ConsumersUnion

POLICY & ACTION FROM CONSUMER REPORTS

HEALTH DATA REPORT
MAY 2012

Health Reform's 'Value for Your Dollar' Rule: Early Impact in Arizona

SUMMARY

Beginning in 2011, the Affordable Care Act required insurers covering individuals and small businesses to spend at least 80 percent of premiums on actual medical care and activities that improve the quality of care, or provide rebates to consumers if the standard isn't met. This new rule, known as the "medical loss ratio" or MLR rule, also shines a light on how insurers spend premium dollars with new reporting requirements and public disclosures.

Consumers Union (CU) reviewed 2011 MLR results for Arizona insurance companies in the individual and small group markets. CU found that the new rule benefits consumers in some of the state's major health plans with millions in forthcoming rebates and improved insurer efficiency. In addition, the rule may be moderating health insurance rates and rate increases, with at least two major insurers filing for reduced rates or lower increases in 2011. CU also found that most rebating insurers were profitable in 2011 even after rebates were taken into account. This report describes CU's findings about the impact of the new MLR rule in Arizona during its first year in effect.

Introduction

A new rule that demands better value from health insurance companies is beginning to change business practices at some of Arizona's insurance companies and consumers will soon be due millions in rebates, according to preliminary data released in April.

Enacted as part of the Affordable Care Act, also known as the health reform law, the new rule says that insurers must spend at least 80 percent of premiums on actual medical care and activities that improve the quality of care for small

businesses and individuals who buy coverage on their own. For large group customers, the standard is 85 percent. If insurers miss the mark, they must rebate policyholders the difference.

The goal of the new rule – known as the medical loss ratio or "MLR" rule – is to ensure that consumers get better value for their money by encouraging insurers to be more efficient. To avoid paying rebates, insurers must be smarter in how they spend their premium revenue on marketing, CEO salaries, broker commissions and other administrative costs and profit.

The rule also brings broad new transparency and accountability to health insurers. It requires them for the first time to publicly disclose more details about how they spend premium dollars. By June 1 of each year, health insurers will file a report showing how much they spent on medical care and quality activities for the prior year. Starting in 2012, consumers will be able to view the reports by going to http://companyprofiles.healthcare.gov/, entering the name of their insurer, and choosing the Medical Loss Ratio tab.

Other new financial reporting requirements related to the MLR rule allowed Consumers Union (CU) to examine the early impact of the new rule in Arizona. CU examined filings that Arizona health insurers made in April showing preliminary results of their 2011 earnings, spending, and profits in the individual and small group markets. CU also reviewed rate change information provided by the Arizona Department of Insurance for select insurance companies.

Here are highlights of what we found in Arizona.

Consumers are due millions in premium rebates

Individual market insurers estimate that they will owe about $24.4 million to consumers, with Blue Cross Blue Shield of Arizona expecting to pay out the highest rebates.

The MLR rule went into effect on January 1, 2011. The first round of rebates must be paid by August 1, 2012, and will be based on insurers' 2011 spending. Rebates may be in the form of refund checks or a credit toward future premiums. CU examined rebate estimates for Arizona insurers in the individual market and small group market.

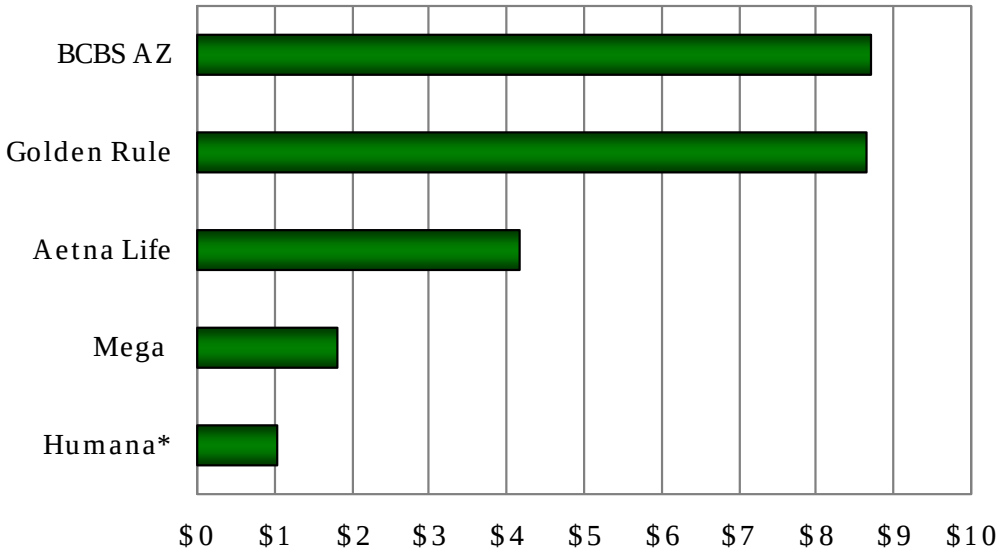
In the Arizona individual market, insurance companies expect to pay millions to policyholders, led by Blue Cross Blue Shield of Arizona, which anticipates giving $8.7 million back to 77,350 policyholders.[1] Golden Rule Insurance Co. has the second highest rebate amount, estimated at $8.66 million to 30,817 individual market policyholders.

