COMPLETE ACTUARIAL SOLUTIONS COMPANY

The CASCO Bulletin

SEPTEMBER 2013

Healthcare Reform Update

The Affordable Care Act (ACA) is bringing profound changes to the healthcare delivery landscape. Below are some notable developments and progress reports related to the act.

Health Insurance Rates

The ACA increased scrutiny on rate increases and also required insurers to provide premium rebates if minimum medical loss ratios (MLRs, which reflect the proportion of premium spent on care) are not met. A February 2013 study by the Department of Human Services suggests the ACA has contributed to a slowdown in rate increases for the individual market but that it has not slowed rate increases in the group market. A June 2013 Kaiser Family Foundation study found that MLRs have increased since the ACA for the individual market but have remained relatively stable for the group market.

Studies suggest the ACA contributed to slower rate increases for the individual health insurance market but has had little impact on rates in the group market.

Incentives Based Medicare Payments

As part of the ACA, Medicare instituted a value-based purchasing program to reward or penalize programs from FY2013 onwards based on the quality of care provided to Medicare patients. For FY2013, 1,557 providers were rewarded and 1,427 were penalized. In addition, Medicare began applying hospital readmissions penalties to reimbursements in October 2012. As of March 2013, 2,213 hospitals have received readmission penalties, with 276 of those receiving the maximum penalty of 1%.

Bundled Payments for Providers

The Bundled Payments for Care Improvement (BPCI) initiative will provide bundled Medicare payments for episodes of care rather than individual services for selected providers. This pilot program will be implemented from 2013 to 2016 and could be expanded if successful. The ACA also created the Health Care Innovation Awards (HCIA) to test new payment and service delivery models for Medicare and Medicaid/CHIP that will lower costs (with actuarial certification required for cost savings estimates) and improve outcomes. The second round of awards is underway with up to $1 billion available in total funding. Programs such as the BPCI initiative and the HCIA that promote bundling of payments could be a sign of things to come for Medicare and Medicaid/CHIP.

Employer Mandate

On April 29, 2013 the IRS issued proposed rules for determining if employer plans meet the affordability criteria set forth in the ACA for providing affordable health insurance. On July 2, 2013 the implementation of the employer mandate was delayed until 2015 with officials citing the need to simplify reporting requirements and give employers a chance to adjust their healthcare coverage.

Health Insurance Exchanges

18 states and DC have chosen to operate their own exchanges, 25 have chosen not to operate their own and are relying on "Federally-Facilitated Marketplaces" operated by the federal government, and 7 have opted for hybrid "State Partnership Exchanges" in which the state runs certain functions.

Continued on next page.

INSIDE THIS ISSUE:

Healthcare Reform Update (continued)

