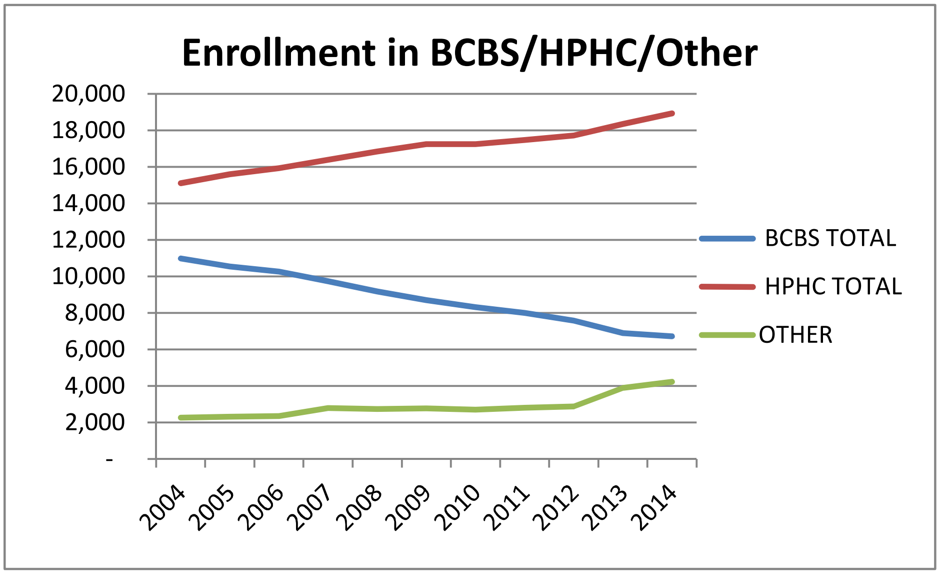
4. **Fund Balance**
   The Fund should maintain a Fund balance, with reserves, sufficient to:
   a. Make prompt payment of claims and related liabilities;
   b. Maintain an "incurred but not reported" reserve to cover the anticipated liability of incurred claims not yet paid due to lags in claims payments;
   c. Maintain an additional claims reserve to cover unanticipated claims and related liabilities, including extraordinary claims in lieu of stop loss insurance. In addition, this reserve may also allow for stabilization in working rate increases over time.

   Fund balance reserves should meet actuarial recommendations for the appropriate level of reserve.

5. **Compliance Audit**
   An annual Fund audit will verify that the accounting of the Fund follows generally accepted accounting principles and is administered in compliance with the basic guidelines outlined above.

Merging Health Insurance Trust Funds

11-Mar-14



Health Insurance Trust Funds ($ millions)

	TRUST FUNDS		COMBINED
	BCBS	**HPHC**	**FUND**
FY13 Reserve Balance (1)	$ 44.23	$ 22.76	$ 66.99
FY14 Proj Change (Segal)	$ (5.40)	$ 17.11	$ 11.71
FY14 Projected Final Balance	$ 38.83	$ 39.87	$ 78.70
FY15 Projected Claims Paid	$ 70.26	$ 244.81	$ 315.07
Balance as % Annual Claims	**55%**	**16%**	**25%**
# members	8,252	36,210	44,462

(1) After IBNR Reserve