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Date: July 13, 2010

To: Steve Oslund, Chair Accident & Health Working Group – PPACA Subgroup

From: Allan I. Schwartz, on Behalf of the NAIC Consumer Representatives

Re: Comments on IRD008 – Capitation Agreements

There is general agreement that under capitation agreements a portion of the payments from health insurance issuers to health care providers include some administrative expenses that would not be included in the numerator of the MLR rebate calculation if those expenses could be separately identified. However, because of the difficulty in identifying the portion of those payments that are expenses, this subgroup has indicated that, “Therefore, we recommend that no effort be made at this time to recharacterize capitated payments to providers as part claim and part administrative expenses.”

The result of including all payments from health insurance issuers to health care providers in the numerator of the rebate calculation is an artificially inflated MLR. This has two possible consequences. Those are:

1. Health insurance issuers that sell only capitated plans will have the calculated rebates lessened or minimized.
2. Health insurance issuers that sell both fee for service plans and capitated plans could use the inappropriately inflated MLR from the capitated plans to offset the otherwise indicated rebate from the fee for service plans.

With regard to the first issue, we agree with the subgroup that Health and Human services and insurance regulators should follow provider contracting trends and keep watch for potential abuses to the intent of the MLR rebate provisions. However, Health and Human services and insurance regulators, as well as the NAIC, should also attempt to determine what portion of capitated fee payments are for administrative expenses. Health insurance issuers must have some measure of what portion of its expenses are being transferred to health care providers in the capitated payments. An attempt should be made to obtain that information so that in the future the MLR standard for capitated plans can be set appropriately.

With regard to the second issue, a possible course of action would be to separate out capitated business from fee for service business. The capitated business loss ratio would be included in the rebate calculation if the actual loss ratio (adjusted for credibility) was below the MLR standard. However, if the capitated business had an actual loss ratio (adjusted for credibility) above the MLR standard, then that business would not be included in the rebate calculation.

If a procedure such as this is not followed, then there could be adverse consequences to policyholders. As an example, let us take a health insurance issuer that has an equal amount of fee for service business and capitated business. Let us assume that both business segments have a true MLR of 75%, but because of the expenses included in the capitated payments, the capitated business has a reported loss ratio of 85%. If both books of business are combined, the loss ratio will be 80% and no rebate is paid. This is the situation even though we know based upon the underlying assumptions that both groups of business should have a 5% rebate. Using the previously discussed procedure, since the capitated business MLR is above the standard, that business is not included in the rebate calculation. Following that procedure, there would be a 75% loss ratio for the fee for service business, which would then receive a 5% rebate, while the capitated business would not receive a rebate. This falls between the two extremes of reducing the reported capitated loss ratio by 10%, or the alternative of using the capitated loss ratio of 85% in the rebate calculation even though it is known to be inflated and will eliminate the rebate for all policyholders.

Please feel free to contact me if there is anything you would care to discuss.