Report of the Health Care Reform Actuarial (B) Working Group to the Health Insurance and Managed Care (B) Committee on Referral from the Professional Health Insurance Advisors (EX) Task Force Regarding Producer Compensation in the PPACA Medical Loss Ratio Calculation

Draft 5/19/11

Introduction

The Professional Health Insurance Advisors (EX) Task Force made the following referral on 3/27/11 to the Health Insurance and Managed Care (B) Committee at the NAIC's 2011 Spring National Meeting in Austin, TX:

> **Referral Language:** *Health Insurance and Managed Care (B) Committee is to complete the following:*
>
> - *Collect, analyze and report on relevant data regarding the level of commissions and/or other payments to producers in the individual, small and large group markets, including, but not limited to evaluating 2010 gross commission or fee payments as a portion of the denominator in the medical loss ratio (MLR).*
> - *Without determining whether any change is necessary, identify options to modify MLR definitions, methodology and/or numerical standards that may be necessary to protect health insurance consumers, and to preserve the important role of producers in the health insurance transaction and in the resolution of disputed health insurance claims.*
> - *Other related matters as necessary.*

This was then referred to the Health Care Reform Actuarial (B) Working Group (HCRAWG) of the Health Actuarial (B) Task Force on 4/4/11 for completion.

Data Collection

Data to perform analyses to complete the charge were of two general types: NAIC Supplemental Health Care Exhibit (SHCE) Data and producer reimbursement data from outside sources.

NAIC Supplemental Health Care Exhibit Data

Our primary source of data was the Supplemental Health Care Exhibit (SHCE), a new exhibit added to the annual statement reporting requirements to provide data needed for the MLR calculation under the Affordable Care Act (ACA). Data for the year 2010 from the SHCE (a list of elements can be found in Appendix A) as of 4/14/11 was extracted from the NAIC database. The data is unaudited and was used without modification. The collected SHCE data was used to calculate the approximate MLR and rebates in the manner detailed in the NAIC's ***Regulation for Uniform Definitions and Standardized Methodologies for Calculation of the Medical Loss Ratio for Plan Years 2011, 2012 and 2013 per Section 2718 (b) of the Public Health Service Act* (#190).** The data was also used to calculate MLRs and rebates using modifications to the standardized calculation to reflect some of the options identified regarding commissions.

Producer Compensation Data from Outside Sources

Because the SHCE is not available for years other than 2010, we needed to rely on outside sources for data regarding commission trends in prior years and changes occurring in 2011.

National Association of Health Underwriters (NAHU)

NAHU provided compensation schedules by company by state, generally from 2009 through 2011, with a few schedules provided back to 2008. The data was blinded as the information is considered proprietary and is used for competitive differentiation. This blinding presented analytical challenges and conclusions reached are debatable. However it appears that while some schedules went down from 2009 to 2010, many more have dropped from 2010 to 2011. There were anomalous cases where schedules apparently went up from 2009 to 2010, but generally most remained at the same level. Complicating

the analysis, several schedules were restructured year over year with no apparent indication of the relative level of the subsequent schedule. It is not apparent if these restructurings were for new product packaging, strategic positioning, reflection of relative inconsistencies in prior schedules or for some other reason. There was no indication that reductions in scheduled compensation were intended to offset the growth in premium to maintain a consistent income level for producers.

On the basis of our analysis we conclude that companies have not systematically been decreasing the percentage of premium provided as provider compensation. We further conclude there has been a general decrease in first year compensation in 2011.

Connecture

Connecture is a software company that works with health insurance carriers and brokers. Given the sensitive nature of the data, it cannot be made public. The Connecture data is based on broker commission schedules for large carriers from 2005 through 2011. The data shows for some larger carriers in the individual market that first year premium commissions have dropped as much as 30% - 50% in 2011, in some states. No pattern can be seen in the individual market renewal premium commissions nor the group market commissions. No pattern can be seen in any market for years prior to 2011. The data generally provides validation to conclusions reached with the NAHU data.

Major carriers

The Working Group asked the three largest groups of health insurers, Aetna, United Healthcare, and WellPoint, to submit data showing company experience by individual, small group, and large group lines of business by state for the years 2006-2010. At the suggestion of the companies, a template was prepared to clarify the data request and promote uniformity in the data being submitted to the Working Group. The companies were not able to provide data for all states within the short time available, but provided data for three or four representative states. They also were not able to provide information on current commission scales. The Working Group has identified this as a lower priority. The data was submitted to the Working Group through AHIP (America's Health Insurance Plans), a national association of health insurers, with the names of the companies and states replaced by "1, 2, 3" and "A, B, C.). The companies requested confidentiality with respect to the data submitted, even though it was blinded, due to a concern that it would be possible to identify the company and state based on the data.