Chart 1 shows estimated rebates for insurers that expect to owe rebates to individual market policyholders.

[1] "Policyholders" in this report does not include dependents. "Covered lives" includes both policyholders and dependents.

CHART 1: ESTIMATED 2012 REBATES ARIZONA INDIVIDUAL MARKET INSURERS

(in millions)



*Source: 2011 Supplemental Health Care Exhibits – Part 1, filed with the National Association of Insurance Commissioners. An additional company, Companion Life Insurance Co., estimates $462 in rebates but was not included in the chart because of the low amount. *Humana refers to the Humana Insurance Co.*

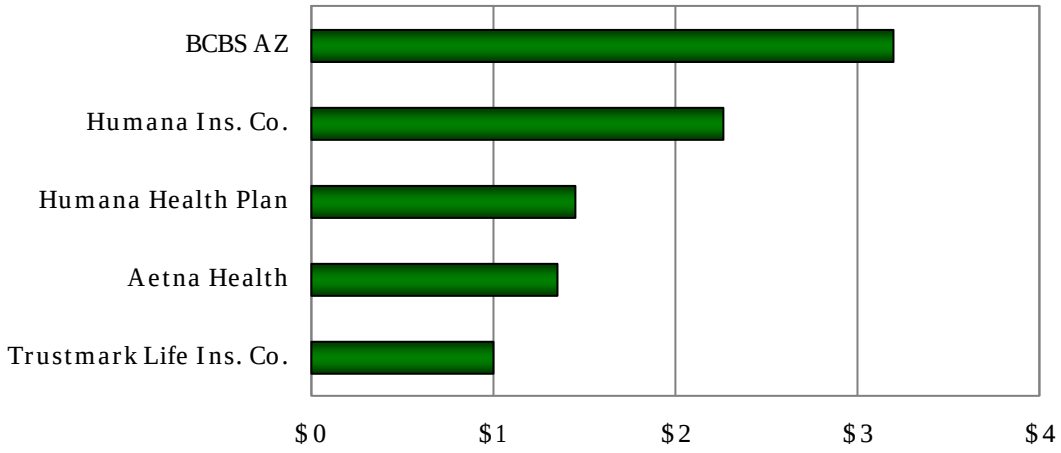
In the small group market – where employers with 2 to 50 employees purchase coverage[2] – Blue Cross Blue Shield of Arizona expects to pay the highest rebates, an estimated $3.2 million to about 3,741 small businesses and other groups. In total, insurers are expected to owe about $9.3 million to small groups.

Chart 2 shows estimated rebates for insurers that will owe rebates to small group market policyholders.

[2] *See* http://www.statehealthfacts.org/profileind.jsp?rgn=4&ind=350

CHART 2: ESTIMATED 2012 REBATES ARIZONA SMALL GROUP MARKET INSURERS

(in millions)



Source: 2011 Supplemental Health Care Exhibits – Part 1, filed with the National Association of Insurance Commissioners. United Healthcare Insurance Co. estimates it will owe $25 in rebates but was not included in the chart because of the low amount.

The Kaiser Family Foundation reported that total rebates in the Arizona large group market, which covers employers with more than 50 employees, would be about $2.9 million, bringing total Arizona rebates across all three market segments to $36.5 million.[3]

Insurance companies issuing rebates will send notices to policyholders with information about the rebate. Insurers will issue group rebates to employers who will share them with employees who paid premiums or otherwise use them to benefit employees, depending on the type of plan.

