North Carolina Department of Insurance

MEDICAL LOSS RATIO ADJUSTMENT REQUEST

North Carolina Individual Health Insurance Market

September 6, 2011

BACKGROUND

The Patient Protection and Affordable Care Act (PPACA) requires health insurers to pay a rebate to consumers if they do not meet the minimum medical loss ratio (MLR) standard of 80% for individual and small group products and 85% for large group products. The requirement begins for calendar year 2011 with the first set of applicable rebates for 2011 payable by August 2012.

Issuers and regulators have typically calculated an "incurred loss ratio," as medical service costs (paid claims plus change in claims reserves) as a percentage of earned premiums. The federal requirement in PPACA adjusts the MLR calculation to include the cost of quality improvement activities as medical costs and subtracts federal and state taxes and assessments from premiums in the denominator. These two adjustments generally result in a higher MLR relative to the incurred loss ratio.

In early December 2010, the US Department of Health and Human Services (HHS) released interim final rules[1] related to the implementation of the MLR requirements. These rules allow for an additional adjustment to the MLR calculation above for credibility based on the number of covered lives (under 75,000) and the average deductible level. The rules also exempt carriers with fewer than 1,000 lives from the rebate requirement. Credibility adjustments can be up to 14.4 percentage points (this would be for an issuer with 1,000 life years with an average deductible of over $10,000).

Subpart C of the interim final rules provides a mechanism for a state to request that the Secretary of HHS adjust the 80% MLR requirement for individual health insurance in that state for calendar years 2011 through 2013. The rules only allow for an adjustment to the MLR level, there is no allowance for an adjustment to the prescribed MLR formula. In order to receive an adjustment, the state must demonstrate that the 80% MLR may destabilize the individual market based on the number of issuers reasonably likely to exit the market, the number of enrollees covered by these issuers, the alternative coverage options for these individuals, and access to agents and brokers.

The following provides information on the North Carolina individual health insurance market based on information reported in issuers' 2010 Supplemental Health Care Exhibits, as well as information reported in response to surveys from the North Carolina Department of Insurance (NCDOI). Also provided is NCDOI's case for requesting an adjustment to the 80% MLR requirement of 72% in 2011, 74% in 2012, and 76% in 2013.

[1] 45 CFR Part 158 issued in Vol. 75, No. 230, on December 1, 2010

REQUESTED INFORMATION PER 45 CFR 158.321

1. STATE MLR STANDARDS

North Carolina non-group accident and health insurance policies are required to meet the NAIC minimum future or lifetime loss ratio standards (generally 60% for comprehensive major medical policies). HMOs are subject to a minimum average incurred loss ratio of 65% and a maximum of 80%. (Note that a loss ratio greater than 80% may be allowed if the company satisfies the data requirements and demonstrates that the resulting rates are adequate). In order to recognize the company's not-for-profit status and unique position in the individual health insurance market as North Carolina's only Medical Service Corporation, Blue Cross Blue Shield of North Carolina (BCBSNC) has agreed with the NCDOI to use allowable loss ratio standards that are higher than the requirements above. North Carolina does not have any loss ratio standards for individual policies sold through associations.

See Appendix A for minimum loss ratios standards defined in the North Carolina Administrative Code (NCAC).

B - STATE MARKET WITHDRAWAL REQUIREMENTS

NCGS 58-68-65(c)(2) allows an insurer to make a decision to discontinue offering individual health insurance and to terminate the in-force coverage as long as the insurer gives the Commissioner and the plan participants 180-day notice of the termination and the decision to terminate is made consistently across the entire block of business. Since individual health insurance coverage is guaranteed renewable except for stated reasons, the Commissioner could require compliance with the guaranteed renewability statutes should an insurer's withdrawal plan not provide the Commissioner or the plan participants with the required days of notice. However, the insurer need only then provide adequate notice to effectuate the terminations. Insurers who withdraw from the market place and terminate the business are prohibited from reentering the market for five years from the date of the last discontinuation of coverage under this section.