The companies provided data for total direct premiums earned, agents and brokers fees and commissions, and member months. They were unable to break out first-year versus renewal experience in the time allowed. Using this data, the Working Group calculated commission rates both on a percentage basis and a member month basis over the years reported. In reviewing these summary results, there were no detectable commission trends in any of the lines of business leading up to and including 2010. Please note that this is an aggregate result, which is affected by factors such as the states reported, product mix over time, and the relative proportions of new business versus renewal business in each reported year.

States

The Working Group contacted 11 states that have higher minimum loss ratios and asked them to provide comments about the impact of those loss ratios in their states. Ten states responded and Appendix B contains a summary of the responses. The following are general comments about the responses:

1. State calculations of MLR differ from the federal MLR calculation.
2. Consumers continue to have access to insurance without noticeable problems.
3. There have been some reductions in both individual and small group producer compensation, with more individual health insurance being sold directly to consumers.
4. For several states, the MLR changes have been too recent to allow for changes to be observed.

There were 4 states in addition to the 11 surveyed states that provided data related to producer compensation. Maryland provided some data on compensation arrangements for specific companies. The data went back as far as 2005, but in most cases only the most recent schedules are provided. There are three companies where previous and current compensation schedules can be compared.

For the first company, only the small group schedules can be compared. This shows a switch from a percentage of premium method for commissions to a per employee per month (PEPM) schedule. A second company has reduced per capita per month commission (PCPM) levels by about 15% for both small group and individual business, although it has apparently

introduced new incentives, so the overall effect is not known. Finally, a third company introduced a new small group schedule which appears to increase agent compensation, since the percentages are unchanged, but new incentives are added. While this information limited, it is basically consistent with other information discussed above in that it suggests movement from commission arrangements based on percentages of commissions to a flat dollar amount per employee, particularly for group business.

Maryland provided data back to 2002 for the ratio of total compensation to earned premium for the individual, small group, and large group. The data for all three markets shows sizeable increases in that percentage over the time period. Without more specific data it is only possible to hypothesize about the cause of the increases. This data is only for one state so it is not possible to make nationwide inferences.

Data received from the other states is useful for background purposes but does not add to the above analysis.

Options

The following options to modify MLR definitions, methodology and/or numerical standards are ones communicated to us by various parties during our discussions. All of these are variations on the initial proposal to exclude broker compensation from the MLR calculation. Some of these variations could be combined as appropriate. All of these options are in addition to the default option of making no changes to the current MLR formula.

1. Types of compensation in addition to commissions, if any, eligible for special treatment:
    a. Bonuses
    b. Incentives
    c. Direct sales salaries and benefits
    d. Payments by one carrier to another to market the first carrier's health plans
    e. Fees paid to exchanges (beginning in plan year 2014)

2. Types of producers for which compensation is eligible for special treatment:
    a. Independent
    b. Captive
    c. Employees of the carrier

3. Limits, if any, on the amount of compensation given special treatment:
    a. Cap on percentage of premium excluded
    b. Cap on dollar amount per individual policy or group certificate or per member month

4. Increase the numerical MLR standards (85% and 80%) to reflect the exclusion of commissions

5. Currently, the MLR formula allows all federal taxes to be excluded from the calculation. A possible modification to the formula would allow producer compensation to be excluded from the calculation, but would allow the deduction of only those federal taxes that result from the enactment of the ACA. (These taxes will not be levied until 2014.)

6. Limit the number of years that special treatment of producer compensation will be applicable.

As discussed below, we were able to estimate the effect of many of these options had they been in effect in 2010, from the SHCE.

MLR Rebate Estimate Modeling

2010 SHCE data was used to calculate an estimate of MLRs and payable rebates if Section 2718 of PPACA were valid for plan year 2010. The exact calculation is given in Appendix D. There are differences between some of the data elements that would be used for an actual MLR rebate calculation and the data that is found in the SHCE, which lead to differences in the calculation used in this analysis and the actual calculation under Section 2718:

- The SHCE defines incurred claims as any claims paid in the reporting year, irrespective of incurral year, plus the year-over-year change in year-end reserve estimates. The actual MLR calculation defines incurred claims as claims

incurred in the reporting year and paid as of 3/31 of the following year, plus the estimate of remaining amounts unpaid as of 3/31 of the following year.

- The actual MLR calculation incorporates a credibility adjustment based on the number of life years and the average deductible for a given block of insurance plans. The SHCE does not give deductible information, so it was assumed the deductible adjustment factor in the credibility adjustment was 1.0, implying all deductibles in the SHCE data were less than $2,500. The effect of this assumption is to overstate the rebates

- The impact on federal income taxes that result from rebates is not considered in the calculation for this analysis. Only taxes as reported in the SHCE enter the calculation. Because no rebates are actually payable for 2010, reported taxes do not reflect any adjustment for rebates. The effect of this simplification is to overstate the taxes and therefore understate the rebates. (See Appendix C for discussion of this issue).

The variances between the calculated and actual MLRs due to these differences cannot be accurately determined. However, while the second and third effects are offsetting, we believe rebates produced from the SHCE data are understated by about a quarter, i.e. if the rebate law had been in effect for 2010, rebates would have been 25% greater absent company strategic activity.