These are preliminary estimates made by insurers and actual rebates reported by June 1 may vary slightly.

The rule is improving value for Arizona consumers

Several insurers brought better value to their customers by increasing the portion of premiums that they spent on actual medical care, including spending on activities to improve the quality of care.

For example, Health Net Life Insurance Co., which covers about 13,700 people in the Arizona individual market, spent 76.4 percent of premiums on medical care in 2010 and 85.4 percent in 2011, as shown in Chart 3. Golden Rule, which

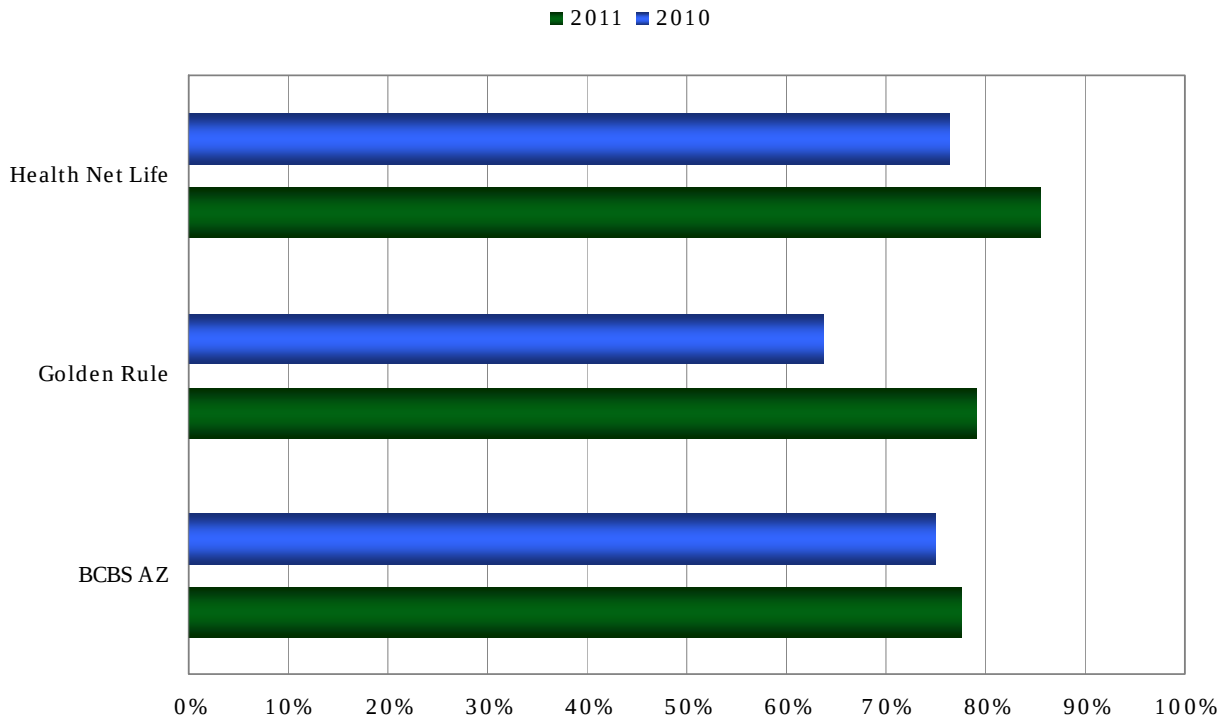
[3] *See* Kaiser Family Foundation, Insurer Rebates Under the Medical Loss Ratio: 2012 Estimates, April 2012, available at www.kff.org.

covers about 56,800 people in the Arizona individual market, spent 63.7 percent of premiums on medical care in 2010 and 79.2 percent in 2011. Blue Cross Blue Shield of Arizona, covering about 129,800 people in the individual market, improved value from 74.9 percent in 2010 to 77.6 percent in 2011.

The percentage of premiums spent on medical care refers to the total amount an insurer spent, on average, for all the people it covers in a certain market in the state, such as the individual market or small group market.

These are preliminary MLR results and may not include some adjustments that some insurers can make for their final MLR reports to the U.S. Department of Health and Human Services. Therefore, final MLR percentages to be reported by June 1 may differ slightly.

CHART 3: 2010 vs. 2011 PERCENT OF PREMIUMS SPENT ON MEDICAL CARE, ARIZONA INDIVIDUAL MARKET SELECT COMPANIES



Source: 2011 Supplemental Health Care Exhibits – Part 1, filed with the National Association of Insurance Commissioners.