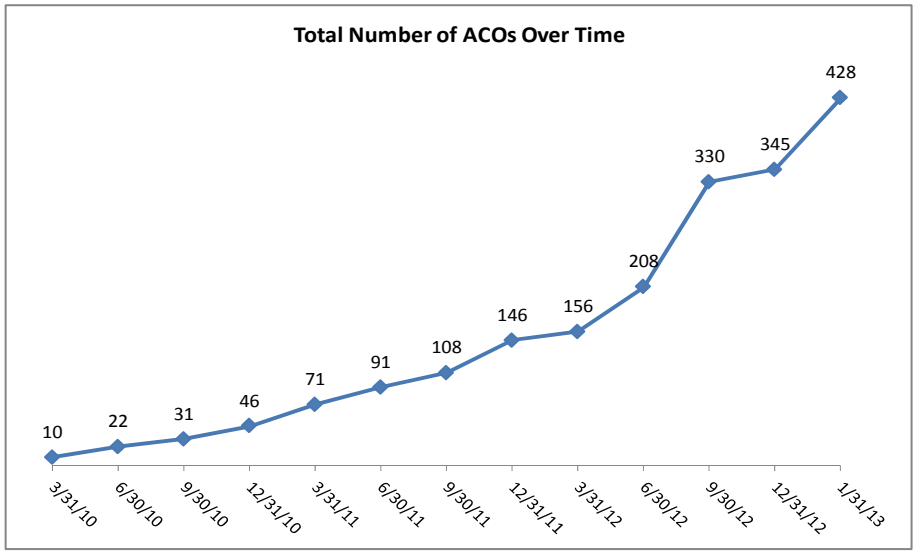
Medicaid Expansion

23 states and DC have chosen to expand Medicaid so far, with 21 electing not to and 6 still debating the option.

Accountable Care Organizations (ACOs)

The chart below shows the number of ACOs from March 2010 to January 2013. The number of new ACOs formed by year has accelerated, with 2012 seeing around 200 new formations. The number of formations in 2013 is expected to be higher than in 2012.

The number of new ACOs formed by year has accelerated, with around 200 formed in 2012 and an even higher number expected in 2013.



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Ask the Actuary: Discount Rates - Then & Now

Historically, the selection of a discount rate was based on a wide range of alternatives, from "risk-free" rates to actual portfolio rates of return to cost of capital targets, due to high investment earnings and more relaxed professional standards. As interest rates started dropping several years ago, changes to discount rates lagged behind in hopes of an economic upturn. Now, due to improved financial reporting standards and a continuing low interest rate environment, there is an increased focus on discount rate selection.

Actuarial Standard of Practice No. 41 (effective December 2010) requires actuaries to comment on the reasonability of the discount rate used in their analyses. A reasonable range of discount rates can be determined by reviewing yields on U.S. Treasuries and high-quality fixed-income securities, actual investment rates of return, and discount rates used by other similar entities. Management selects the final discount rate after discussions with their actuary, auditors, and regulators.

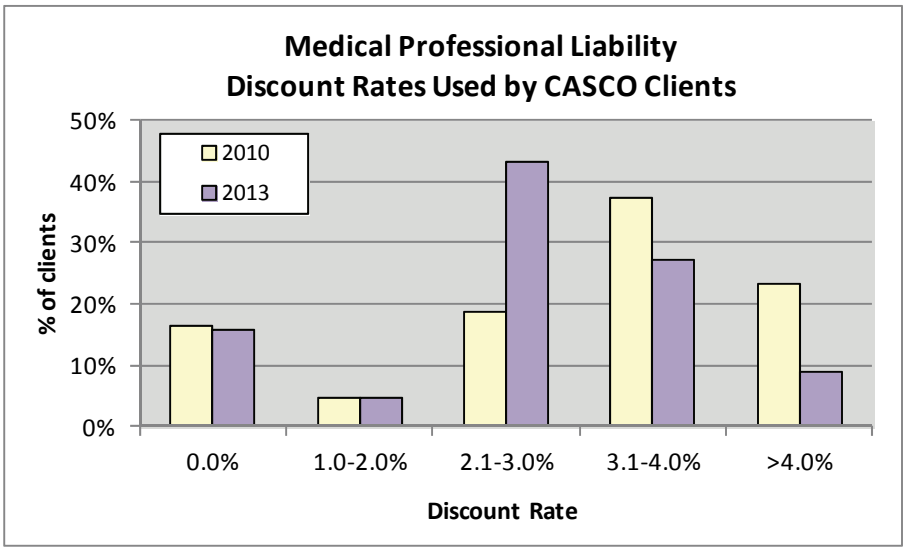
Continued on next page.

Ask the Actuary: Discount Rates - Then & Now (continued)

Q: How have discount rates changed over the past few years?