The results of the rebate estimate modeling are as follows (PMPM = per-member-per-month). Please see Appendix D for the detailed calculation:

Table 0: no change to current formula

	% of Companies Paying Rebates*	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Individual Market, Nationwide	14.3%	52.9%	73.8%	$978.3	$8.09	121
Small Group Market, Nationwide	15.7%	22.8%	82.3%	$447.4	$2.12	211
Large Group Market, Nationwide	15.0%	14.7%	89.4%	$526.0	$1.13	465

*3,196 company/state combinations in data, each company counted for each state in which it writes.

Quantifiable Options

As previously mentioned, we were able to estimate the effects of many of the options identified above, assuming they had been applicable in 2010, using 2010 SHCE data.

These modifications exclude either all or some of payments made to producers from the adjusted earned premium, which is both the denominator of the MLR formula, and the amount to which the rebate percentage is applied.

The following table shows which of the items listed in the "Options" section above relate to the various modifications discussed below:

Modification	1.c. Exclude Direct Sales Salaries and Benefits in addition to Commissions	3.a. Cap exclusion as percent of premium	3.b. Cap exclusion per member month	4. Increase the numerical MLR standards	5. Exclude only federal taxes that result from the ACA (none in 2010)
1					
2	X				
3		X			
4	X	X			
5			X		
6	X		X		
7		X		X	
8	X	X		X	
9			X	X	
10	X		X	X	
11					X
12	X				X

Modification 1

This modification subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2) from the adjusted earned premium used in the rebate formula (please see Appendix D for the detailed calculation). Line 10.2 should include bonuses and incentives as well as commissions. However, because this is the first year the SHCE has been completed and the data has not been audited, we cannot verify this with certainty. The results of the rebate estimate modeling are as follows:

Table 1

	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Individual Market, Nationwide	9.4%	31.3%	71.7%	$401.3	$3.32	121
Small Group Market, Nationwide	7.7%	7.6%	85.6%	$146.2	$0.69	211
Large Group Market, Nationwide	8.5%	5.4%	91.4%	$215.2	$0.46	465

Modification 2

This modification subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), and direct sales salaries and benefits (SHCE Part 1, Line 10.1) from the adjusted earned premium used in the rebate formula (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as follows:

Table 2

	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Individual Market, Nationwide	9.2%	30.9%	72.5%	$358.6	$2.97	121
Small Group Market, Nationwide	7.3%	7.4%	86.3%	$126.4	$0.60	211
Large Group Market, Nationwide	7.4%	4.1%	91.8%	$195.3	$0.42	465

Modification 3

This modification subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), capped at a maximum percentage of earned premium, from the adjusted earned premium used in the rebate formula (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as shown in the three tables below. The results under current law and the results with no cap are shown for comparison.

Table 3a

	Individual Market, Nationwide					
Percentage of Earned Premium Cap on Excluded Commissions	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	14.3%	52.9%	73.8%	$978.3	$8.09	121
2%	13.5%	46.7%	74.6%	$800.1	$6.62	121
4%	12.9%	41.3%	75.6%	$655.7	$5.43	121
6%	12.2%	33.0%	77.0%	$556.5	$4.60	121
8%	12.0%	32.7%	77.8%	$485.9	$4.02	121
10%	11.5%	31.5%	78.6%	$425.7	$3.52	121
No Cap	11.2%	31.3%	79.2%	$401.3	$3.32	121

Table 3b

	Small Group Market, Nationwide					
Percentage of Earned Premium Cap on Excluded Commissions	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.7%	22.8%	82.3%	$447.4	$2.12	211
2%	12.4%	17.0%	83.9%	$259.9	$1.23	211
4%	10.5%	9.7%	85.2%	$181.3	$0.86	211
6%	9.1%	7.8%	86.0%	$157.7	$0.75	211
8%	8.9%	7.8%	86.5%	$152.1	$0.72	211
10%	8.7%	7.7%	86.7%	$148.9	$0.71	211
No Cap	8.4%	7.6%	87.0%	$146.2	$0.69	211

Table 3c

	Large Group Market, Nationwide					
Percentage of Earned Premium Cap on Excluded Commissions	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.0%	14.7%	89.4%	$526.0	$1.13	465
2%	12.0%	9.2%	90.8%	$281.6	$0.61	465
4%	10.0%	5.6%	91.3%	$221.9	$0.48	465
6%	9.4%	5.4%	91.4%	$217.5	$0.47	465
8%	9.4%	5.4%	91.4%	$217.0	$0.47	465
10%	9.4%	5.4%	91.5%	$216.6	$0.47	465
No Cap	8.8%	5.4%	91.6%	$215.2	$0.46	465

Modification 4

This modification subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2) and direct sales salaries and benefits (SHCE Part 1, Line 10.1), the sum of both capped at a maximum percentage of earned premium, from the adjusted earned premium used in the rebate formula (please see Appendix D for the exact calculation). The results under current law and the results with no cap are shown for comparison.

