AON

San Francisco Health Service System

Health Service Board

Review and Approve Proposed Modifications to Health Service Board (HSB) Contingency Reserve Policy 210

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December 12, 2024

Proposed Modifications to HSB Contingency Reserve Policy 210—Agenda

- **Introduction—**basis for today's proposed modifications to Policy 210 (remove active dental PPO plan from policy)
- **Background—**HSB Contingency Reserve Policy 210
- **Rationale for Removing Active Dental PPO Plan from Policy 210**
- **Recommendation for HSB action**

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Introduction — Basis for Today's Proposed Modifications to Policy 210

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Removing Active Dental PPO Plan from HSB Contingency Reserve Policy 210

- At the March 14, 2024, HSB meeting, Aon presented suggestions to modify June 30, 2023, contingency reserve amounts for all self-funded/flex-funded medical/Rx and dental plans offered by San Francisco Health Service System (SFHSS), in response to addressing unprecedented near-term adverse financial outlooks for participating employers.

- The approved one-time modifications—adopting medical/Rx contingency reserves at the 95th percentile confidence level (within Policy 210 framework, though prior precedence was to utilize calculations at the 99th percentile confidence level), as well as setting active dental PPO plan contingency reserves as of June 30, 2023, to $0—led to a lower calendar year 2025 budget forecasts for these health plans than would have occurred at contingency reserve levels approved at the January 2024 HSB meeting.

Introduction—Basis for Today's Proposed Modifications to Policy 210

Removing Active Dental PPO Plan from HSB Contingency Reserve Policy 210

- During the March 14, 2024, HSB meeting, the HSB approved the suggestion to request the Governance Committee of the HSB, then the full HSB, later in 2024 to consider the elimination of the self-funded active dental PPO plan from HSB Contingency Reserve Policy 210.
- The Governance Committee approved the requested action to eliminate the self-funded active dental PPO plan from HSB Contingency Reserve Policy 210 at its December 6, 2024, meeting.
- Today's presentation and request for approval is the final step in the process—the request of the full HSB to approve Policy 210 modifications that would remove the active dental PPO plan from Policy 210.

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Background — HSB Contingency Reserve Policy 210

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The HSB Reserve Policies are captured in the sfhss.org website within the Governance Policies and Terms of Reference document (revised January 2023) available at this link:

https://sfhss.org/sites/default/files/2023-01/HSB%20Governance%20Policies%20and%20Terms%20of%20Reference%20Revised%201-2023%20Full%20Packet_1.pdf

The Reserve Policy numbers and descriptions are (with emphasis on the Contingency Reserve Policy for today's recommendations for HSB action):

- **210 — SFHSS Contingency Reserve Policy**
- 211 — SFHSS Self-Funded Plans' Rate Stabilization Policy
- 212 — SFHSS IBNR Reserve Policy and Methodology

Background—HSB Contingency Reserve Policy 210

What is a Contingency Reserve? Think of It As The Trust's "Emergency Fund"

- First implemented by SFHSS in 2007, a Contingency Reserve protects the Trust from highly unusual, adversely high health plan claim experience that could occur in a self-funded or flex-funded health plan. These events, as outlined in Policy 210, can include:
  - Random variation from expected claims;
  - Credibility of the experience;
  - Fluctuations in large claims experience;
  - Vendor processing stability;
  - Changes in COBRA enrollment; and
  - Catastrophic events and whether to make and allowance or not.

Background—HSB Contingency Reserve Policy 210

Contingency Policy Objectives—Protecting Unusually High Claim Experience

- It is prudent for self-funded and flex-funded health plans to have a Contingency Reserve, otherwise known as excess loss reserve, to absorb financial strain brought about by adverse claims experience. This covers the risk of claims exceeding expected claims targets used in the underwriting rate setting process.
- Contingency reserves allow SFHSS to establish a budget based on a predetermined funding level and maintain that structure regardless of claims experience level.
- As stated in Policy 210, having a contingency reserve serves the same purpose as external stop loss insurance, **and therefore external stop loss insurance will not be purchased** except where required by the health plan.
  - Blue Shield of California requires $1.25 million per covered life large claim pooling in 2025 in the Access+ and Trio HMO plans.

