Impact of COVID-19 on PHI

Financial Condition Reports

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PREPARED BY: Health Practice Committee

Objective, scope and context

Objective

The purpose of this note is to assist actuaries assess the impact of COVID-19 and the current economic environment on Private Health Insurers (insurers) at 30 June 2020 balance dates in the context of the Financial Condition Report (FCR).

Scope

This note focuses on the preparation of the 2020 FCR. It considers key implications of the claims and economic uncertainty for inclusion in the FCR.

Context

COVID-19 has resulted in an unprecedented level of uncertainty for insurers, directly impacting the hospital and provider system and the economic conditions in which they operate.

Historical trends and risks will be less reliable for informing the future. Some trends and risks may have accelerated during this period of uncertainty. New trends and risks may also have emerged without much prior anticipation. Other trends and risks may no longer be as important.

The situation is also rapidly changing, making assumption setting difficult, and especially challenging for assessing the insurer's financial condition. Further the publicity around the impact of COVID-19 may encourage insurers to make decisions without considering the longer-term implications. The Appointed Actuary and the FCR are key to ensuring all matters are considered by insurers when making decisions.

Quick Checklist of Considerations

Assessing an insurer's financial condition requires analysing and understanding the historical experience, in order to inform its prospects in the future.

For an FCR at 30 June 2020, looking back over historical experience therefore requires interpretation of trends and impacts during the current COVID-19 phase, assessing their potential to persist and/or how they might further evolve into the 'New Normal'. In particular, there are multiple effects that impact health insurance:

- Lockdowns – which have both a health demand and economic impact.
- Physical distancing – which has altered the way health care is delivered.
- Economic response of the government - which affects demand for health insurance.

The Appointed Actuary has a critical role to identify and support actions that help to protect the insurer's financial condition. Given the increased uncertainty because of COVID-19, understanding the uncertainty, communicating and justifying assumptions and perspectives will be equally important.

Considerations for AAs in preparing FCRs

Focus Area	Consideration
Business Overview	• Fund strategy • Organisational structure
Insurance Liabilities	• Interpretative guidance from APRA/ASIC
Pricing	• Estimating Claims • Constraints on pricing
Investment Strategy	• Review of Strategic Asset Allocation • Execution of Investment Strategy
Actual vs Expected Experience	• COVID-19 impact on claims • COVID-19 impact on membership
Risk Management	• New risks • Disruption to risk management
Capital Management	• Appropriateness of capital management
Future Profitability and Capital Adequacy	• Projection of future profitability • Uncertainty for capital adequacy
Actuarial Advice Framework	• Effectiveness of AAF

In stepping through the considerations above, the actuary could consider what analyses and conversations might be helpful.

Detailed Considerations

1. Business overview

Fund Strategy

Is COVID likely to impact the insurer's current strategy and set of strategic initiatives? Potential risks include:

- Product offering, distribution and servicing channels, and digital strategy are no longer aligned with the expected membership mix and target market.
- Product offering is not aligned with future case mix and preferences for seeking treatments in different settings.
- Product offering is not aligned to changes in the value proposition and societal perception of the purpose of private health insurance.
- Non-health insurance business activities present a contagion risk to the health benefits fund e.g. aged care facilities, private hospitals.
- The insurer's strategy to retain members through hardship benefits is not successful.

Organisational Structure

Is the organisation structure still appropriate for thriving in a COVID-19 and post COVID-19 world? Potential risks include:

- Disruption to the efficient synthesising and understanding of changing information for timely decision making.
- Disruption to the execution of risk controls and flows of monitoring information.

2. Liability Valuation

Interpretative Guidance from APRA/ASIC

Is the insurer's approach consistent with the interpretative guidance from APRA and ASIC?

- Are there any deviations from this guidance that warrant discussion?
- Are there any uncertainties with the results that should be highlighted?

More detailed discussion on the impact of COVID-19 on the liability valuation is extensively covered in Pandemic Briefing Note 1, 'Impact of COVID-19 on PHI' from 26 May 2020.

3. Pricing

Assessing the adequacy of pricing

Is the insurer able to accurately assess the underlying performance of its products? Can products be assessed as being within appetite? Is corrective action required? Potential risks include:

- Accurately assessing underlying benefits, especially given experience of the June quarter. Usual measures to assess performance will be less reliable in 2020. Claim payments will be lower due to restrictions on elective surgeries and benefits in the financial statements will be affected by the deferred claims liability.
- Accurately assessing benefits against a backdrop of increasing costs in the delivery of treatments. Providers may be facing additional costs due to personal protective equipment, higher staffing ratios, and medical staff being more exposed to contracting COVID-19.
- Accurately assessing underlying premiums. Premium receipts will be lower as most insurers have delayed the 1 April 2020 premium increase and through the provision of hardship benefits, including discounts, premium deferrals and suspensions. This will mean that underlying premiums may be higher than those reported.
- The result being that gross margins may be misleading and suggest that corrective action may not need to be taken. To address this actuaries may:
    - Focus on the nine months of experience to March 2020 rather than include the June quarter.
    - Make specific allowances for each of the factors above to determine underlying performance.
    - Allocate the deferred claims liability to each product.
    - Reference product groups that may have underlying performance outside of appetite. This could be a product with reported gross margins within appetite when adjusted for the factors above is outside of appetite or vice-versa.