C - MECHANISMS TO PROVIDE OPTIONS TO CONSUMERS

Options for individuals impacted by a withdrawal from the market as described in response to section 158.321(b) are somewhat limited in North Carolina. While North Carolina laws require an insurer of individual health insurance coverage to provide credit for the individual's previous creditable coverage, North Carolina laws also permit the insurer to refuse to issue the coverage based upon the individual's health status or past claims experience. Therefore individuals seeking to replace individual health insurance coverage will be underwritten for coverage (including determining the use of exclusionary riders or the appropriate premium rate) based upon the individual's health status or past claims experience. Individuals who are higher risks may not find

an insurer to issue replacement coverage or may find the coverage that can be issued has a high premium or limitations which are unacceptable.

High risk individuals – those who are denied coverage through the individual health insurance market or who are offered coverage with exclusionary riders or at an excessive premium rate, may request coverage through the North Carolina Health Insurance Risk Pool (also known as "Inclusive Health".) Premium rates for coverage issued through the High Risk Pool are set by state law to be within an allowable range of 135% to 175% of the standard risk rate in North Carolina's individual market. Inclusive Health is also an alternative mechanism for coverage for federally qualified HIPAA eligible individuals and administers the new federal high risk pool in North Carolina. Additional information on Inclusive Health is available at http://inclusivehealth.org/.

Lastly, North Carolina law provides that if an insurer chooses to withdraw from the individual health insurance market in North Carolina and terminates coverage as permitted by state law, then any individuals impacted by the termination who obtained that coverage as a federally qualified HIPAA eligible individual is able to obtain guaranteed to issue replacement coverage from any other insurer in the individual health insurance market, and the insurer is able to limit the replacement coverage to those plans they issue to federally qualified HIPAA eligible individuals.

D1 - Information on the North Carolina Individual Market

Individual Health Insurance Market Share

The following illustrates the market share of each issuer in the North Carolina individual health insurance market as reported in the 2010 Supplemental Health Care Exhibit (unless otherwise indicated). See also Exhibit A in Excel attachment.

Exhibit A - Covered Lives in Individual Health Insurance Market as Reported in 2010 Supplemental Health Care Exhibit

Company Name	2010 Covered Lives - Individual Market	2010 Market Share - Individual Market	2010 Earned Premiums
BCBS of NC Inc	337,545	81.1%	$844,918,312
Wellpath Select Inc	18,612	4.5%	$38,954,674
Golden Rule Ins Co	12,164	2.9%	$22,830,683
Time Ins Co[1]	9,788	2.4%	$22,679,728
Humana Ins Co	5,348	1.3%	$9,420,984
Aetna Life Ins Co	5,216	1.3%	$10,824,309
Celtic Ins Co	4,322	1.0%	$8,737,239
Mega Life & Hlth Ins Co The [2]	3,541	0.9%	$13,537,488
Mid West Natl Life Ins Co Of TN [2]	3,322	0.8%	$8,115,514
World Ins Co	2,172	0.5%	$5,914,819
National Found Life Ins Co	1,946	0.5%	$2,434,366
American Republic Ins Co	1,927	0.5%	$6,274,902
Connecticut Gen Life Ins Co	1,628	0.4%	$1,910,750
John Alden Life Ins Co[1]	1,397	0.3%	$4,024,332
American Medical Security Life Ins C	1,331	0.3%	$4,096,225
Metropolitan Life Ins Co	1,140	0.3%	$97,476
UnitedHealthcare Ins Co	1,095	0.3%	$6,448,057
New York Life Ins Co	954	0.2%	$4,961,232
Independence Amer Ins Co	670	0.2%	$1,309,195
American Natl Life Ins Co Of TX	571	0.1%	$2,026,299
Prudential Ins Co Of Amer	267	0.1%	$112,385
Standard Security Life Ins Co Of NY	261	0.1%	$463,622
State Farm Mut Auto Ins Co	227	0.1%	$1,056,330
American Gen Life & Acc Ins Co	153	0.0%	$16,635
Madison Natl Life Ins Co Inc	133	0.0%	$338,933
Standard Life & Accident Ins Co	113	0.0%	$223,817
Other (<100 Lives)	514	0.1%	$3,176,455
Total	416,357	100.0%	$1,024,904,761

[1] Excludes mini-med

[2] Self-reported

Individual Health Insurance Enrollees By Product

See Exhibit B in the Excel attachment for the number of enrollees in 2010 by product as self-reported by each issuer.