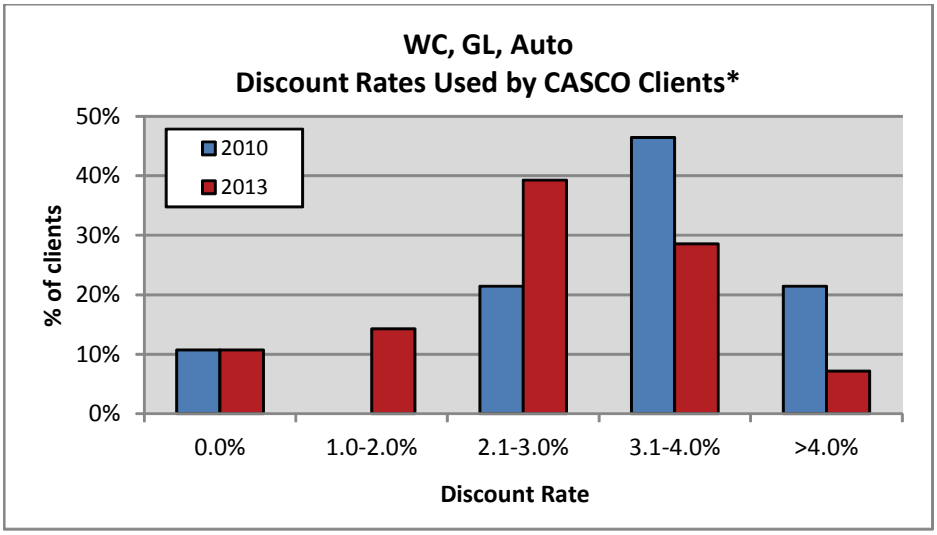
Among CASCO's clients, there has been a noticeable shift to using lower discount rates for purposes of booking financial statement liabilities, as shown below. For medical professional liability, 64% of our clients are currently using a discount rate of 3.0% or lower compared to 40% in 2010. On average, the discount rate has decreased by 0.5% (from 3.2% to 2.7%).

On average, the medical professional liability discount rate used by CASCO clients has decreased by 0.5% (from 3.2% to 2.7%).



Among CASCO's university and healthcare entity clients, the shift is even more dramatic for other property casualty lines such as WC, GL, and Auto, with 64% of our clients currently using a discount rate of 3.0% or lower compared to 32% in 2010. On average, the discount rate has decreased by 0.8% (from 3.5% to 2.7%).

The average WC, GL, Auto discount rate used by CASCO healthcare and university clients has decreased by 0.8% (from 3.5% to 2.7%).



*University and healthcare entities.

Ask the Actuary: Discount Rates - Then & Now (continued)

Q: How has the interest rate environment changed over the past few years?

Generally, yields on low-risk investments, such as U.S. Treasuries, are used to approximate "risk-free" rates of return, which auditors and regulators tend to prefer for property and casualty discounting. Treasury yields over the past several years are shown below. Rates declined during the two-year period from June 30, 2010 to June 30, 2012 but have since returned within 0.5% of the June 30, 2010 levels.

Treasury Yield Curve Rates

	Maturity			
	1 year	3 years	5 years	10 years
June 30, 2010	0.32%	1.00%	1.79%	2.97%
June 30, 2011	0.19%	0.81%	1.76%	3.18%
June 30, 2012	0.21%	0.41%	0.72%	1.67%
June 30, 2013	0.15%	0.65%	1.39%	2.50%

The choice of a discount rate for self-insured workers' compensation liabilities involves additional consideration and discussion, due to that line's similarities with two employee benefit areas: disability and medical benefits. Discount rate selections for those lines tend to be more consistent with the GAAP rules for pension and post-retirement benefits accounting (adjusting for any duration differences), where the selected rates are generally pegged to "high-quality" fixed-income securities whose yields are normally higher than those of "risk-free" securities such as U.S. Treasuries. Yields from the Citigroup Pension Discount Curve (a commonly used measure of average yields for high-quality fixed-income securities) over the past several years are shown below. While rates have generally rebounded somewhat since last year, they are still around 1% lower than they were in mid-2010.