Table 4a

	Individual Market, Nationwide					
Percentage of Earned Premium Cap on Excluded Commissions + Direct Sales	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	14.3%	52.9%	73.8%	$978.3	$8.09	121
2%	13.5%	46.7%	74.6%	$799.5	$6.62	121
4%	12.8%	41.0%	75.9%	$649.2	$5.37	121
6%	12.1%	32.8%	77.1%	$540.0	$4.47	121
8%	11.8%	32.3%	78.2%	$465.5	$3.85	121
10%	11.3%	31.1%	78.8%	$401.8	$3.32	121
No Cap	11.0%	30.9%	79.9%	$358.6	$2.97	121

Table 4b

	Small Group Market, Nationwide					
Percentage of Earned Premium Cap on Excluded Commissions + Direct Sales	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.7%	22.8%	82.3%	$447.4	$2.12	211
2%	12.4%	17.0%	83.9%	$256.6	$1.22	211
4%	10.4%	9.6%	85.5%	$171.9	$0.82	211
6%	8.9%	7.7%	86.6%	$142.4	$0.68	211
8%	8.7%	7.7%	87.1%	$135.6	$0.64	211
10%	8.2%	7.5%	87.3%	$130.4	$0.62	211
No Cap	7.9%	7.5%	87.7%	$126.4	$0.60	211

Table 4c

	Large Group Market, Nationwide					
Percentage of Earned Premium Cap on Excluded Commissions + Direct Sales	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.0%	14.7%	89.4%	$526.0	$1.13	465
2%	11.6%	8.1%	90.9%	$272.1	$0.59	465
4%	9.5%	4.5%	91.6%	$206.1	$0.44	465
6%	8.6%	4.2%	91.8%	$198.0	$0.43	465
8%	8.3%	4.1%	91.9%	$197.1	$0.42	465
10%	8.3%	4.1%	91.9%	$196.7	$0.42	465
No Cap	7.7%	4.1%	92.1%	$195.3	$0.42	465

Modification 5

This modification subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), capped at a maximum PMPM amount multiplied by member months, from the adjusted earned premium used in the rebate formula (please see Appendix D for the exact calculation). The results under current law and the results with no cap are shown for comparison.

Table 5a

	Individual Market, Nationwide					
PMPM Cap on Excluded Commissions	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	14.3%	52.9%	73.8%	$978.3	$8.09	121
$6	13.0%	43.5%	75.3%	$724.9	$6.00	121
$12	12.0%	34.1%	77.0%	$548.5	$4.54	121
$18	11.5%	31.7%	78.0%	$445.0	$3.68	121
$24	11.3%	31.5%	78.6%	$422.5	$3.50	121
$30	11.3%	31.5%	78.8%	$406.2	$3.36	121
No Cap	11.2%	31.3%	79.2%	$401.3	$3.32	121

Table 5b

	Small Group Market, Nationwide					
PMPM Cap on Excluded Commissions	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.7%	22.8%	82.3%	$447.4	$2.12	211
$6	12.7%	17.2%	83.6%	$269.9	$1.28	211
$12	10.4%	9.9%	84.9%	$192.0	$0.91	211
$18	9.3%	8.4%	85.8%	$161.0	$0.76	211
$24	8.8%	7.7%	86.4%	$155.3	$0.74	211
$30	8.6%	7.7%	86.5%	$149.6	$0.71	211
No Cap	8.4%	7.6%	87.0%	$146.2	$0.69	211

Table 5c

	Large Group Market, Nationwide					
PMPM Cap on Excluded Commissions	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.0%	14.7%	89.4%	$526.0	$1.13	465
$6	11.6%	9.2%	90.7%	$288.0	$0.62	465
$12	9.2%	5.5%	91.4%	$223.4	$0.48	465
$18	8.8%	5.4%	91.5%	$217.0	$0.47	465
$24	8.8%	5.4%	91.5%	$216.0	$0.46	465
$30	8.8%	5.4%	91.6%	$215.5	$0.46	465
No Cap	8.8%	5.4%	91.6%	$215.2	$0.46	465

Modification 6

This modification subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2) and direct sales salaries and benefits (SHCE Part 1, Line 10.1), the sum of both capped at a maximum PMPM amount multiplied by member months, from the adjusted earned premium used in the rebate formula (please see Appendix D for the exact calculation). The results under current law and the results with no cap are shown for comparison.

