

SAN FRANCISCO HEALTH SERVICE SYSTEM
Health Service Board
Contingency Reserve Policy and Methodology

Policy Objectives

It is prudent for an Administrator of a self-funded benefit program to establish a Contingency Reserve, otherwise known as excess loss reserve, to absorb financial strain brought about by adverse claims experience. A Contingency Reserve is funding reserves to cover the risk of claims in excess of expected claims target.

Independent of the ability of a Self-Funded Benefit Plan to access external dollars to fund adverse experience, it is prudent and sound to consider implementing a Contingency Reserve. It allows the Plan Sponsor to establish a budget based on a predetermined funding level and maintain that structure regardless of claims experience level.

In the case of the City Plan it is additionally important to recognize that there is no reinsurance for this self-funded program. Full responsibility remains with the Trust to absorb potential excess cost over expected cost. This makes it essential that the Trust hold an excess loss reserve.

Policy History

The Board adopted this policy on March 12, 2008, amended it on March 14, 2013, and amended it again on February 13, 2014.

Review

The Board shall review this policy at least every three years.

Contingency Reserve Policy

This policy standardizes the **Contingency Reserve** setting methodology for the Health Service System's (HSS) self-funded health plans. The purpose of the Contingency Reserve is to establish reserve funds that are available in the event that claims are in excess of target costs. The Contingency Reserve policy is specific to HSS's self-funded healthcare plans:

- The Self-Funded PPO City Plan
- The Self-Funded Employee Dental PPO Plan
- The Flex-Funded/Self-Funded HMO Plan(s) (non-capitated costs)

The methods specified in this document will be applied for Contingency Reserve estimation as of June 30 each year, at the end of each fiscal year.

Definitions

Contingency Reserve: Any actuarial estimate is based upon the information available at a point in time and is subject to unforeseen and random events. At any point in time, estimated reserves may be higher or lower than required. Future funding projections will generate revenue that may be higher or lower than actual experience. There are multiple factors that impact the eventual experience of the self-funded health plans. The range of plausible results around the best estimate rates would consider:

Random variation from expected claims
Credibility of the experience
Fluctuations in large claims experience
Vendor processing stability
Changes in COBRA enrollment
Catastrophic events and whether to make allowance or not

The contingency reserve is intended to immunize against such adverse experience.

Contingency Reserve Methodology

To establish the Contingency Reserve(s), linear regression is used, specifically:

- The City and County of San Francisco's third party administrator(s) provide either 36 or 48 months of claim data which the actuarial consultant firm summarizes by incurred and paid period. This data is separate for each line of coverage (medical, pharmacy and dental) and for each plan.

These amounts are converted to a per employee per month (PEPM) basis and linear regression is performed on the monthly PEPM values.

The regression data is used to determine the predicted monthly values and the corresponding monthly variances, as well as the predicted annual claims per employee per year (PEPY) and corresponding variance PEPY.

Using the predicted claims PEPY and variance PEPY, the expected value is calculated at a particular level of confidence. This is done by using the normal distribution. For our analysis, we use three levels of potential excess cost; confidence levels of 95%, 97% and 99%.

The gross Contingency Reserve is the difference between the cost at a particular confidence level and the projected PEPY costs times the anticipated enrollment, plus a margin between 0% and 10%.

The actuarial consultant firm presents the analysis at the three levels of confidence (95%, 97% and 99%) to the HS Board for final determination of the approved contingency reserve amount for each plan.