Yields for High-Quality Fixed-Income Securities *

	Maturity			
	1 year	3 years	5 years	10 years
June 30, 2010	1.49%	2.14%	3.07%	4.87%
June 30, 2011	0.88%	1.69%	3.03%	4.77%
June 30, 2012	0.69%	1.06%	1.74%	3.28%
June 30, 2013	0.60%	1.22%	2.20%	3.83%

* Based on the Citigroup Pension Discount Curve.

The current trend towards greater regulatory scrutiny, coupled with the continuing low interest rate environment, has resulted in a narrower range of reasonable discount rates than in the past. Therefore, open communication between management, actuaries, and auditors is important in deciding on an acceptable rate.

Market Focus

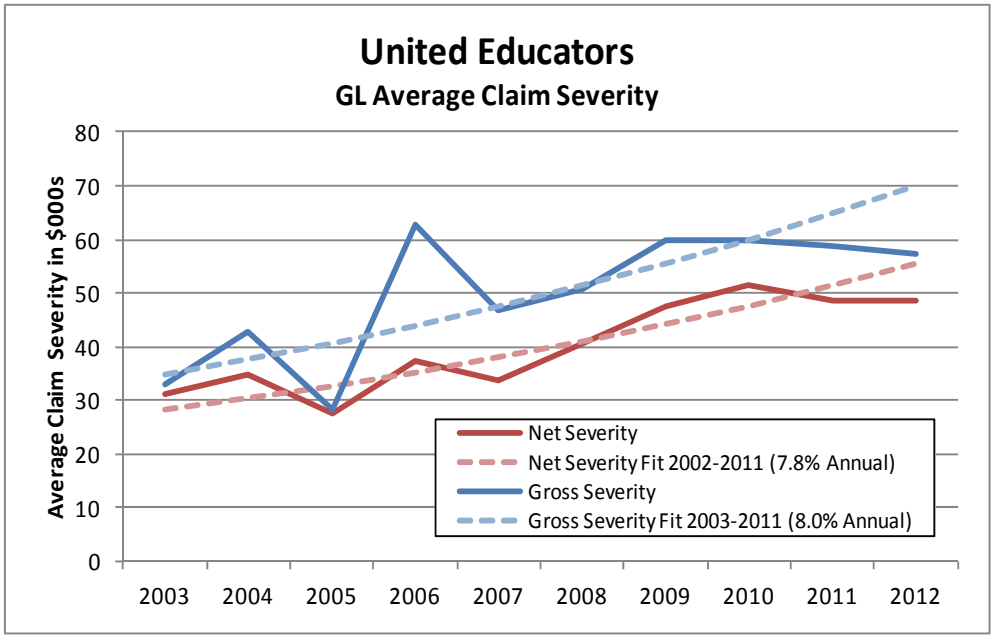
In this issue, we show results for the largest risk retention group in the education sector.