Table 6a

	Individual Market, Nationwide					
PMPM Cap on Excluded Commissions + Direct Sales	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	14.3%	52.9%	73.8%	$978.3	$8.09	121
$6	13.0%	43.3%	75.6%	$719.2	$5.95	121
$12	11.8%	33.7%	77.5%	$534.1	$4.42	121
$18	11.3%	31.3%	78.5%	$420.8	$3.48	121
$24	11.1%	31.1%	79.2%	$393.2	$3.25	121
$30	11.1%	31.1%	79.3%	$365.9	$3.03	121
No Cap	11.0%	30.9%	79.9%	$358.6	$2.97	121

Table 6b

	Small Group Market, Nationwide					
PMPM Cap on Excluded Commissions + Direct Sales	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.7%	22.8%	82.3%	$447.4	$2.12	211
$6	12.7%	17.2%	83.7%	$266.3	$1.26	211
$12	10.3%	9.8%	85.1%	$178.2	$0.84	211
$18	9.2%	8.3%	86.2%	$146.0	$0.69	211
$24	8.6%	7.6%	86.8%	$138.4	$0.66	211
$30	8.3%	7.5%	87.2%	$130.8	$0.62	211
No Cap	7.9%	7.5%	87.7%	$126.4	$0.60	211

Table 6c

	Large Group Market, Nationwide					
PMPM Cap on Excluded Commissions + Direct Sales	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Current Law	15.0%	14.7%	89.4%	$526.0	$1.13	465
$6	11.2%	8.1%	90.9%	$277.3	$0.60	465
$12	8.7%	4.4%	91.6%	$207.5	$0.45	465
$18	8.0%	4.2%	91.9%	$198.5	$0.43	465
$24	7.8%	4.1%	92.0%	$196.9	$0.42	465
$30	7.8%	4.1%	92.0%	$195.6	$0.42	465
No Cap	7.7%	4.1%	92.1%	$195.3	$0.42	465

Modification 7

This modification is a variation of modification 3. It subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), capped at a maximum percentage of earned premium, from the adjusted earned premium used in the rebate formula. In addition, the minimum MLR is adjusted such that the rebate payable under this modification will equal the rebate payable using a calculation with no modification and the statutory minimum MLRs (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as follows:

Table 7a

Individual Market, Nationwide

Rebate $Millions	$978.3					
Rebate PMPM	$8.09					
Member Months (Millions)	120,856					
Percentage of Earned Premium Cap on Excluded Commissions	No Cap	2%	4%	6%	8%	10%
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	86.23%	81.65%	83.24%	84.46%	85.37%	85.98%

Table 7b

Small Group Market, Nationwide

Rebate $Millions	$447.4					
Rebate PMPM	$2.12					
Member Months (Millions)	210,848					
Percentage of Earned Premium Cap on Excluded Commissions	No Cap	2%	4%	6%	8%	10%
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	84.15%	81.66%	83.20%	83.99%	84.08%	84.11%

Table 7c

Large Group Market, Nationwide

Rebate $Millions	$526.0					
Rebate PMPM	$1.13					
Member Months (Millions)	464,780					
Percentage of Earned Premium Cap on Excluded Commissions	No Cap	2%	4%	6%	8%	10%
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	87.30%	86.52%	87.24%	87.28%	87.29%	87.29%

Modification 8

This modification is a variation of modification 4. It subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), and direct sales salaries and benefits (SHCE Part 1, Line 10.1), the sum of both capped at a maximum percentage of earned premium from the adjusted earned premium used in the rebate formula. In addition, the minimum MLR is adjusted such that the rebate payable under this modification will equal the rebate payable using a calculation with no modification and the statutory minimum MLRs (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as follows:

Table 8a

Rebate $Millions	$978.3					
Rebate PMPM	$8.09					
Member Months (Millions)	120,856					
Percentage of Earned Premium Cap on Excluded Commissions	No Cap	2%	4%	6%	8%	10%
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	86.99%	81.65%	83.31%	84.79%	85.82%	86.53%

Table 8b

Small Group Market, Nationwide

Rebate $Millions	$447.4					
Rebate PMPM	$2.12					
Member Months (Millions)	210,848					
Percentage of Earned Premium Cap on Excluded Commissions	No Cap	2%	4%	6%	8%	10%
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	84.59%	81.69%	83.30%	84.28%	84.49%	84.55%

Table 8c

Large Group Market, Nationwide

Rebate $Millions	$526.0					
Rebate PMPM	$1.13					
Member Months (Millions)	464,780					
Percentage of Earned Premium Cap on Excluded Commissions	No Cap	2%	4%	6%	8%	10%
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	87.60%	86.59%	87.47%	87.56%	87.59%	87.59%

Modification 9

This modification is a variation of modification 5. It subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), capped at a maximum PMPM amount multiplied by member months, from the adjusted earned premium used in the rebate formula. In addition, the minimum MLR is adjusted such that the rebate payable under this modification will equal the rebate payable using a calculation with no modification and the original statutory MLRs (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as follows:

Table 9a

Individual Market, Nationwide

Rebate $Millions	$978.3					
Rebate PMPM	$8.09					
Member Months (Millions)	120,856					
PMPM Cap on Excluded Commissions	No Cap	$6	$12	$18	$24	$30
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	86.23%	82.44%	84.49%	85.78%	86.11%	86.17%

Table 9b

Small Group Market, Nationwide

Rebate $Millions	$447.4					
Rebate PMPM	$2.12					
Member Months (Millions)	210,848					
PMPM Cap on Excluded Commissions	No Cap	$6	$12	$18	$24	$30
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	84.14%	81.54%	82.91%	83.82%	84.05%	84.09%

