



Pension and Health Benefits Committee

Agenda Item 6a

September 25, 2018

Item Name: Health Care Fund Reserve Policy

Program: Health Benefits

Item Type: Action

Recommendation

Staff recommends that the Pension and Health Benefits Committee (PHBC) adopt the Health Care Fund Reserve Policy (Policy).

Executive Summary

The proposed Policy updates the prudent level of Preferred Provider Organization (PPO) plan reserves and their treatment should they exceed or fall below a certain threshold. The Policy also addresses surpluses within the Flex-Funded Health Maintenance Organization (HMO) plan accounts.

Strategic Plan

This item supports the California Public Employees' Retirement System (CalPERS) 2017-22 Strategic Goal "Transform health care purchasing and delivery to achieve affordability."

Background

CalPERS bears all the financial risk for its self-funded and self-insured PPO plans so it is crucial to have reserves to protect CalPERS and its members in years where medical and/or pharmacy claims are higher than expected. It is also important to safeguard against the over accumulation of reserves due to lower than anticipated claims or larger than projected investment returns. Although CalPERS is not responsible for costs which exceed the premiums for its Flex-Funded HMOs, there are times when costs could come in slightly lower than the premiums. The Policy formalizes CalPERS' management of the PPO reserves and Flex-Funded HMO surpluses.

PPO Plans

In 1997, a reserve practice was developed to protect against adverse business and investment risks and other potential future liabilities with the CalPERS PPO plans. In May 2004, the Board of Administration adopted the National Association of Insurance Commissioners Risk-Based

Capital (RBC) approach as part of this reserve practice. In June 2018, this Committee directed the CalPERS team to revisit current practices regarding the following:

- Medical Incurred But Not Reported (IBNR) Liability – Covers the estimated liability for IBNR medical claims that CalPERS may be liable for at the end of any given plan year. It is developed based on the observed claims lag patterns between the time claims are incurred, and the time they are processed for payment. This reserve amount has been approximately 1.4 months of average medical claims.
- Pharmacy IBNR Liability – Covers the estimated liability for the IBNR prescription drug claims that CalPERS may be liable for at the end of any given plan year. It is developed based on the observed claims lag patterns between the time claims are incurred, and the time they are processed for payment. This reserve amount has been approximately 0.3 months of average prescription drug claims.
- Continuity of Care Liability – Covers the estimated liability for continuity of care for those members who could be in the middle of treatment should a plan suddenly terminate. This reserve amount has been 15 percent of the Basic plan IBNR reserve and 30 percent of the Medicare Supplement plan IBNR reserve.
- Administrative Liability – Covers CalPERS' estimated administrative expenses associated with overseeing the claims runout and wind-down should a plan suddenly terminate. This reserve amount has been 7.5 percent of the sum of the IBNR and Continuity of Care Liabilities.
- RBC – Covers the estimated liabilities for unexpected claims due to a sudden drop in enrollment, major health event, natural disaster, or other causes. For the past several years, CalPERS has mirrored the National Association of Insurance Commissioners' methodology.

Analysis

The CalPERS team evaluated the current reserve level and methodology, assessing actual claims experience, CalPERS' administrative expenses, historical patterns and potential claims fluctuations. Due to benefit design improvements and increased economies of scale from a larger membership, the CalPERS' PPOs have recently experienced less price volatility and smaller yearly premium increases than in the past. As a result, the team recommends the following:

PPO Plans

On an individual PPO plan basis, the CalPERS team recommends decreasing the current RBC reserve level from 300 percent to 250 percent, and maintaining the current medical and pharmacy IBNR, Continuity of Care Liability, and the Administrative Liability reserve levels. In addition, the CalPERS team proposes handling any reserves that exceed or fall below an actuarially prudent threshold as outlined in Attachment 1, Health Care Fund Reserve Policy.

HMO Plans

While CalPERS is generally not responsible for expenditures above the premiums for its Flex-Funded HMOs, there are times when premiums might slightly exceed costs. Accordingly, the CalPERS team recommends handling potential Flex-Funded HMO plan surpluses as outlined in Attachment 1, Health Care Fund Reserve Policy.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The Policy will formalize and update the actuarially prudent level of PPO reserves and the management of reserves that exceed or fall below a certain actuarially determined threshold. It also develops a method for handling Flex-Funded HMO plan surpluses to smoothly transition from one contract cycle to the next. While we believe that the current healthcare landscape calls for less PPO reserves than in the past, unanticipated changes in healthcare could require CalPERS to revisit the Policy sooner than every four years.

Attachments

Attachment 1 – Health Care Fund Reserve Policy

Attachment 2 – Health Care Fund Reserve Policy Presentation

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