Some rate increases appear to be moderating in Arizona

Some evidence suggests that rate increases may be moderating in Arizona. For example, Blue Cross Blue Shield of Arizona implemented average rate increases ranging from 8.8 percent to 19.4 percent on individual market plans each year from 2007 to 2010, according to records from the Arizona Department of Insurance. But in 2011, the highest increase that the company requested was 3 percent and the lowest was a decrease of 2.9 percent. The records indicate that no rate changes actually went into effect on the plans in 2011. Humana Insurance Co. requested average rate decreases between 5 percent and 2.4 percent on individual market plans in 2011 after implementing small increases in 2010, records show.

Insurance companies set rates by projecting what their medical claims costs will be in the future. Rates are set so that total premiums collected will cover those projected claims costs, as well as future administrative expenses and profit. The federal MLR rule impacts health insurance rates because health insurers use "target" medical loss ratios when they determine what their rates should be for a future time period. In other words, they try to set rates so that a certain percentage of premiums will go toward medical care and the remainder will be retained for plan administration and profit.

Insurers that traditionally have used more than 20 percent for administrative expenses and profits will need to rein in those expenses. As a result, customers may see lower premiums or at least smaller increases.

Further, in the past, when actual medical costs turned out lower than projected costs, insurers often could pocket the difference. With the higher MLR standard in place, insurers must give the money back to policyholders if actual medical costs fall below 80 percent of premiums. This means insurers now have an incentive to try to ensure that projected medical costs do not exceed actual costs. To avoid rebates, they may reduce rates or rate increases if cost growth trends begin to fall, as they have in the last few years with consumers using less healthcare than some insurers predicted and other factors contributing to a slowdown in growth.[4] In this way, the MLR rule makes it more likely that lower health spending and slowing medical cost growth will equate to lower rate increases or even rebates for consumers.

The MLR rule gives insurers an incentive to more accurately predict future medical costs when setting rates.

Various factors may contribute to rate changes, so not all may be related to the MLR rule. In some cases, for example, rates may be lowered if plan benefits are reduced or if deductibles or other cost-sharing components of a plan are increased. And some insurers, such as Health Net Life Insurance Co., continue to

[4] *See* In Hopeful Sign, Health Spending is Flattening Out, New York Times, April 28, 2012, http://www.nytimes.com/2012/04/29/health/policy/in-hopeful-sign-health-spending-is-flattening-out.html.

raise rates in the double digits in the individual market, according to state records.

Before the federal MLR rule went into effect, Arizona insurers complied with state MLR rules, which set a minimum medical loss ratio standard of between 50 percent and 60 percent depending on the renewal terms of the policy.[5] Insurers had to certify in a rate filing that their rates were in compliance with the standards.

The Affordable Care Act requires state regulators to review individual market and small group rate increases of 10 percent or more. The Act set aside $250 million in additional funds for states to hire actuaries, improve their rate review, and provide more information to consumers about rates. The U.S. Department of Health and Human Services (HHS) reviews rate increases of 10 percent or more in a handful of states, including Arizona, that lack an effective rate review program. However, HHS has no authority to disapprove a rate; it can only issue findings as to whether a rate increase is reasonable. HHS has found 10 small group rate increases unreasonable in Arizona as of May 2012.