Table 9c

Large Group Market, Nationwide

Rebate $Millions	$526.0					
Rebate PMPM	$1.13					
Member Months (Millions)	464,780					
PMPM Cap on Excluded Commissions	No Cap	$6	$12	$18	$24	$30
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	87.30%	86.44%	87.22%	87.29%	87.30%	87.30%

Modification 10

This modification is a variation of modification 6. It subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), and direct sales salaries and benefits (SHCE Part 1, Line 10.1), the sum of both capped at a maximum PMPM amount multiplied by member months, from the adjusted earned premium used in the rebate. In addition, the minimum MLR is adjusted such that the rebate payable under this modification will equal the rebate payable using a calculation with no modification and the statutory minimum MLRs (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as follows:

Table 10a

Individual Market, Nationwide

Rebate $Millions	$978.3					
Rebate PMPM	$8.09					
Member Months (Millions)	120,856					
PMPM Cap on Excluded Commissions	No Cap	$6	$12	$18	$24	$30
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	86.99%	82.49%	84.78%	86.30%	86.77%	86.90%

Table 10b

Small Group Market, Nationwide

Rebate $Millions	$447.4					
Rebate PMPM	$2.12					
Member Months (Millions)	210,848					
PMPM Cap on Excluded Commissions	No Cap	$6	$12	$18	$24	$30
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	84.59%	81.57%	83.03%	84.08%	84.46%	84.53%

Table 10c

Large Group Market, Nationwide

Rebate $Millions	$526.0					
Rebate PMPM	$1.13					
Member Months (Millions)	464,780					
PMPM Cap on Excluded Commissions	No Cap	$6	$12	$18	$24	$30
Equivalent Minimum MLR to Match Rebate Under Unchanged Rebate Formula	87.60%	86.51%	87.45%	87.56%	87.59%	87.59%

Modification 11

This modification is a variation of modification 1. It subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2) from the adjusted earned premium used in the rebate formula and adds federal taxes back in (please see Appendix D for the detailed calculation). The results of the rebate estimate modeling are as follows:

Table 11

	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Individual Market, Nationwide	9.7%	35.2%	70.0%	$699.1	$5.78	121
Small Group Market, Nationwide	11.6%	19.2%	83.6%	$415.3	$1.97	211
Large Group Market, Nationwide	12.3%	11.7%	90.8%	$497.1	$1.07	465

Modification 12

This modification is a variation of modification 2. It subtracts agents and brokers fees and commissions (SHCE Part 1, Line 10.2), and direct sales salaries and benefits (SHCE Part 1, Line 10.1) from the adjusted earned premium used in the rebate formula and adds federal taxes back in (please see Appendix D for the exact calculation). The results of the rebate estimate modeling are as follows:

Table 12

	% of Companies Paying Rebates	% of Members Receiving Rebates	Median MLR	Rebate $Millions	Rebate PMPM	Member Months (Millions)
Individual Market, Nationwide	9.4%	33.8%	70.4%	$648.6	$5.36	121
Small Group Market, Nationwide	11.4%	18.2%	84.5%	$368.9	$1.75	211
Large Group Market, Nationwide	10.9%	9.6%	91.3%	$452.5	$0.97	465

Modification 13

This modification applies either a percentage of premium or PMPM cap on excludable producer compensation that would vary by market segment. For example, the excludable percentage of earned premium for individual business could be higher than the percentage for small and large group business. The effects of different percentage and PMPM caps are shown in the examples above.

Non-Quantifiable Modifications

Any of the modifications presented in the quantifiable modifications section could include additional restrictions on either the types of compensation that could be excluded from the MLR calculation, compensation to only specified types of producers being excluded, or a combination of both types of restrictions. For example, total compensation to producers can be split into commissions, bonuses, incentives, direct sales salaries and benefits, and other types. It is also possible that beginning in plan year 2014, fees paid to American Health Benefit Exchanges could be considered to be a form of producer compensation. Compensation that could be excluded from the MLR calculation could be restricted to only one of the types of compensation, or a combination of more than one of the types. Types of producers include independent, captive, and employees.

Compensation that could be excluded from the MLR calculation could be limited to payments to only one type of producer, or a combination of types of producer. We were unable to quantify the effects of restrictions to either types of compensation or types of producer, as the SHCE data is not reported at these levels of detail.

Any of the modifications presented in the quantifiable and non-quantifiable modifications sections could be limited to a predetermined number of plan years, such as expiration of the modification beginning in plan year 2014. A variation on this would be grading the allowable excluded amounts from a maximum in the first plan year to no allowable excludable amounts in the terminal plan year. Since we have no reliable way of projecting SHCE data beyond plan year 2010, we were unable to quantify the effect of these modifications.