Estimating claims and constraints on pricing

Is the insurer prepared for different scenarios that might play out from a pricing perspective? Does it understand the financial implications under each scenario? Potential risks include:

- Accurately estimating future expected claims may be challenging because utilisation may be affected by the general economy, membership mix, hospital bed supply and provider behaviour generally, any further elective surgery restrictions and any further physical distancing measures impacting access to general treatment.

- The timing and size of the next premium increase may be constrained by the general economy and societal expectations and may be different from the Appointed Actuary's recommendation.
- Distinguishing between national versus state trends particularly as the epidemiology of COVID-19, and hence both the economic and health response, may not be uniform across Australia.

4. Investment Strategy

Review of Strategic Asset Allocation

Is the strategic asset allocation still appropriate? Potential risks include:

- The strategic asset allocation is no longer aligned with the insurer's risk appetite given the change in the risk return characteristics of different asset classes.
- The strategic asset allocation is no longer consistent with the strategic direction of the insurer and use of investment returns for income will be impacted.
- Whether liquidity is more of a concern as a result of COVID-19, either due to the volatility in the health insurance business or for a strategic action.

Execution of Investment Strategy

Are there any implications of COVID-19 on the capabilities, from both a skills and operations perspective, of investment managers? Potential risks include:

- Disruption to the operation of the investment manager has led to issues around compliance with the insurer's investment policy.
- Disruption to the operation of the investment manager has led to issues with the transparency and timeliness of asset valuations.

5. Actual experience and performance

COVID-19 impact on claims

What has been the impact of COVID-19 on actual claims compared with expected? As some of these impacts unwind, there is a risk of interpreting the historical experience incorrectly with consequent issues for forecasting. Issues to potentially consider:

- Distinguishing and quantifying claims that are just postponed versus claims that represent a permanent saving versus new claims that have not been delayed in any way. This could include analysing claims at more detailed levels of granularity than normal e.g. by treatment, date of confirmation of eligibility.

- Estimating the experience of the insurer relative to the industry and implications that has for estimating claims in the future and for risk equalisation.

COVID-19 impact on membership

What has been the impact of COVID-19 on actual membership compared with expected? Issues to potentially consider:

- Estimating the benefits of initiatives introduced to address financial hardship to evaluate their appropriateness for the future and the implications as they are unwound.
- Estimating the membership impact by economic implications for different product and population segments to understand implications for future membership retention and growth.
- Estimating the membership impact by distribution channels.

6. Risk Management Framework

New Risks

Is the risk management framework still appropriate? Potential risks include:

- New risks have not been identified and appropriately incorporated into the risk management framework because of ineffective awareness or review by the insurer.
- Monitoring and mitigation may not have been kept up to date to deal with additional risks arising from COVID-19.
- Identified management actions are no longer appropriate or achievable due to COVID-19.

Disruption to Risk Management

Is risk management still being performed effectively? Potential risks include:

- A lack of availability of staff and resources to maintain monitoring of risks due to working from home arrangements both during the initial lockdown of COVID-19 and on an ongoing basis, and/or gaps left by re-assignment of responsibilities.
- Disruption to insurer operations may have impacted on the timely and accurate capture of data.
- Disruption to operations of third-party providers on which the insurer is reliant on for risk management.

7. Capital Management

Appropriateness of Capital Management

Is the insurer prepared for different scenarios that might play out from a capital management perspective? Does it understand the capital implications under each scenario? Overall is the capital management plan still appropriate? Potential risks include:

- The uncertainty arising from different patterns of premium increases, patterns of claims rebounding, membership and product mix and 'normal' claims
- There are new or changing nature of risks identified (e.g. strategic implications for the health system and/or mispricing because of the uncertainty with forecasting future claims) that have not been reflected appropriately for capital management.
- The tolerance for failure by the insurer is no longer consistent with the capital management plan or the system of capital triggers (due to changes in the distribution of potential financial outcomes for health insurers).

The above list focuses on health insurance and does not include capital considerations that are not unique to health insurance. The COVID-19 Working Group's pandemic briefing note 'ICAAP Considerations' cover them well and they have not been repeated here. The reader could consider that note for other considerations around capital.

8. Future profitability and capital adequacy

Projection of future profitability

How has the insurer allowed for the COVID-19 uncertainty in the projection of the fund's future profitability and capital adequacy? Potential risks include:

- The scenarios and sensitivities modelled turn out to be significantly different from what transpires. Similarly, to the discussion under 'Capital Management', uncertainty arises from different patterns of premium increases, patterns of claims rebounding, membership and product mix, and 'normal' claims. Reverse stress testing may be helpful in identifying the boundaries of where risks become material issues.
- The potential risk mitigation measures may be incomplete if the scenarios and sensitivities modelled do not capture the range of possible scenarios.

Uncertainty for capital adequacy

How has the insurer allowed for the COVID-19 uncertainty in setting risk margins for capital adequacy? Potential risks include:

- The distribution of outcomes for net margin, investment income and their correlation are now different from historical experience.
- The approach for understanding uncertainty around future profitability and other items are inconsistent.

The impact of COVID-19 on capital adequacy is covered in the Pandemic Briefing Note 1, 'Impact of COVID-19 on PHI' from 26 May 2020.

9. Actuarial Advice Framework (AAF)

Effectiveness of the AAF

Has the AAF been effective in supporting the Appointed Actuary to understand and advise on the financial condition of the insurer? Potential risks include:

- New risks and drivers of those risks that lead to instances where the AAF was ambiguous around the role of the Appointed Actuary, or where there are now gaps in the advice framework that should be captured.
- Disruption to the flow of information and decisions that prevented the Appointed Actuary from being able to provide advice in a timely manner.