Background—HSB Contingency Reserve Policy 210

Contingency Policy—Health Plans Covered Currently

- The HSB Contingency Reserve Policy 210 establishes contingency reserves for SFHSS flex-funded and self-funded health care plans:
  - Flex-Funded HMO Plans (non-capitated costs);
  - Self-Funded PPO Plan; and
  - Self-Funded Active Dental PPO Plan **(proposed for elimination from Policy 210 today)**.
- Further background and information on contingency reserves are contained in the Appendix to this document.

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Rationale for Removing Active Dental PPO Plan from Policy 210

Rationale for Removing Active Dental PPO Plan from Policy 210

- The contingency reserve concept is highly prudent for medical plans, as outlined in language contained in this presentation from the HSB Contingency Reserve Policy 210.
    - A key element guiding this is for **medical** plans, the member financial responsibility on high-cost claims is capped through plan out-of-pocket maximums, whereas plan financial responsibility for a member is not capped.
- However, for **dental**, the plan's financial responsibility per member is capped through plan annual maximums and lifetime orthodontic benefit maximums.
    - Self-funded active dental PPO plan annual benefit maximum per person (excluding diagnostic and preventive services): $2,500.
    - Self-funded active dental PPO plan lifetime orthodontic maximum per person: $1,500 to $2,500, depending on provider network status.

Rationale for Removing Active Dental PPO Plan from Policy 210

- Thus, the criteria outlined within the Contingency Reserve Policy for prudency of a dental plan contingency reserve do not apply to a self-funded dental plan as a practical matter—though historically the Contingency Reserve Policy 210 has included provision for the active employee self-funded dental PPO plan.
  - Dental plan experience has historically not been subject to random variation from expected claims.
  - There is full credibility of experience given over 30,000 covered employees and 70,000 covered lives.
  - Benefit maximums control any potential for large claims experience.
  - Catastrophic events historically do not alter the course of dental plan utilization (in fact, there was a substantial utilization reduction during the COVID-19 pandemic).

Rationale for Removing Active Dental PPO Plan from Policy 210

- As a result, as part of the prior SFHSS and Aon review of contingency reserve modifications at the March 2024 HSB meeting, it is recommended that the active dental PPO plan contingency reserve be eliminated from HSB Contingency Reserve Policy 210.

- Specific language changes to Policy 210 have been provided to the HSB today that upon approval, will eliminate the active dental PPO plan from Policy 210.

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Recommendation for HSB Action

Recommendation for HSB Action

It is recommended that the Health Service Board approve today's recommendation as also approved by the Governance Committee on December 6, 2024, to adopt the proposed language modifications within HSB Contingency Reserve Policy 210 that will remove the active dental PPO plan from Policy 210.

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Appendix—Additional Contingency Reserves Background and Information

Appendix—Contingency Reserve Calculation Methodology

- The HSB Contingency Reserve Policy 210 outlines the calculation methodology that Aon uses annually to produce three levels of statistical confidence intervals for reporting to the SFHSS Chief Financial Officer (CFO).
- Per Policy 210, Aon's calculations are performed at the 95th, 97th, and 99th percentile confidence intervals (where the 95th is statistically significant on its own, with the two other methods producing higher, more conservative amounts).
  - This three-calculation methodology was adopted within Policy 210 in 2013.
  - Since 2013, the practice for SFHSS has been to set contingency reserves at 99th percentile confidence interval levels—or the highest of the three calculated amounts per methodology outlined in HSB Contingency Reserve Policy 210.

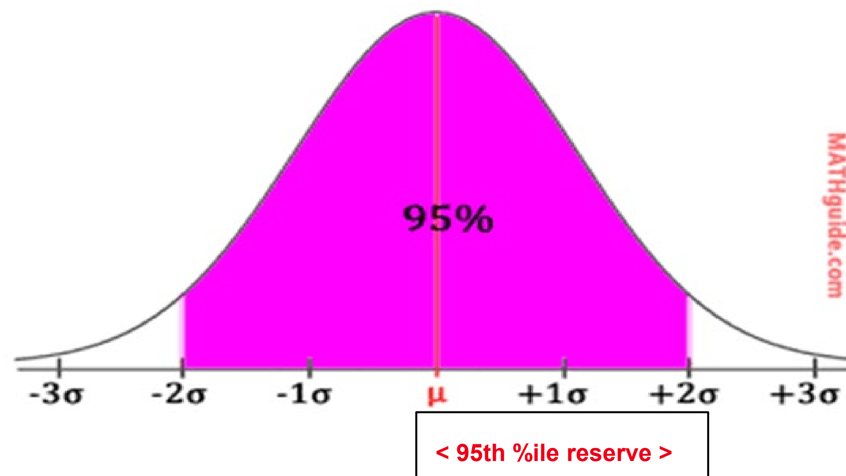
Appendix—Contingency Reserve Calculation Methodology