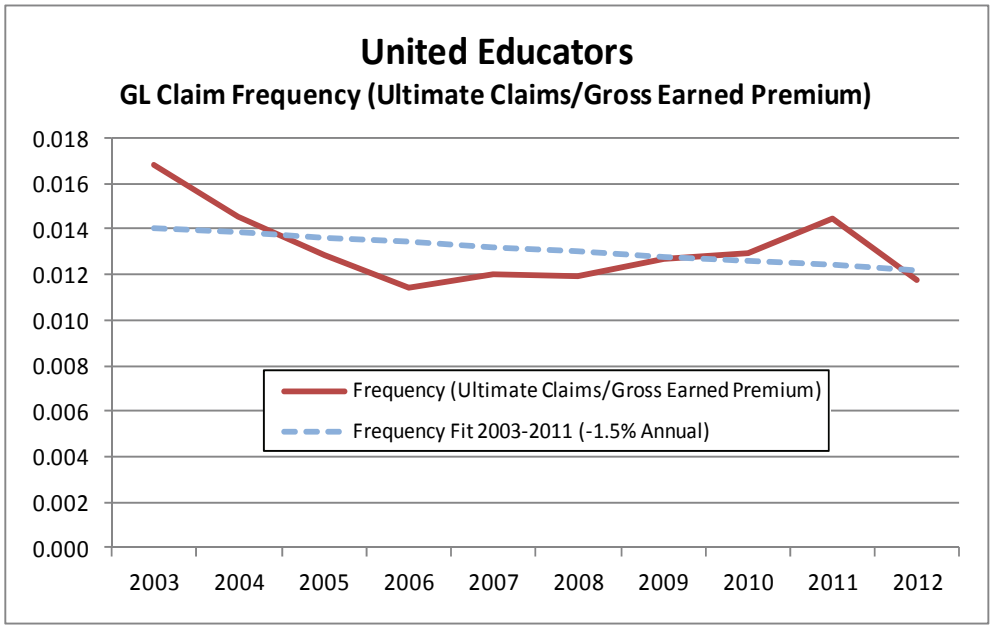
Claim severity has been increasing at a rate of about 8% annually but has flattened out in recent years.

Frequency relative to premium has been decreasing by about 1.5% annually but has flattened out in recent years.

Market Focus: United Educators

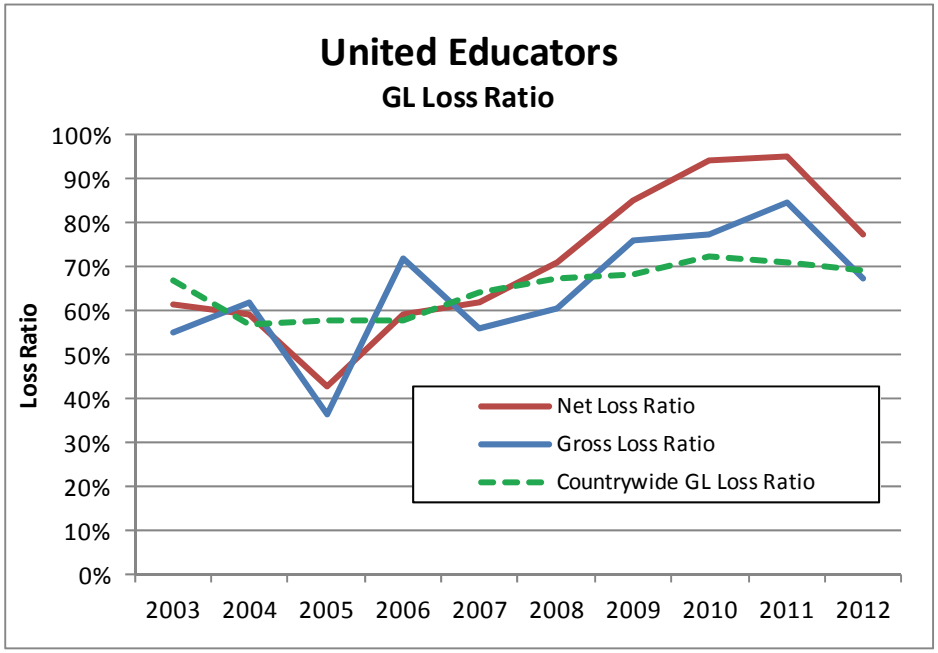
United Educators (UE) is a Vermont-based risk retention group insuring over 1,000 universities and other educational institutions. UE's general liability (GL) average claim severity, claim frequency, and loss ratios for the last ten coverage years, and underwriting and operating ratios for the last seven years, are shown below. This information is based on their most recent publicly filed annual statement, a copy of which can be obtained from the National Association of Insurance Commissioners.





Market Focus: United Educators (continued)

Net loss ratios have been higher than the overall P&C industry since 2008.