Earned Premium By Product

See Exhibit C in the Excel attachment for the 2010 earned premium by product as self-reported by each issuer.

D2 - Information for Health Insurance Issuers with 1,000 or more lives

See Exhibit D in the Excel attachment. Please note the following:

1. Metropolitan Life Insurance Company (MetLife) is not included in this exhibit, because the 1,140 lives reported on their 2010 Supplemental Health Care Exhibit were for a fixed indemnity product and we do not believe they should be included in this analysis.

2. UnitedHealthcare Insurance Company (UHCIC) reported 1,095 lives in the 2010 SHCE, of which 686 were reported as being in an AARP branded product which has been closed since 2008 and the remainder are in student plans. Because these plans are not open to the general population in the individual market, they were not included in the Department's analysis.

3. Risk-Based Capital Ratio: Pursuant to North Carolina General Statute 58-12-35, all risk-based capital reports and the risk-based capital plans constitute information that shall be kept confidential by the Commissioner. Therefore the Department is precluded by statute from releasing this information.

4. Notice of Exit: Pursuant to G.S. 58-68-65(c)(2), an insurer who chooses to cease actively marketing individual health insurance coverage and to terminate existing business must give 180-day notice of the termination to the Commissioner and each plan participant impacted by the termination. Since the passage of the PPACA, no carriers in North Carolina have provided notice that they are terminating existing individual health insurance business. However, the Department is aware of a number of insurers who have ceased marketing individual health insurance business in North Carolina since the passage of the ACA. These are identified later in this report.

5. Most of the information in Exhibit D was pulled from the 2010 Supplemental Health Care Exhibits (SHCE) as reported to the NAIC, with some exceptions as noted. Note that MEGA Life and Health Insurance Company and Mid-West National Life Insurance Company of Tennessee requested that we not use their data as reported in the 2010 SHCE with the following justification: "Because SHCE MLR includes reserve adjustments for the prior years, it is not a true reflection of the actual claims serviced in the current year. Therefore, SHCE MLR is not deemed a proper base for the rebate calculation for year 2010. Instead, actual incurred MLR for the year is used to calculate estimated rebate." They also note that "The underwriting gain for

2010 includes significant reserve adjustments for the prior years. It is not expected to happen in this kind of magnitude in 2011."

IMPACT OF 80% MLR REQUIREMENT

The North Carolina individual health insurance market is highly concentrated with BCBSNC, which covered 81% of the covered lives in 2010 (See Exhibit A). The Department has some serious concerns that the 80% MLR requirement will reduce the already limited competition in this market.

In a survey to issuers with over 1,000 covered lives, of those still actively marketing, BCBSNC was the only one that reported not favoring an adjustment to the 80% MLR requirement. As outlined below, other issuers see the 80% MLR requirement as a barrier to maintaining and growing their individual business in NC. NCDOI believes that without an adjustment to the 80% MLR requirement, there will be significant reductions to the health insurance options available to consumers in the individual market.

REDUCTIONS IN CONSUMER CHOICE

Although no issuers in the North Carolina individual health insurance market have yet exited the market as a result of PPACA, several have ceased marketing new policies. MEGA Life and Health Insurance Company (MEGA) (3,570 lives) and Mid-West National Life Insurance Company of Tennessee (Mid-West) (3,354 lives), both discontinued marketing their individual plans in August 2010. American Medical Security Life Insurance Company (American Medical Security) (1,331 lives) ceased marketing new policies in May 2010. American National Life Insurance Company of Texas (American National Life of Texas) (954 lives) and Standard Life & Accident Insurance Company (Standard Life & Accident) (113 lives) ceased marketing on June 1, 2010. These last two issuers indicated that they would seriously consider re-entering the market if North Carolina was granted an adjustment to the 80% MLR requirement.

Other issuers have indicated that they may consider exiting the market if North Carolina does not receive an adjustment to the 80% MLR requirement. American Republic Insurance Company (American Republic) (1,927 lives) and World Insurance Company (World) (2,172 lives) reported reduced sales due to commission reductions and noted that "this lack of new business within the block will continue to put pressure on our management decisions as it relates to the ability to keep the block active and could increase the likelihood of a decision to cancel the existing business."

