San Joaquin Valley Insurance Authority

Actuarial Review and Strategic Observations - Overview

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Presentation to SJVIA Board on March 18, 2016

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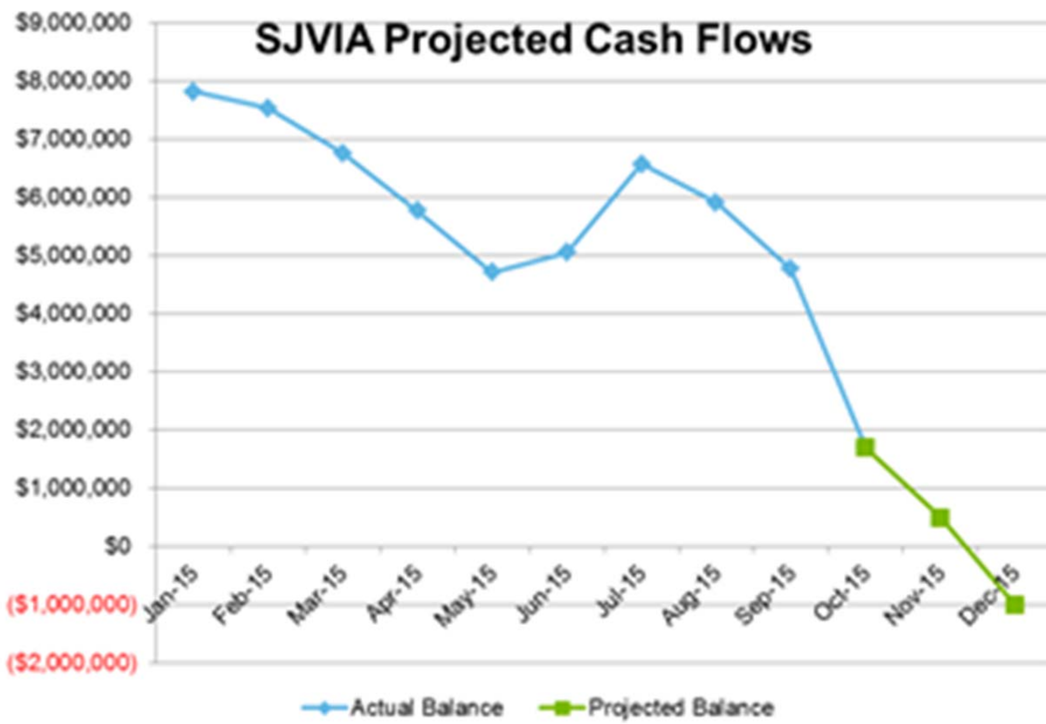
Agenda

1. Overview of Scope
2. 2015 and 2016 Funding Review
3. IBNR Adequacy Review
4. Program Recommendations
5. Strategic Considerations

Overview

- Aon Hewitt (AH) was retained to provide an independent actuarial review of the SJVIA's rate development and reserve adequacy
- Throughout 2015, SJVIA experienced deterioration of its financial health as illustrated below (Cash Flow as of 11/06/15):



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2015 and 2016 Funding Review

2015 Underfunding

- The SJVIA Projected Cash Flows indicate that reserves were estimated to be reduced by $9M in 2015, 67% more than the planned $5.4M reserve release in 2015.

- Based on the data and information provided, AH expects several factors were key to the underfunding of the SJVIA plans in 2015:

  – Claim Volatility and High Prescription Drug Trends

  – SJVIA Growth

  – Fresno County Anthem HMO migration to the Kaiser HMO

2016 Fund Projection

- AH expects a funding deficit of 2.0%-3.5% of the self-funded costs or $2.2M – $4.0M due to:
  - Aggressive Medical and Prescription Drug Trend Rates used in the development of the 2016 rates.

    SJVIA consultant used 4.5% prescription drug trend, despite presenting to this board that the most recent prescription drug experience for SJVIA had increase by >10% (January 2014 – June 2015). AH internal trend guidance, for that same time period, recommended using prescription drug trends of 10-12% for SJVIA's plans
  - Some deterioration of the self-funded risk pool due to migration to Kaiser for which there does not appear to be any adjustment
  - Volatility from the new business activities

- Additional adjustments are needed for any expected changes in the self-funded pool, such as migration between self-funded plans or migration to Kaiser

- AH recommends that the SJVIA include some margin in their pricing to absorb any unplanned deviations in the self-funded claims experience or unplanned changes in the underlying risk pool (such as migration)

IBNR Reserve Adequacy and Observations

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- The IBNR reserve methodology for SJVIA from inception has been a percent of annual paid claims
- AH reviewed the IBNR percent of claims method that SJVIA uses and found the reserves on average to be adequate.
  - However, an actuarially certified reserve will normally utilize more accurate reserve forecasting methods such as the Development and Projection methods
- AH recommends that the SJVIA consider adopting policies for reserves in excess of the IBNR such as Contingency and/or Stabilization reserves.
  - These excess reserves will reduce insolvency risk for the SJVIA and add additional controls around surplus cash use

Program Recommendations

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Program Recommendations

- AH questions the practice of using the entire reserve surplus in excess of the IBNR to reduce the required annual renewal
  - AH recommends that the SVJIA holds additional reserves in excess of the IBNR such as a Contingency and/or Stabilization reserve to reduce insolvency risk and empower the Board to make more strategic reserve release decisions (such as to reduce the annual renewal)
- AH recommends that some margin be added to the pricing rates to absorb some unplanned deviation from expected costs due to claims volatility or unplanned member migration
- AH recommends that the SJVIA balance it’s growth goals with an appropriate reserve policy recognizing that pricing new entities can introduce additional volatility into the Pool

Strategic Considerations

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- Growth
  – Adopt objective growth goals and targets
  – Implement a temporary moratorium on adding new members until the plan has: 1) stabilized; 2) built up sufficient reserves; and 3) the Board adopts policy changes to prevent future program deterioration
  – Establish underwriting policies based on entities with and without claims experience

- Checks and Balances
  − Add a second layer of analysis when underwriting new members

- Consultant Incentives
  − Change consultant compensation structure to a flat-fee basis
  − Require consultant to place a portion of the fee "at-risk"

- Employer Contribution Strategy
  − Review SJVIA's policies pertaining to member entities contributions strategies