Memorandum

July 6, 2012

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

Re: Comments on IRD14-013

America’s Health Insurance Plans (AHIP) appreciates the opportunity to provide these comments as our support for the position discussed in IRD14-013. 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.

IRD14-013 raises the question of which rebates are to be included in the three-year MLR calculations. The issue description addresses whether inclusion should be based on incurring year or payment year. Both the NAIC and HHS previously determined that rebates are to be included in the MLR numerator, and we do not see the rationale for expanding the scope of IRD14-013 to deal with other options for including the rebates paid. Our comments on the June 27th call might have been misinterpreted as suggesting AHIP wished to change the existing methods. Our intent was to note that if rebates, and other experience rating credits, were not included in the numerator, then standard Statutory accounting would require them to be deducted from the denominator, so that complete exclusion (such as suggested in the “documentation in opposition”) does not seem to be a reasonable treatment.

We would also like to raise other concerns with the use of unrealistic assumptions in the tables that are presented in the “documentation in opposition”.

1. We do not believe that a continuing assumption of a 70% pricing standard is reasonable. All else being equal, this would require premiums 14.3% higher than pricing at an 80% loss ratio. This probably could not be sustained in a competitive marketplace. Today, there may be some markets where there are significant barriers to competition, but other provisions of the ACA are intended to increase competition in those markets. Also, to the extent that health care expenditures continue to increase relative to the economy as a whole, competitive pressures are likely to become even stronger. Price differentials will never be entirely eliminated, but a reduction in the price differential would mean a proportionately lower difference between the cumulative MLR and the threshold.
2. The tables assume that actual experience will exactly match expected experience every year. However, even if the average actual experience does match a reasonable pricing target, year-by-year variations will have an impact on the result, because of the one-sided nature of the rebate requirement. If a company prices to the threshold 80%, but actual experience is not 80% over every 3-year period, then over time the company will have a cumulative MLR (including rebates) greater than 80%. Therefore, the second table, showing the “right” cumulative MLR occurring when rebates are excluded from the numerator, is highly misleading. In fact, even pricing constantly below 80% could result in a cumulative MLR above 80%. Furthermore, including rebates in the MLR numerator does not necessarily eliminate the excess of the cumulative MLR above the threshold; it may only reduce the excess.

As an illustration of the foregoing, consider experience that runs 80%, 80%, 74%, 83%, 74%, 83%, 86% (for simplicity, of a constant premium volume). The average over the seven years is indeed 80%. If prior rebates aren’t in the numerator, the rebates will be 0%, 0%, 2%, 1%, 3%, 0%, 0%, and the cumulative MLR including rebates will be 80.9%. If prior rebates are in the numerator, the rebates will be 0%, 0%, 2%, 0.33%, 2.22%, 0%, 0%, and the cumulative MLR including rebates will be about 80.7% — still above 80%.

3. The tables, then, merely illustrate an inevitable consequence of the 3-year averaging. If the threshold has been met in prior years (whether by initial pricing or by rebates), but the current year’s experience does not meet the threshold (intentionally or by chance), the impact of that year’s experience for MLR calculations (and potential rebates) occurs throughout the three years that any below threshold experience is included in the MLR calculations.

If an issuer has paid a rebate for a given year in accordance with the prescribed MLR calculations, then it has in fact met the statutory threshold for that year, just as much as if the initial pricing met the threshold and no rebate was necessary.
In keeping with the IRD process, we request that these comments be incorporated into the “documentation in support” section of the IRD.

Thank you.

Sincerely,

William C. Weller,
Omega Squared – consultant to AHIP

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