Other issuers, including Humana Insurance Company (Humana) (5,348 lives), and National Foundation Life Insurance Company (National Foundation) (1,946 lives) reported that an adjustment to the MLR requirement would make it less likely that they would cease marketing new policies in North Carolina.

Collectively, the nine issuers mentioned above represented 20,715 covered lives in 2010, or 5% of the total individual market and 26% of the individual market excluding BCBSNC.

Although any market exits will have a significant disruptive impact on current policyholders, a lack of issuers marketing policies in the individual market significantly reduces consumer choice, and reduces competition in the market, which could result in higher premiums.

Reduced Access to Agents and Brokers

Agents and brokers play an important role in assisting and educating consumers with their health insurance. They help consumers sift through and understand highly complex health information, compare plans, and assist consumers in their interactions with insurers. In addition, many issuers in North Carolina rely heavily on agents and brokers to sell their products. Wellpath Select, Inc. (Wellpath), North Carolina's second largest issuer in the individual market and only HMO carrier, sells 96% of its policies through agents and "expects to lose 80-90% of those sales if they cut commissions by more than 50%." Wellpath sells the other 4% of its policies through the internet, but reports that the MLR requirement makes it "impossible to advertise enough to substantially increase internet sales" and "only the biggest brand can get substantial internet sales."

Among those issuers that are continuing to market individual policies in North Carolina, many have made significant reductions to agent and broker commissions and are experiencing reduced sales volume as a result.

WellPath reported reducing its commissions from 27% to 14% for first-year policies and from 7% to 4% for subsequent years. Connecticut General Life Insurance Company (Connecticut General) reported reducing first year commissions from 20% to 12%. Celtic Insurance Company (Celtic) reported a 50% reduction on January 1, 2011 and also noted that they are considering further reductions. Humana reported that they will reduce commissions by 30% by 2012. Golden Rule Insurance Company (Golden Rule), American Republic, World, and Aetna Life Insurance Company (Aetna) also reported reducing their commissions. BCBSNC did not report whether they have made any changes to their commission schedules in the individual market.

American National Life of Texas and Standard Life & Accident both ceased marketing because they "believe that without an adjustment to the 80 percent MLR we would be unable to compensate agents and brokers at a level that would make them available to consumers."

NCDOI is concerned that reduced commissions will hurt more than just the livelihood of agents and brokers. If agents and brokers cannot be adequately compensated for the services they provide, they may cease selling the policies of these smaller issuers that are struggling to compete against the dominant issuer in the State. This, along with the fact that many of these issuers do not have significant brand recognition and rely heavily on agents and brokers for their sales, could severely reduce competition and limit consumer choice in the individual market.

Incentives to Limit New Business

North Carolina's individual policies are medically underwritten and North Carolina's lifetime loss ratio standard accounts for the expectation that loss ratios generally are lower in the early years of a policy and increase throughout of the life of the policy. The annual medical loss ratio standard does not recognize this fact, and creates a disadvantage for issuers with a higher proportion of new policies. This creates both a barrier to entry for new issuers and a barrier to growth, as an increase in new policies could result in a reduction in the medical loss ratio. In addition, smaller plans tend to rely more heavily on agents and brokers, given their reduced ability to advertise on a large scale. This results in higher acquisition costs generally for smaller issuers, which puts them at an additional disadvantage.

As an example, American Republic and World reported that the 80% MLR requirement "could serve as an incentive for us and other carriers who remain in the individual market to minimize their marketing activity prior to 2014."

Viability of Health Insurance Issuers in North Carolina

Six of the 15 health insurance issuers with 1,000 or more lives in 2010 experienced underwriting losses on their individual policies in 2010. BCBSNC's loss reflects a one-time refund to consumers of $155.8 million. Excluding the refund would have resulted in an underwriting gain of $38 million. Of the remaining five issuers with underwriting losses in 2010 (Celtic, American Republic, World, National Foundation, and Connecticut General), three (Celtic, National Foundation, and Connecticut General) would have been subject to a rebate payment in 2010 under the 80% MLR requirement, furthering their losses.

Three issuers reporting underwriting gains in 2010 would have suffered pre-tax losses if they had been required to pay rebates based on the 80% MLR requirement. These include Wellpath, Time Insurance Company (Time), and Humana.

