Agenda

- The Basics
- Risk Tolerance
- Funding Methods
- Renewal Rating
- Questions
The Basics

Definitions which will be used during our discussion will include:

- **Risk**- Exposure to the chance of financial loss
- **Insurance**- Transfer of risk from policyholder to provider
- **Pooling**- The risk-sharing arrangement whereby the provider assumes all liability for claims covered through the pooling arrangement
- **Funding**- The method by which an employer pays the claims and the provider’s expenses
The Basics

Risk is present in many forms:

- Number of members covered under the plan
- The demographics of the members
- Industry/occupation
- The plan design
- The frequency and amount of the average claim
- Sharing of premiums between the policyholder and the members and pricing stability
- Deficit responsibility
- Disputed or litigated claims
The Basics

Premium

- Claims
- Reserves
- Admin Expenses
- Commission
- Provincial Taxes
- Interest
- Other Expenses
The Basics

- **Loss Ratio**
  - Ratio of claims & expenses to premium

- **Target Loss Ratio**
  - Expected Claims / Premium
  - 1 - Expenses

- **Actual Loss Ratios**
  - Paid Claims Loss Ratio
  - Incurred Claims Loss Ratio
The Basics

Reserves

- Sum set aside for future commitments
- Disabled Life Reserve (DLR)
  - Various factors
- Waiver of Premium Reserves
- Incurred But Not Reported Reserve (IBNR)
  - Often a percent of premium
The Basics

After deciding on the plan design(s), there are three additional considerations:

- Policyholder Risk Tolerance
- Funding Approach
- Premium rate determination
Risk Tolerance

Policyholder Risk Tolerance:

- This is the level of exposure to a claim that the employer wishes to take on in the event of a claim (or claims).
- Can range from no risk (limited to the premiums payable) to full risk (where the provider only adjudicates the claims).
- As the risk to the policyholder increases, the ‘insurance’ charges reduce.
Risk Tolerance

- Cash Flow
  - Can policyholder financially manage large swings in experience?

- Budget Process
  - Do they need a predictable monthly cost?

- Sharing of Premium
  - Across departments
  - With Employees
# Risk Tolerance

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
<th>Mega</th>
</tr>
</thead>
<tbody>
<tr>
<td>AD&amp;D</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Life</td>
<td>High</td>
<td>High</td>
<td>High to Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>LTD</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>WI (STD)</td>
<td>High</td>
<td>Medium</td>
<td>Medium to Low</td>
<td>Low</td>
</tr>
<tr>
<td>Health</td>
<td>High</td>
<td>High to Medium</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Dental</td>
<td>Medium</td>
<td>Medium to Low</td>
<td>Low</td>
<td>Low</td>
</tr>
</tbody>
</table>

- **Small**: 1-100 employees
- **Medium**: 100 – 500 employees
- **Large**: 500 to 1,000 employees
- **Mega**: 1,001+ employees
Risk Tolerance

Employers take on additional risk in order to:

- Reduce costs on a long-term basis (possibly!)
- Obtain more flexibility in:
  - Plan designs
  - Pricing
  - Claim adjudication (be careful!)
  - Underwriting
Risk Tolerance

- Full Clarity Required:
  - Policyholder Risk Tolerance
  - Benefit Plan Exposure
  - Policyholder Motivation/Understanding

- Generates Funding Methodology Recommendation
Funding Methodology

Financial Accounting or Funding Method:

- Refers to the ‘sharing’ of financial results at the end of the financial period
  - If no sharing of results, the underwriting is ‘fully insured’ or ‘non-refund’
  - If sharing occurs, the underwriting is ‘refund/retention’ accounting or ‘administrative services only’

- Non-pooled arrangements require a separate agreement, outside the group contract, which outlines the various charges which will apply
Funding Methodology

Non-Refund Accounting / Fully Insured

- In year risk remains entirely with the insurer
- Policyholder has no access to surplus funds nor responsibility to repay a deficit
- Highest risk charge built into expenses
- Appropriate for low risk tolerant policyholders and/or high risk benefits
Funding Methodology

Refund/Retention Accounting

- The policyholder shares in plan surplus and is responsible to repay deficits
- Risk ultimately remains with the provider
- Annual accounting of the plan is provided
- Should include a pooling arrangement inside the EHC benefit
- Low risk charge built into expenses
- Appropriate for medium risk tolerant policyholders
## Funding Methodology

Below is an OVERLY SIMPLIFIED accounting example:

<table>
<thead>
<tr>
<th></th>
<th>Example #1</th>
<th>Example #2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Claims Incurred</td>
<td>$350,000</td>
<td>$450,000</td>
</tr>
<tr>
<td>Administration Charges</td>
<td>$35,000</td>
<td>$45,000</td>
</tr>
<tr>
<td>(10% of claims)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>(2% of premium)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>(10% of premium)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surplus (Deficit)</td>
<td>$55,000</td>
<td>($55,000)</td>
</tr>
</tbody>
</table>
Funding Methodology

