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MERCER

Mr. Chris Bradley
Director of Employee Benefits and Health
Maricopa County
301 W. Jefferson Street, 10th Floor
Phoenix, AZ 85003

April 2, 2015

Subject: Partial Update of Actuarial Analysis of Unpaid Claims Liabilities and Reserves as of June 30, 2014

Dear Chris:

Mercer has performed a high level review of recent experience as a limited partial update to the October 17, 2014 report on the Actuarial Analysis of Unpaid Claims Liabilities and Reserves as of June 30, 2014 of the Maricopa County Self-Funded Employee Benefits Program. This update is only for the premium deficiency reserve (PDR) for the Medical, Pharmacy, Dental, Vision, and Behavioral Health benefits, which was $7.36 million. This was the amount by which expenses for the 12 months ending June 30, 2015 (FY 2015) were expected to exceed the accrual premiums, for which the rates had been established in 2013 using claims data paid through July 2013. For this update, Mercer used claim data through February 2015 from CIGNA, UHC (PPO and HSA that were first effective July 1, 2014), and Catamaran (Pharmacy). We did not use data from Avesis (Vision) or Magellan (Behavioral Health).

We understand that the County is considering a release of $1.7 million of the $7.36 million PDR. Based on our high level review, which found emerging claim experience to be more favorable than expected, Mercer concurs with the release of $1.7 million from the PDR, leaving $5.66 million. In our opinion, this remaining amount will be sufficient to cover the expected excess of FY 2015 expense over premiums with a high degree of probability (90%+).

As part of Mercer's report for June 30, 2015 liabilities and reserves, we will provide a retrospective look at the June 30, 2014 PDR with the benefit of an additional 12 months of claim run-out.

All estimates are based upon the information and data available at a point in time, and are subject to unforeseen and random events. Therefore, any projection must be interpreted as having a likely range of variability from the estimate. Any estimate or projection may not be used or relied upon by any other party or for any other purpose than for which it was issued by Mercer. Mercer is not responsible for the consequences of any unauthorized use.

The undersigned credentialed actuary meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this letter.

Please let us know if you have any questions or need anything else.

Sincerely,

F Kevin Russell

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Principal

Copy:
Patricia Cole, Mercer

Benefits Trust Reserves

Employee Benefits and Health

April 20, 2015

Background

- FY 2008: County self-insured for medical benefits
  - $34.3m reserved in the General Fund
  - Stop-loss purchased/$200k attachment point, $1.9m premium
- FYE 2010: Benefits Trust balance (exc. STD) exceeded reserve target by $10.3m; General Fund reserve eliminated
- FY 2011:
  - Stop-loss increased to $750k, premium reduced to $779k
  - Benefits Trust separated from Risk Trust
  - Premium holiday reduced excess reserves by $5.5m
  - FY 2012: Trustees approved $2.7m reserve for large claims, zero stop-loss
- FY 2014:
  - Board of Supervisors' direction to right-size reserves in all County funds
  - Two premium holidays reduced reserves by $10.4m
  - Claims fluctuation reserve reduced from 250% to 150% CAL
- FY 2015:
  - Two premium holidays planned
  - Mercer projected claims deficiency of $7.5m

Current Reserve Targets

	FYE 2014
Reserves (Retained in Fund Equity)	
Claims Fluctuation (150% CAL)	$ 17,031,381
Excess COBRA Expense	195,703
Large Claims (Stop Loss)	4,781,520
	$ 22,008,604

Options for Claims Fluctuation Reserve (per Mercer)

- RBC-based methods: Yields lower reserves for larger plans; at 100% CAL, result is close to one month of claims for the largest benefit plans
- A factor times the IBNR: As claims adjudication has accelerated, IBNR estimates have diminished
- A number of months' worth of claims

Reserve Options – Illustration

Risk-Based Capital/100% CAL	$11,354,254
1 X IBNR*	$11,158,306
1 Months of Claims	$10,387,823

*In addition to IBNR posted as a liability.