In sum, had issuers been subject to rebate payments based on the 80% MLR requirement in 2010, eight issuers, representing 63% of the individual health insurance market excluding BCBSNC would have suffered pre-tax underwriting losses.

There is further concern about the viability of other issuers who may not have been required to pay a rebate based on their 2010 financials, but are running at a loss. The 80% MLR requirement may limit their ability to create a profitable business model in North Carolina. American Republic and World, for example, reported that they have several vendor contracts that are "locked-in," thus limiting their ability to reduce administrative costs to increase their MLRs in the short term. Other issuers reported needing additional time to modify their business models to best meet the new ACA requirements.

See Exhibit E in the Excel attachment for the development of the estimated 2010 MLR. See Exhibit F in the Excel attachment for the development of rebates based on 2010 financial data. See Exhibit G

in the Excel attachment for a calculation of pre-tax underwriting gain/(loss) for each issuer with 1,000 or more covered lives in 2010.

Impact on Premiums

Another concern is that in an effort to meet the 80% MLR requirement, issuers will cease marketing the lower-cost, leaner plans in favor of higher-cost plans with lower cost sharing. The higher cost plans provide a higher premium base over which to spread administrative costs, making it easier to meet the 80% MLR requirement. A shift to these higher premium plans would limit the number of affordable options available to consumers, potentially increasing the number of uninsured residents until federal subsidies become available in 2014.

As previously mentioned, there is also a concern that the reduced competition in North Carolina could result in increased premiums, although we do not currently have any explicit data to support this premise.

Justification for Proposed Adjustment

North Carolina developed its proposed adjustment of 72% in 2011, 74% in 2012, and 76% in 2013 to help maintain competition in the North Carolina individual market, while continuing to preserve a reasonable level of consumer protections as intended by PPACA. Based on the issuers' 2010 financial information, the 80% MLR requirement would result in rebates from nine issuers, totaling roughly $12.1 million.

Of these nine issuers who would have been subject to rebate payments based on 2010 financials:

- Three (Celtic, National Foundation and Connecticut General) had pre-tax net losses before rebates in 2010.
- Three (Wellpath, Time, and Humana) would have sustained pre-tax losses as a result of required rebate payments under the 80% MLR requirement in 2010.
- Three (Golden Rule, John Alden, and Mid-West) would see reductions in their underwriting gains, but would not have suffered losses.

Based on 2010 financial information, a 72% MLR standard would have resulted in rebate payments from six issuers totaling $4.2 million, a 74% MLR standard would have resulted in rebate payments from six issuers totaling $6.1 million, and a 76% MLR standard would have resulted in rebate payments from seven issuers totaling $8.0 million. See Exhibit F for a summary of estimated rebates under each scenario.

At the 72% MLR level, two of the three issuers that would have sustained losses as a result of rebate payments under the 80% MLR requirement, would be expected to experience underwriting gains based on the 2010 financial information. This includes Wellpath, who is one of only two domestic

issuers in this market (the other being BCBSNC). Wellpath is also the only HMO issuer in this market (note that their product is a Point of Service (POS)).

NCDOI believes that a three-year phase-in to the 80% MLR requirement in 2014 is appropriate given the changes in 2014 that are generally expected to help issuers meet the 80% MLR requirement. These include the introduction of Exchanges as a sales mechanism, which will help level the playing field in terms of acquisition costs, by reducing some of the emphasis on brand name by allowing issuers to market their policies through a virtual marketplace. A change from an underwritten to guaranteed issue market with adjusted community rating will eliminate the issue of the "wearing-off" of underwriting that results in lower loss ratios for newer policies in the current market. In addition, the Essential Benefits and minimum actuarial value requirements will likely increase the value of health insurance, which will provide a higher base for covering administrative costs.

Impact of Adjustment

NCDOI expects that an adjustment to the 80% MLR requirement will help maintain and potentially increase competition in North Carolina's individual health insurance market. Below are some excerpts from survey responses illustrating this point.