United Educators Financial Results

	2006	2007	2008	2009	2010	2011	2012
Net Underwriting Ratio (Excl. Investment Income)	89.4%	91.7%	92.7%	95.5%	104.1%	103.1%	102.8%
Net Operating Ratio (Incl. Investment Income)	60.7%	71.2%	70.6%	72.1%	80.2%	78.3%	82.2%

EGWP: An Attractive Alternative to Retiree Prescription Drug Plan Subsidies

EGWP/Wrap plans can provide significant savings compared to retiree drug subsidy plans without requiring changes to the coverage provided.

The Medicare Part D retiree drug subsidy (RDS) being received by many employers for their retiree prescription drug plans is taxable from 2013 onwards as a result of the Affordable Care Act (ACA). There is however, an attractive alternative to the RDS approach. An Employer Group Waiver Plan with Wrap Around supplement plan (EGWP/Wrap) can offer substantial savings over RDS plans. The EGWP/Wrap plan is a combination of a standard Medicare Part D plan and wraparound benefits that can be designed to provide virtually the same coverage as the current plan.

Savings/benefits are achieved as follows:

- Enhancements to Medicare Part D, including the closing of the "donut hole", have increased federal reimbursement for that part of the EGWP/Wrap plan.

Continued next page

EGWP (continued)

- Certain reimbursements by pharmaceutical companies (pharma) can be received for brand name drugs occurring in the "donut hole" that are not available for employers receiving the RDS (part of the ACA known as the Coverage Gap Discount Program).
- Pharma reimbursements will count as member cost sharing, allowing members to reach the catastrophic layer of coverage (where most of the cost is covered by the federal government) more quickly.
- If your organization pays taxes, the loss of the RDS tax break makes the EGWP/Wrap plan even more attractive.

Administrative expenses are higher for EGWP/Wrap plans due to the complexity of integrating two plans and the need to comply with additional regulations (for example, the Medicare Part D plan must meet CMS requirements and receive explicit approval). However, there should still be significant net savings especially for tax paying organizations.

A transition from the current plan to the EGWP/Wrap plan can be accomplished through your organization's Pharmacy Benefit Manager (PBM). The PBM will also perform many of the ongoing administrative duties associated with the plan, with pharma reimbursements and Medicare payments handled out of sight to the participants. To the retiree, there will be one Rx card and the program will look and feel like the current single plan. To the employer, there are financial savings with minimal backlash from employees or retirees who see nothing changing. Making this change is a win-win proposition for employers who want to continue providing group retiree prescription drug plans and the time to act is now.

Links to Interesting Articles

How will premiums change under the ACA?
A discussion of the factors that will determine how the ACA affects premiums from 2014 onwards.

'Super Losses' in Healthcare Sector Growing in U.S.
For medical professional liability, the number of claims above $50 million and the number above $5 million are on the rise.

Workers Compensation and the Aging Workforce
While average claim severity is higher for older workers than for younger workers, an aging workforce appears to have less of a negative impact on overall workers compensation costs than might have been thought.

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About CASCO

We provide ongoing actuarial services to over 100 clients in several areas:

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- Directors' & Officers' Liability
- Workers' Compensation
- Automobile Liability
- Managed Care Errors & Omissions
- Medical Benefits Stop Loss Risk
- Disability Benefits

We help clients with:

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- Liability and cost projections for accounting and budgeting
- Formal opinions and reports to meet regulatory and audit needs
- Communication with auditors, regulators, and excess insurers
- Other regulatory or administrative problems
- Impact analysis of judicial/law changes affecting program costs
- Strategic risk financing studies
- Retention limit analysis (single and multi-line)
- Internal cost allocation
- Pro-forma projections of program results under varying scenarios
- Cash-flow forecasts to help in setting investment strategy
- Evaluation of insurance products
- Projecting costs for acquisitions and new ventures
- Expert witness testimony
- Benchmarking data on loss costs, trends, retention limits, and more

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