Exclusion of producer compensation up to a maximum percentage of earned premium from the MLR calculation could be at the option of each state. The default would be that no producer compensation would be allowed for exclusion. This option was not easily quantifiable, as there is no reliable way to determine which states would choose this option. However, SHCE data is segregated by state, so the effects of a capped exclusion for a given state could be quantified. SHCE data by state is summarized in Appendix E.

Appendix A

Supplemental Health Care Exhibit Data Elements

	Earned Premium	
[1]	Total direct premiums earned	SHCE Part 2, Line 1.8
[2]	Change in reserve for rate credits	SHCE Part 2, Line 1.7
[3]	Federal high risk pools	SHCE Part 1, Line 1.2
[4]	State high risk pools	SHCE Part 1, Line 1.3
	Federal and State Taxes and Licensing or Regulatory Fees	
[5]	Federal taxes and federal assessments	SHCE Part 1, Line 1.5
[6]	State insurance, premium and other taxes	SHCE Part 1, Line 1.6
[7]	Regulatory authority licenses and fees	SHCE Part 1, Line 1.7
	Expenses to Improve Health Care Quality	
[8]	Total of Defined Expenses Incurred for Improving Health Care Quality	SHCE Part 1, Line 6.3
[9]	**Deductible Fraud and Abuse Detection/Recovery Expenses**	SHCE Part 1, Line 4
[10]	**Total Incurred Claims**	SHCE Part 1, Line 5
[11]	**Agents and Brokers Fees and Commissions**	SHCE Part 1, Line 10.2
[12]	**Direct Sales Salaries and Benefits**	SHCE Part 1, Line 10.1
[13]	**Member Months**	SHCE Part 1, Other Indicators, Line 4

Appendix B State Experience with Higher Minimum Loss Ratios

State	Summary of Response
Colorado	70% MLR for group since 2005 – not really a limit, but a safe harbor for benefits being reasonable in relation to premium. Erosion in small group carriers since 2000, sharply since 2007 when claims experience and health status were removed as allowable rating factors. Target loss ratios have increased to above 70%. A letter from Commissioner Postolowski, provided to the Working Group by an NAIC Consumer Representative, indicated that: (1) consumer access has not changed significantly; (2) MLR requirements may have moderated rate increases; and (3) competition may have provided an incentive to keep benefit ratios high.
Maine	On July 1, 2004 small group carriers had a choice of 75% with prior approval or guaranteed 78% with no prior approval. One company switched from selling small group to individual (65% loss ratio). No other observable impact on commissions or number of producers.
Maryland	Small group 75% MLR since 1993. Observed reducing commissions to small group, starting before healthcare reform. No problem with lack of producers for small group.
Minnesota	Provided state data. No issues about commissions.
New Jersey	From 75% to 80% in 2009. Most individual is sold direct. Small group – no problem with access. High average small group premiums, so may be a special case.
New Mexico	On May 19, 2010, 75% for individual (in process of changing to 80%). 85% for all group. Three years before any refunds are paid.
New York	Until 2010, rebate payable when individual loss ratio < 80% and small group loss ratio less than 75%. In 2011, all community-rated plans 82% (adjustments bring closer to federal level). No access or producer comp issues in small group or individual.
South Dakota	Just changed MLR 1/11/11. Too early to tell what impact the higher MLRs will have. Previous minimums: 65% individual, 75% group
Washington	For individual, 74% (minus 2% premium tax) loss ratio. Since 2000, excess is remitted by company to high risk pool. Companies appear to be reducing agent commissions and terminating contracts to cut costs and move to an on-line system. For small group, there is a trend toward not paying commissions on groups of 1-3 lives.
West Virginia	No problems with consumer access. Some agents are no longer writing for carriers that have limited or ended commissions.

Appendix C

Discussion of Federal Income Tax impact on MLR Rebates

Under current law, all federal taxes are deducted from premium before calculation of the medical loss ratio (MLR) and rebates. The NAIC recommended that this be limited to federal taxes other than income tax on investment income, since the MLR calculation does not consider investment income. This recommendation was accepted by HHS in their Interim Final Regulation. There have been assertions made by some Members of Congress that they intended the federal tax deduction to apply only to those taxes used to fund the law. However, statutory language prevailed in developing the regulation.

Within this report, the issue of federal income taxes (FIT) is relevant in two regards. First, the Supplemental Health Care Exhibit (SHCE) does not reflect the impact of rebates on FIT, since rebates were not required in 2010. When rebates are required, they will affect FIT, which in turn will affect the amount of the rebate as discussed below. Second, one of the options discussed in this report is to substitute broker commissions for federal taxes in the MLR calculation – that is, to deduct commissions from premium but not deduct federal taxes other than the ACA-related taxes that begin in 2014.