- Aetna reported that an adjustment would "allow for larger investments in marketing and other efforts to sell new business in the state of North Carolina."
- Time and John Alden Life Insurance Company (John Alden) report that "our companies would expect to write more new business if transitional relief is granted because we would have the flexibility to re-engage agent channels that have left the business either due to commission reductions or anticipation of reduced commission revenue."
- Aetna indicated that they would re-visit their commission reductions if an adjustment was granted to North Carolina.
- American National Life of Texas and Standard Life & Accident reported that they would "seriously consider re-entering the market" if North Carolina were granted an adjustment.
- Wellpath, World, and American Republic reported that given a waiver they would likely either increase commissions or not make planned reductions.

An adjustment to the MLR requirement will also allow time for issuers to transition their business models to meet the new requirements. Several issuers reported that they have contracts with brokers/agents that are "locked in," giving them less flexibility to make changes needed to meet the new MLR requirements.

APPENDIX A

11 NCAC 16 .0201 MINIMUM LOSS RATIO STANDARDS

(a) For individual accident and health insurance policies and riders delivered in this State, the standard minimum guideline loss ratio for conditionally renewable, guaranteed renewable, and noncancelable medical expense, loss of income, and other type coverages (but not including long-term care insurance policies issued in this State on or after February 1, 2003) shall be as promulgated by the National Association of Insurance Commissioners for such coverages as of the issue date of such policies and riders.

(b) If a company fails to satisfy NAIC minimum future or lifetime loss ratio standards for a particular type of coverage, then to comply with the loss ratio standards in Paragraph (a) of this Rule, the company shall:

(1) Combine the experience of such policy form(s) with other forms with similar type of coverage for which the pooling of experience is actuarially justified;

(2) Provide premium credits or refunds;

(3) Decrease premium rates for one or more subsequent rating periods; or

(4) Implement an actuarially justified alternative proposal.

11 NCAC 16 .0607 HMO INCURRED LOSS RATIO STANDARDS

(a) The following apply to all HMO rate revision filings:

(1) The application of a requested rate increase or decrease shall result in an average incurred loss ratio projected for North Carolina over the period required in 11 NCAC 16 .0606(8) of this Section which is not less than:

(A) 75.0% for full-service HMO products issued on a group basis;

(B) 65.0% for single-service HMO products issued on a group basis;

(C) 65.0% for full-service HMO products issued on an individual basis;

(D) 55.0% for single-service HMO products issued on an individual basis;

(2) If the average incurred loss ratio projected for North Carolina over the period required in 11 NCAC 16 .0606(8) of this Section, is greater than the minimum limit cited in Subparagraph (a)(1) of this Rule plus 15.0%, then the following supporting documentation shall be included in the filing:

(A) a listing of each of the specific components which make up the total retention loading expressed as a percentage of premium;

(B) a brief description of the methodology employed to obtain each of the components which make up the total retention loading;

(C) a brief explanation as to why any of the components which make up the total retention loading have changed and a statement of opinion from an officer of the HMO that these changes are permanent in nature;

(D) a brief, summary description of the impact of any special fee negotiations or contract arrangements which affect the premium rates; identification of specific hospitals or physician groups is not required;

(E) a comparison of the rates to other HMO rates with similar benefit plans.

(b) The following apply to all initial HMO rate filings and HMO expansion requests:

(1) The average incurred loss ratio projected for North Carolina over the last 12 months of the three year financial projection period shall be no less than:

(A) 75.0% for full-service HMO products issued on a group basis;

(B) 65.0% for single-service HMO products issued on a group basis;

(C) 65.0% for full-service HMO products issued on an individual basis;

(D) 55.0% for single-service HMO products issued on an individual basis;

(2) If the average incurred loss ratio projected for North Carolina over the last 12 months of the three year financial projection is greater than the minimum limit cited in Subparagraph (b)(1) of this Rule plus 15.0%, then the following supporting documentation shall be included in the filing:

(A) a listing of each of the specific components which make up the total retention loading expressed as a percentage of premium;

(B) a brief description of the methodology employed to obtain each of the components which make up the total retention loading;

(C) a brief explanation as to why any of the components which make up the total retention loading have changed and a statement of opinion from an officer of the HMO that these changes are permanent in nature;

(D) a brief, summary description of the impact of any special fee negotiations or contract arrangements which affect the premium rates; identification of specific hospitals or physician groups is not required;

(E) a comparison of the rates to other HMO rates with similar benefit plans.