

To: Commissioner Praeger

From: Steve Ostlund

The B Committee has received several comments on the MLR regulation being exposed by the Committee. I would like to provide background on several of the technical issues .

1. Credibility at 50%

Concern has been expressed about the choice of a 50% confidence interval in developing credibility factors. It is common in state solvency regulation to require that a company hold reserves that would cover variance in its experience in excess of 90% of the time. Commenters have suggested a similar level of confidence be employed in developing their medical loss ratio rebate requirement.

The Sub-group wants to balance the desire to not require rebates based upon stochastic variance against the desire to not invite abuse of the provision. The use of any level of credibility standards will still result in an experienced MLR greater than the statutory standard, (except for the obvious 100% level which would entirely eliminate rebates for the smaller issuers). The Sub-group has chosen a level that eliminated roughly two-thirds of the payments due to variance rather than 95%+.

In essence, the use of the 50% standard allows the consumer to share the gain from some of the variance a company will experience. There is no "right" answer. The Sub-group has not chosen the "wrong" factors, only made a choice to balance interests of consumers and issuers. To choose a higher confidence level would invite criticism from consumers and other regulators that the proposed regulation is unbalanced in favor of insurance companies.

2. Reinsurance

The Sub-group recognizes that some reinsurance transactions could be in the public interest, especially those relating to excess loss. However the opportunity for abuse is significant. We believe reinsurers and companies will be able to construct agreements that can recognize the financial implications of the treaties on the MLR experience of a carrier.

3. Contract Reserve

The Sub-group chose to not define a methodology for contract reserves, but rather to rely upon statutory calculations. This is consistent with an underlying bias to rely upon statutory guidance and to minimize unnecessary deviations from statutory entries.

4. Earned Premium Run Out

The Sub-group identified a major source of variance that we minimized by allowing a three month look back provision for claims. Claims are subject to significant variance as they mature. The Sub-group does not believe the variance in earned premium is as significant.

5. Deduct Rebate in 2013

Comments have been received that assert the regulation is flawed in not deducting previously paid rebates from that calculated in 2013. We assert that our methodology is not wrong, while acknowledging alternatives are possible. Several such alternatives have been proposed, most incorporating a deduction of past paid rebates. In evaluating each, the Sub-group was able to find deficiencies in each. One test I have considered for these methodologies is to insert them into later years, after the initial transition.

If a plan were to begin selling insurance in 2015, the formula proposed by Congress would require that the rebate be determined based solely upon experience in 2015. In 2016, the rebate would be calculated based upon experience in both 2015 and 2016, but without adjustment for a rebate paid in 2015. Similarly in 2017, the rebate would be calculated based upon experience in 2015, 2016, and 2017, but again without adjustment for any rebates paid in 2015 or 2016. With the exception of combining two year's experience in 2016, our method reproduces the Congressional results. Clearly to deduct previous rebates would not reproduce Congressional results.

The Sub-group had a strong preference to combine 2011 and 2012 experience, as this would accelerate progress to the ultimate formula, and would increase the data used to calculate the rebate. But we believed to do so would exceed authority granted by Congress unnecessarily. We believe that to deduct previous rebates would also exceed authority granted by Congress. Such a deduction does not specifically address the special circumstances of smaller plans, different types of plans, and newer plans, but rather would seem to reverse a dictation of Congress. We believe our role is to interpret the law, not to correct the law.