Interaction of FIT and Rebates

If rebates had been required in 2010, companies would have had lower taxes due to payment of the rebates. These lower taxes would have been deducted from earned premium in the formula, leading to yet lower taxes, leading to yet greater rebates. Companies would have been able to evaluate this recursive formula to develop the actual taxes and rebates due. This concept may be easier to visualize with an example:

Example:

Assume no quality improvement expenses or state taxes and no federal taxes other than FIT, so we have only claims, premium and federal income tax entering the calculation. The MLR is calculated as claims divided by the quantity premium minus FIT. Taxes impact the calculation two ways, in determining the initial MLR and in determining the amount to which the rebate percentage is applied to calculate the rebate. If we have claims of 7,000, premium of 10,000 and FIT of 1,000, then the MLR is 77.8%, and the rebate initially is 200, (7,000 / (10,000-1,000) = 77.8%. 80% - 77.8% = 2.2%. 2.2% * (10,000 - 1,000) = 200.). However the tax is reduced by the deductible rebate paid, so if the tax rate is 30%, then taxes would be reduced by 60, (200 * 30%)[1]. But the new taxes of 940 would be deducted from earned premium in calculating the MLR, so that the new MLR would be 77.3% and the new rebate would be $248. Again the higher rebate would result in lower taxes resulting in higher rebates. Evaluation of the recursive formula results in an ultimate tax of 921 and ultimate rebate of 263, (263 * 30% = 79, 1,000 – 79 = 921, 7,000 / (10,000 - 921) = 77.1%. 80% - 77.1% = 2.9%. 2.9% * (10,000 - 921) = 263.) In this case, rebates with a tax rate of 30% are 31% higher after evaluating the recursive formula, (263 / 200 = 131%). Generally the increase in rebates will be about equal to the tax rate.

Possible Elimination of Non-ACA Federal Tax Exclusion:

Eliminating the federal tax deduction from premium would generally increase the MLR rebates, while incorporating a producer reimbursement deduction from premium would decrease the MLR rebates. It has been suggested that by substituting a producer reimbursement deduction for the federal income tax deduction, perhaps the level of rebates to be paid to consumers would remain at a comparable level to the current statutory level. We evaluated this substitution and found near equality for small group and large group, but a decrease in rebates to be paid for the non-group pool. However as noted above, federal taxes in the SHCE did not incorporate the impact of rebates on the level of taxes, suggesting that the illustrated rebates were lower than they would have been if the recursive relationship had been evaluated. Perhaps a better comparison would be the rebates illustrated in the paper after deducting producer reimbursement versus rebates illustrated as derived from the SHCE inflated by an after tax factor of 25% to 35%. It appears rebates would be reduced with this substitution.

Appendix D

MLR Calculation Details

Bracketed numbers are elements from Appendix A

Table 0

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]}\right)$

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1]+[2]+[3]+[4]-[5]-[6]-[7])$.

Else, Rebate = 0

Table 1

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]-[11]}\right)$

If MLR < minimum MLR,

[1] FIT laws and regulations are very complicated. This illustration uses a simplified calculation of the additional FIT incurred by only applying a marginal tax rate to the change in underwriting gain.

Rebate = $[Minimum\ MLR - MLR] * ([1] + [2] + [3] + [4] - [5] - [6] - [7] - [11])$

Else, Rebate = 0

Table 2

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]-[11]-[12]}\right)$

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1] + [2] + [3] + [4] - [5] - [6] - [7] - [11] - [12])$

Else, Rebate = 0

Table 3

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]-[11]}\right)$, where[11] is capped at a maximum percentage of earned premium.

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1] + [2] + [3] + [4] - [5] - [6] - [7] - [11])$

Else, Rebate = 0

Table 4

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]-[11]-[12]}\right)$, where [11] + [12] is capped at a maximum percentage of earned premium.

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1] + [2] + [3] + [4] - [5] - [6] - [7] - [11] - [12])$

Else, Rebate = 0

Table 5

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]-[11]}\right)$, where[11] is capped at a maximum PMPM amount multiplied by member months.

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1] + [2] + [3] + [4] - [5] - [6] - [7] - [11])$

Else, Rebate = 0

Table 6

MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[5]-[6]-[7]-[11]-[12]}\right)$, where [11] + [12] is capped at a maximum PMPM amount multiplied by member months.

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1] + [2] + [3] + [4] - [5] - [6] - [7] - [11] - [12])$

Else, Rebate = 0

Table 7

The MLR is calculated as in Table 3, but uses a modified minimum MLR.

Table 8
The MLR is calculated as in Table 4, but uses a modified minimum MLR.

Table 9
The MLR is calculated as in Table 5, but uses a modified minimum MLR.

Table 10
The MLR is calculated as in Table 6, but uses a modified minimum MLR.

Table 11
MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[6]-[7]-[11]}\right)$

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1]+[2]+[3]+[4]-[6]-[7]-[11])$

Else, Rebate = 0

Table 12
MLR = $\left(\frac{[8]+[9]+[10]}{[1]+[2]+[3]+[4]-[6]-[7]-[11]-[12]}\right)$

If MLR < minimum MLR,

Rebate = $[Minimum\ MLR - MLR] * ([1]+[2]+[3]+[4]-[6]-[7]-[11]-[12])$

Else, Rebate = 0

Appendix E

Provided as separate Excel workbook.