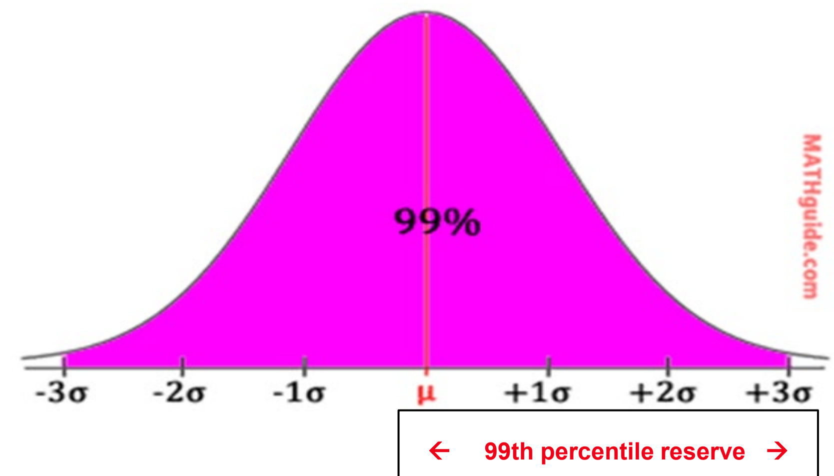
Confidence Intervals = Ranges of Deviation from Expected

From MATHguide.com (https://www.mathguide.com/lessons3/BC.html)

If we look at data that is two standard deviations from the mean (average), we should be looking at roughly 95% (or more accurately 95.4%) of the total data.

Looking at data that is within three standard deviations from the mean (average), we will find roughly 99% (actually closer to 99.7%) of the total data.





Appendix—Contingency Reserve Calculation Methodology

- Across Aon public sector client experience for contingency reserve levels, the 95th percentile confidence level is typical for contingency reserve determination.
- Excerpt from National Institutes of Health article (https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3263226/):
  - "In accordance with the conventional acceptance of statistical significance at a P-value of 0.05 or 5%, confidence intervals (CI) are frequently calculated at a confidence level of 95%."
- It is prudent for the HSB and SFHSS to continue evaluating medical contingency reserve levels as calculated using the three existing confidence interval levels in Policy 210—and retain the lower limit (95th percentile confidence interval) in the methodology to ensure statistical significance.

Appendix—Reserves in SFHSS Financial Accounting

Required Liabilities Per Accounting Rules

- Liabilities are required to be booked in financial statements per Accounting Rules for certain items—in this category, SFHSS needs sufficient assets to cover the following liabilities to avoid a deficit net position (e.g., insolvent):
  - Incurred But Not Reported (IBNR) reserves (for costs of health plan services delivered to members but not yet known as of June 30 each year, guided by HSB Policy 212);
  - Any advance payments received;
  - Any premiums due for services already received; and
  - Other one-time required liabilities (example: litigation claims).

Appendix—Reserves in SFHSS Financial Accounting

How Contingency Reserves Are Reflected

- Beyond Accounting Rules requirements described on the prior page, HSB reserve policies require SFHSS to hold a certain of amount of funds for any reason as determined by the HSB—to carry out this goal, SFHSS should have sufficient assets on its books.
- HSB policies guide the Contingency and Rate Stabilization reserves held by SFHSS—these reserves are footnoted items on SFHSS financial statement.
- As SFHSS current net assets exceed the total amount of these items, SFHSS is fully funded for these items. HSB Contingency Reserve Policy 210 language indicates this reserve should be fully funded.

Appendix—Reserves in SFHSS Financial Accounting

How Contingency Reserves Are Reflected (continued)

- Contingency reserve changes from the prior fiscal year-end to the most recent fiscal year-end are incorporated into the annual Rate Stabilization calculations to determine the annual recommended Rate Stabilization actions for next year's self-funded and flex-funded health plan rate cards each year.