State of Arizona

- Program serves over 60,000 subscribers for medical insurance
- CY 2013:
  - IBNR = \$104.4 m (19.4% of medical and dental claims)
  - "Contingency Reserve" equal to IBNR
  - \$78.6 million transferred out to General Fund or repaid to federal programs
  - Unrestricted balance of \$73.4 m
  - Total ending balance (cash basis) \$283.2 m
- FY 2015 ending cash balance of \$320 m, almost 41% of total expenses
- State has engaged Mercer to evaluate reserves and options; IBNR considered over-valued
- Statute specifies that funds paid by employees are spent first, so any excess balances revert to the State
- Does not purchase stop-loss

Cities

- City of Mesa:
  - No formal policy, but have felt that reserves were too high; excess spent down via premium holidays and holding back increases
  - As of June 30, 2014
    - IBNR: $4.7m
    - Ending Balance: $44.2m (80.4% of "claims and premiums paid")
- City of Chandler:
  - Reserves 2 months of medical claims, 1 month of pharmacy claims
  - Purchases stop-loss insurance
  - FYE 2014
    - Claims expense: $8.4m
    - IBNR: $1.1m
    - Ending balance: $4.2m (50% of claims expense)
    - Reserve: $2.7m

Counties

- Pima County:
  - Benefits Trust formed in 2013
  - Reserve targeted at $20m, benchmarked against Maricopa County reserve at prior level
  - Plans to have actuary to recommend reserves
  - Purchases stop-loss
- Pinal County
  - Dissolving benefits trust; joining Arizona Metropolitan Benefits Trust
  - $5.4m reverting to the County General Fund on July 1, 2015

Recommendations

- Continue Reserve for Adverse Claims Fluctuation based on RBC methodology
  - Employer-subsidized plans: 100% - 150% CAL
  - Employee funded plans (STD): 250% CAL
- Continue to forgo stop-loss insurance; target reserve for large claims at $750k attachment point equivalent
- Continue reserve for Excess COBRA Expense
- Establish policy that General Fund will cover a shortfall in the Trust

Recommended Reserve Targets

		FYE 2014
Reserves (Retained in Fund Equity)		
Large Claims (Stop Loss)	$	2,132,448
($750 attachment point equivalent)		
Excess COBRA Expense		195,703
Claims Fluctuation:		
150% CAL		17,031,381
Total Reserves	$	19,359,532
100% CAL	$	11,354,254
Total Reserves	$	13,682,405

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Mr. Chris Bradley
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301 W. Jefferson Street, 10th Floor
Phoenix, AZ 85003

April 14, 2015

Subject: Partial Update of Actuarial Analysis of Unpaid Claims Liabilities and Reserves as of June 30, 2014 — Reserve for Claim Fluctuation and Reserve for Large Claims

Dear Chris:

This letter provides a limited partial update to the October 17, 2014 report on the Actuarial Analysis of Unpaid Claims Liabilities and Reserves as of June 30, 2014 of the Maricopa County Self-Funded Employee Benefits Program. Any readers of this letter who do not have a copy of this report should request that Mercer provide it to them. The reason for the update is that the County is considering a change in policy with respect to the following reserves:

- Reserve for claim fluctuation for the Medical, Pharmacy, Dental, Vision, and Behavioral Health benefits.
- Reserve for large claims.

Reserve for Claim Fluctuation

The reserve for claim fluctuation is the subject of Section 7 of the report, with details of the calculation provided in Appendix C. The calculation uses the underwriting risk component of the risk-based capital (RBC) formula for health insurers developed by the National Association of Insurance Commissioners. For the October 17, 2014 report, the County elected to use 150% of the Company Action Level (CAL) RBC underwriting gain component as the reserve for claim fluctuation, which was $17,031,381 and 13.3% of annual claims. The County is considering a policy change to use 100% instead of 150%, which would reduce the reserve for claim fluctuation to $11,354,254 and 8.9% of annual claims. In Mercer's opinion, it is appropriate for the County to use 100% of the CAL RBC underwriting gain component as a reserve for adverse claim fluctuation. For insurers with surplus at the CAL, state departments of insurance generally do not impose additional financial monitoring or restrictions on company operations, which they can impose on insurers with lower surplus levels.

The Short-Term Disability (STD) benefit is funded entirely by employee contributions. Employee contributions for STD benefits and expenses for the STD benefits are accounted for separately from those for the Medical, Pharmacy, Dental, Vision, and Behavioral Health benefits. For the

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Please let us know if you have any questions or need anything else.

Sincerely,

F. Kevin Russell

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Patricia Cole, Mercer