Administrative Services Only (ASO) Methodology:

- A self-funded plan!
- Policyholder hires provider to adjudicate claims
- Can be set based on ‘budgeted rates’ or a deposit/float if paying in advance; or may be billed in arrears which means rates are not usually established by the insurer
- Policyholder bears the full risk/liability of the claims experience and claim litigation
  - Should include a pooling arrangement inside EHC benefit
Funding Methodology

Administrative Services Only (ASO) Methodology:

- No IBNR reserves held by the provider
- The policyholder has full access to surplus and is responsible to repay deficits
- Monthly or annual accounting for claims and expenses against deposits (i.e. premiums); administration charges are often % of claims
- If funding stops, claim payments also stop!
Funding Methodology

- Industry pooling introduced in 2012
- What’s changed?

Before Agreement

- Internal Pool
  - LAP
  - Stop Loss
- Experience rated

After Agreement

- Industry Pool
- Internal Pool
- EP3
- Experience rated
Funding Methodology

- Eligibility Thresholds

<table>
<thead>
<tr>
<th>Year</th>
<th>Initial threshold</th>
<th>Ongoing threshold</th>
<th>Maximum CDIPC coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$25,000</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2013</td>
<td>$25,000</td>
<td>$50,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>2014</td>
<td>$27,500</td>
<td>$55,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>2015</td>
<td>$30,000</td>
<td>$60,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>2016</td>
<td>$32,500</td>
<td>$65,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>
Funding Methodology

- Fully insured Extended Health Benefit (EHB) policies are required to have an EP3 unless they have one of the following provisions:
  - an annual deductible equal to or higher than $1,100 single or $2,200 family, and/or
  - a series of annual and lifetime maximums that meet or exceed either EP3 or Industry Pooling thresholds.

- Eligibility under the plan depends on coverage in place June 7, 2011
Funding Methodology

Additional Pooling Arrangements:

- Usually included in EHC benefit (but may also be included in Life or LTD benefits)
  - Can apply to any and all components
- Annual review of claims and removal of amounts in excess of the set limit
  - Large amount pooling (i.e. $15,000 per individual)
  - Aggregate pooling (i.e. exceeding 125% of premium)
- 1st $ pooling for Out-of-Province/Canada claims
## Funding Methodology - Summary

<table>
<thead>
<tr>
<th>Feature</th>
<th>Non-refund</th>
<th>Refund</th>
<th>ASO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk</td>
<td>Insurer</td>
<td>Shared</td>
<td>Policyholder</td>
</tr>
<tr>
<td>Accounting Stmt.</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Limits on Risk to Policyholder</td>
<td>N/A</td>
<td>Yes</td>
<td>No (unless pooling)</td>
</tr>
<tr>
<td>Stop Loss &amp; Pooling</td>
<td>Likely</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Risk Tolerance</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Benefit Payment</td>
<td>Unpredictable</td>
<td>Moderately Predictable</td>
<td>Highly Predictable</td>
</tr>
</tbody>
</table>
# Funding Methodology - Risk

<table>
<thead>
<tr>
<th>Risk Factor</th>
<th>Non-refund</th>
<th>Refund</th>
<th>ASO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Plan Members</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Plan Design Flexibility</td>
<td>Limited</td>
<td>Moderate</td>
<td>High</td>
</tr>
<tr>
<td>Legal Risk</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Deficits</td>
<td>None</td>
<td>High</td>
<td>Full</td>
</tr>
</tbody>
</table>
Renewal Rating

Premium rate determination (or renewal rating):

- Refers to the method of setting the premium rates
  - Pooled
  - Prospectively rated
- Rates are most commonly set by the insurance provider utilizing their own internal guidelines
Renewal Rating

Process:

- Insurance provider establishes the premium rates based on past experience, plan expenses and other factors (i.e. trend and/or inflationary factors) for the upcoming period.
- Approach depends on the benefit, type of underwriting and size of the group.
- Premium rates are usually established for a 12-month period.
  - Life, AD&D and LTD may be set for a longer period of time (i.e. 2 to 3 years).
Renewal Rating

Factors to be included in establishing renewal rates include:

- Demographics of the group (age, gender, salary)
- Manual rates for the group
- Credibility factors to be applied to experience
- Actual claims experience, by benefit
- Plan expenses or break-even/target loss ratio
- Inflation or utilization factors
- Incurred but Not Reported (IBNR) reserve requirements
- Waiver of Premium and Disabled Life reserves
Renewal Rating

Pooled Methodology:

- Initial and renewal rates are set by the insurance provider based on plan member demographics and benefits insured.
- Rates are based on the provider’s block of business for similar sized policyholders and make-up of the group.
- Reports the premiums and claims experience for information purposes.
Renewal Rating

- Demographics of the group (age, gender, salary):
  - Represents the age and volume distribution inside the group
  - How has this changed over the past year
  - Pricing variations

- Manual rates for the group:
  - Uses the insurance providers book/manual rates for each employee’s age and gender
  - Also applies industry and location factors
  - Incorporated into the demographics information
Renewal Rating

Prospectively Rated Methodology:

- Initial and renewal rates are set based on the claims experience of the plan, in whole or in part, for future financial periods.
- Level of credibility is based on the size of the group.
- The provider reports the premiums and claims experience as this is taken into consideration when establishing the renewal rates.
- Will exclude premium and claims based on EHC pooling level.
Renewal Rating

- Actual claims experience, by benefit:
  - Life and LTD: usually the last 5 years
  - WI: usually the last 2 or 3 years
  - Health and Dental: usually the most recent year, or the last 2 or 3 years if a smaller group

- Plan expenses or break-even/target loss ratio:
  - Expenses are the costs associated with operating a particular benefit and include: general administration; claims administration; pool charges; risk and/or profit charges; premium taxes; commissions; printing charges (if applicable)
  - The target loss ratio represents the break-even point for the account (i.e. the percentage of claims versus premium needed for the plan to break even)
Renewal Rating

Basic renewal calculation:

- **Step 1:** Paid premiums to adjusted premiums\(^1\)
- **Step 2:** Paid claims plus change in IBNR\(^2\) = Incurred claims
- **Step 3:** Incurred Loss Ratio = Incurred claims to adjusted premium
- **Step 4:** Trended Incurred Loss Ratio = Incurred Loss Ratio \times \text{Trend Factor} (Health and Dental benefits only)
- **Step 5:** Experience Rate Adjustment = Trended Incurred Loss Ratio / Target Loss Ratio – 1

1- The adjusted premium represents the amount that would have been collected over the experience period if the current rate, adjusted for plan design change or rate adjustments had been in force over the period.

2- The IBNR is an estimate of the value of claims incurred prior to the reporting period but still unreported. The change in IBNR is the difference between the prior period’s IBNR and the current period’s IBNR.
Renewal Rating

Credibility factors to be applied to experience:

▪ The proportion of the rating that is driven by actual claims experience
  ❖ How credible/believe-able is the experience compared to the insurance provider’s block

▪ Credibility factors are based on the number of life years available
  ❖ Life years is a unit of measurement (number of lives x number of years in force) (i.e. 500 employees for 5 years = 2,500 life years)
  ❖ Health and Dental benefits require a relatively lower number of life years than Life and LTD benefits
  ❖ The longer the period, the better the indicator of a pattern
Renewal Rating

- Weightings are Applied when more than one year of Experience is considered
  - Weightings vary by Insurance Provider
  - Weightings vary by benefit
  - Weighting can be applied over a three-year, a two-year or a one-year period
  - Changes by benefit and likelihood of claims
- Example: 5-3-1 weighting
  - Current Year Increase X 5
  - Year 2 Increase X 3
  - Year 1 Increase X 1
  - Divide sum of that by 9 (5+3+1) for weighted increase
Renewal Rating

Inflation or utilization factors:
- Most applicable to Health and Dental benefits where product cost and usage tend to increase year over year
- Inflation on Health and Dental costs are significantly higher than the Consumer Price Index
  - Health care is a small component of the CPI ‘basket of goods’
- These factors vary by insurance provider
- Generally, older employees have a higher likelihood of illness which can result in higher claims
- Dental fee guides
- Changes in legislation or the economy
Renewal Rating

Incurred but Not Reported (IBNR) reserve requirements:

- Represents the estimated amounts insurance providers need to set aside to pay for future claims that are incurred in one contract year but not reported and paid until the next contract year.

- Reserve factors vary by benefit and by provider:
  - Life: 8% to 12% of premium
  - LTD: 40% to 60% of premium (based on qualifying period)
  - WI: 15% to 25% of premium (based on duration)
  - EHC: 5% to 8% of claims with a drug card
    - 15% to 30% of claims without a drug card
  - Dental: 8% to 12% of claims

- Factors vary by group size and/or plan design.
Renewal Rating

Waiver of Premium and Disabled Life reserves:

- Represents the estimated cost of the present value of future benefit payments for disabled employees
  - Waiver of premium relates to the future death claim of a currently disabled employee
  - Disabled Life Reserve (DLR) relates to LTD benefit payments expected to be made for each claimant
- Reserve amounts are based on the claimant’s age at disability, gender, benefit amount and expected duration of the disability
- At renewal, the providers will report on the aggregate reserve liability of all disabled employees as part of their rating/pricing
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