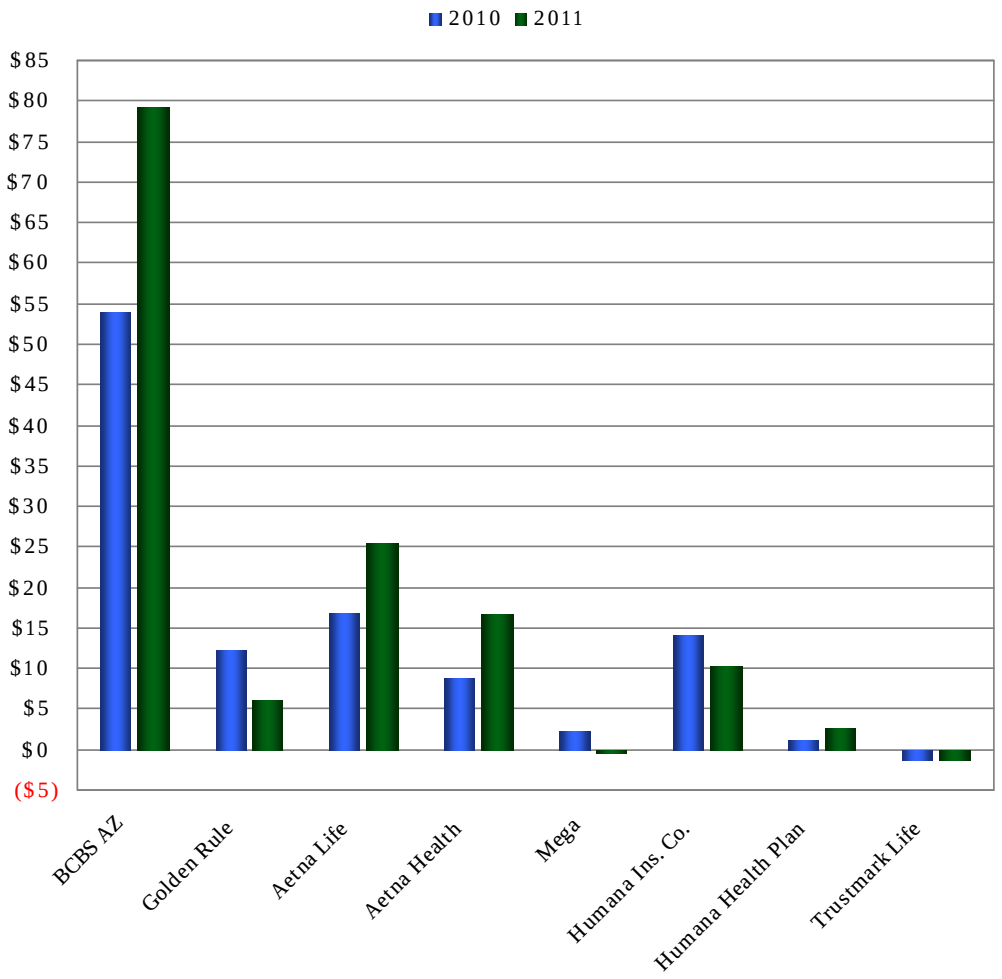
Insurers remain profitable

Even after estimated rebates or business adjustments that increased spending on medical care are taken into account, most insurers anticipating rebates earned profits on their Arizona health insurance business. The preliminary results shown in Chart 4 demonstrate that insurers can offer greater value to their customers and still be profitable.

[5] *See* Arizona Administrative Code R20-6-604 and R20-6-607.

CHART 4: NET PROFITS ON ARIZONA HEALTH INSURANCE BUSINESS, 2011 REBATING INSURERS

(in millions)



Source: 2011 Supplemental Health Care Exhibits – Part 1, filed with the National Association of Insurance Commissioners.

Conclusion

Early evidence showing the impact of the new MLR rule during its first year in effect shows that many of Arizona's insurers are changing business practices or preparing for millions of dollars in rebates in response to the new law. At the same time, most insurers remain profitable on Arizona health insurance business. For consumers and small businesses, this means the rule is bringing greater value for their premium dollars.

This report was written by Sondra Roberto, Consumers Union Staff Attorney, with assistance from Blake Hutson, Outreach Coordinator.

ConsumersUnion®

POLICY & ACTION FROM CONSUMER REPORTS

Consumers Union is the policy and advocacy division of *Consumer Reports*. We have a long history of advocating for improvements in the consumer marketplace. Since our creation in 1936, we have worked for safer, more affordable, and better quality products and services at both the state and federal levels. We are a non-profit, non-partisan organization with an overarching mission to test, inform and protect.

WWW.CONSUMERSUNION.ORG

HEADQUARTERS
101 Truman Avenue, Yonkers, NY 10703
Phone: (914) 378-2000 Fax: (914) 378-2928

SOUTHWEST OFFICE
506 West 14th St., Suite A, Austin, Texas 78701
Phone: (512) 477-4431 Fax: (512) 477-8934

WASHINGTON DC OFFICE
1101 17th Street NW, Suite 500, Washington, DC 20036
Phone: (202) 462-6262 Fax: (202) 265-9548

WEST COAST OFFICE
1535 Mission Street, San Francisco, CA 94103
Phone: (415) 431-6747 Fax: (415) 431-0906