Memorandum

August 20, 2012

To: Steve Ostlund, Chair, HCRAWG Medical Loss Ratio Subgroup

Re: Comments on IRD14-017

America’s Health Insurance Plans (AHIP) appreciates the opportunity to provide these comments as our recommendation with respect to IRD14-017. AHIP is the nation’s trade association representing member companies providing health, long-term care, dental, disability and supplemental coverage to more than 200 million Americans.

IRD14-017 addresses the question of whether rebates are to be included in the three-year MLR calculations for the years starting with 2015. The Evaluation presents arguments that the rebates from prior years should not be included in the numerator in the calculation of the three year average loss ratio. The preliminary resolution is consistent with the evaluation. AHIP does not support the preliminary resolution.

The NAIC has consistently stated that statutory accounting should be the default basis for defining the elements of the MLR calculation. The NAIC has also recognized that the MLR rebates are experience-rating refunds, and has prescribed the same accounting treatment for the rebates as for other experience-rating refunds. This leads, in turn, to the rebates being reflected in statutory experience measures such as the loss ratio calculations in the Health Annual Statement’s Exhibit of Five-Year Historical Data, in just the same way as other experience-rating refunds are. For purposes of the MLR calculation, the NAIC has determined that experience-rating refunds should be included in the numerator of the MLR. Therefore, that is likewise the natural treatment of MLR rebates for prior years, and in fact that is the treatment afforded the 2011 and 2012 rebates already. In light of the foregoing, any proposal that rebates should be treated differently than other experience-rating refunds should face a heavy burden of proof. We do not see where that burden has yet been met.

The inclusion of rebates in the numerator is consistent with the intent of Congress to determine if a rebate is to be paid for the current year based on the average results of that year plus the prior two years. It is important, in achieving that intent, that the two prior years reflect all elements of the experience in those years, including any material subsequent revisions. “Material subsequent revisions” would include not only claim run-out but also the MLR rebates for the prior years.

While the MLR calculations that include 2011 or 2012 have unique circumstances — namely, that the 2011 and 2012 rebates are based on single-year experience (or in some cases two-year experience) — those circumstances are not the sole reason for including prior rebates in a MLR
calculation that involves multiple years. As we have just indicated, the rebates paid for 2013 and later years are legitimate elements of a company’s experience for those years, and should be reflected as such.

The Subgroup has expressed concerns about a situation in which a carrier consciously prices to a loss ratio lower than the MLR threshold. It is clear that the MLR provision was not intended as a constraint on advance pricing; prior MLR experience is not included in the rate-review provisions of ACA, and the MLR does not give credit for advance pricing that meets the threshold but uses actual experience instead. However, because the Subgroup seems to have focused on this issue, we offer a compromise that the Subgroup may find acceptable. In this compromise approach, the rebates would be excluded from the three-year calculation whenever all three years are equal to or less than the MLR threshold.

The attached spreadsheet gives numerous examples. Descriptions of each are:

1. This example has three consecutive years with varying loss ratios. It shows that where at least one of the years has a loss ratio above the MLR standard, the three year average excluding rebates does not allow for full averaging. Under Statutory accounting, the premiums for the prior two years would be $100 less $1 plus $100 or $199 while the claims (and other allowed expenses) would be $161.00. When these are added to the third year’s results, the three year totals are premiums of $299 and claims of $239.50 with a three year loss ratio of 80.1%.
2. This example shows a situation where loss ratios cycle above and below the MLR standard but the cycle size reduces over time. The proposed approach (excluding all rebates) does not allow full averaging to be reflected.
3. This example shows the situation where the premiums are being adjusted to increase the loss ratio but the full impact takes a few years.
4. This example is the same as 3 above but with increasing premiums.
5. This is an example of the situation where three years are all below (or equal to) the standard.

We would also like to provide comments on the Evaluation section. The second paragraph appears to suggest that the intent of the change is to increase the loss ratios after rebates. We find no grounds in the law or regulations for using this consideration as a basis for choosing the method for determining the three year average loss ratio. The three year average loss ratio should be reflective of the average results of the three years after adjusting for all impacts of the provision of health insurance to the policyholders. If that result is less than the MLR standard, then the current policyholders are due a rebate; if not, then the current policyholders are not due a rebate.

We disagree with the sixth paragraph. We recognize that the one-sided nature of the MLR calculation will produce loss ratios over a three-year period that are higher than a consistent
pricing assumption. However, including those rebates is the correct method of determining the full impact of experience over the three year period; this is the correct basis for determining whether or not the MLR standard has been met for the current year.

We also disagree with the seventh paragraph that the delay for new business until the next year is a sufficient allowance for a new insurer. In circumstances where an existing carrier is withdrawing from the health insurance business, policyholders may be best provided for by an arrangement that allows another company to “take over” the existing business. Since reinsurance is not recognized in the MLR calculations, the new company cannot assume a potentially sizable block (net of some policyholders who transfer to another insurer) and reflect the block’s prior experience. Even delaying the results of the first year to the next year will still create the situation where the MLR calculation is not averaging three years and the resulting difference between the single year’s MLR experience and the MLR standard will produce a difference that produces a rebate exactly like the 2011 rebate. Without some consideration, a likely outcome would be that no other carrier would offer to assume all the existing policyholders of an insurer that withdraws from the market.

Thus, we disagree with the conclusion in the last two paragraphs for the reasons stated above. In keeping with the IRD process, we request that these comments be incorporated into the “documentation in opposition” section of the IRD.

Thank you.

Sincerely,

William C. Weller,
Omega Squared – consultant to AHIP

Attachment: AHIP Rebate Worksheet(081612)

cc: Candy Gallaher SVP State Policy - AHIP
    Eric King, NAIC staff to HATF