STATE OF MAINE
DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION
BUREAU OF INSURANCE

In re: MEGA LIFE AND HEALTH INSURANCE COMPANY RATES FOR INDIVIDUAL HEALTH PLANS Docket No. INS-08-1000	]]]]]]]	DECISION AND ORDER

INTRODUCTION

Title 24-A M.R.S.A. § 2736(1) requires that insurance carriers obtain the approval of the Superintendent of Insurance for proposed policy rates for non-group health insurance products. On May 5, 2008 and pursuant to § 2736(1), MEGA Life and Health Insurance Company ("MEGA") submitted a rate filing for its individual health products.

In its filing, MEGA requested specific rate changes for policy forms and riders ranging from a decrease of 50% to an increase of 40%, depending on the benefit design offered. The overall average rate change requested is an increase of 7%. MEGA proposes that the rate changes be effective approximately 30 days after issuance of the Superintendent's Decision and Order.

To assist in consideration of MEGA's filing and pursuant to Bureau of Insurance Rules, Chapter 350(13)(D), the Superintendent established an Advocacy Panel representing Bureau of Insurance staff. Soon after MEGA's filing and pursuant to 5 M.R.S.A. 9054(1), the Maine Attorney General intervened in this proceeding as a matter of right.

This Decision and Order constitutes final agency action by the Superintendent of Insurance.

PROCEDURAL HISTORY

On July 3, 2008, the Superintendent issued a procedural order outlining rules for consideration of this matter, including the conduct of discovery. The order also set this matter for hearing.

From July 7, 2008 to September 12, 2008, the Bureau Advocacy Panel and the Attorney General served MEGA with discovery requests. Additionally, the Superintendent made three information requests of MEGA. MEGA made, and then withdrew, a motion that certain information in response to the Superintendent's third request be treated as confidential.

On several occasions and in response to motions by one or more of the parties, the Superintendent enlarged the periods of time for performance of tasks set forth in her original procedural order. Public notice of an original hearing date of August 18, 2008 preceded one continuance of hearing. Consequently, on August

18, 2008, the Superintendent opened hearing for the limited purpose of affording members of the public who may have relied upon notice of hearing on that date an opportunity to make unsworn statements or to testify under oath about MEGA Life's rate filing.

On September 19, 2008, the parties pre-filed testimony and exhibits.

Hearing occurred October 3, 2008. Members of the public again had an opportunity to make either sworn or unsworn statements for consideration by the Superintendent. No individual provided such a statement.

At hearing, MEGA presented testimony from three individuals: Philip Rydzewski, its Chief Accounting Officer and Senior Vice-President; Virgil Meier, an Assistant Vice-President and actuary; and Jack Heller, a Vice-President and overseer of the Company's marketing division. MEGA offered its exhibits numbered 1 through 7, which the Superintendent admitted. The Attorney General presented testimony from one witness, Beth Fritchen, an actuary. The Attorney General offered an exhibit numbered 1, which the Superintendent admitted. The Advocacy Panel presented testimony from one witness, Charles DeWeese, an actuary. The Advocacy Panel offered its exhibits numbered 1 through 3, which the Superintendent admitted. The Superintendent took official notice of all filings made by the parties in the course of the proceeding; MEGA's settlement of its prior rate proceeding; Bureau of Insurance Docket No. INS-07-1010; and a national trade association's 2007 survey of health insurance premiums, availability, and benefits.

Subsequent to hearing and in response to an order of the Superintendent, MEGA filed post-hearing exhibits. The Attorney General and Advocacy Panel engaged in discovery related to those filings. That discovery continued to October 10, 2008.

On October 15, 2008, all three parties filed written closing statements. The Attorney General filed an addendum to his closing statement on October 17, 2008, to which MEGA filed a response on October 20, 2008.

On October 20, 2008, the Superintendent addressed a post-hearing discovery request to MEGA. MEGA responded on October 22, 2008.

On October 28, 2008, the Superintendent addressed a post-hearing discovery request to the Attorney General. The Attorney General responded on October 30, 2008.

STANDARD OF REVIEW

MEGA's filing must meet 24-A M.R.S.A. § 2736's requirement that rates not be excessive, inadequate, or unfairly discriminatory; the requirement that the rates satisfy the provisions of 24-A M.R.S.A. § 2736-C and Maine Bureau of Insurance Rules, Chapter 940, "Requirements for Health Insurance Rate Filings and Data Reporting"; and the requirement that rates otherwise meet the standards set forth in the Maine Insurance Code and regulations promulgated thereunder. Noteworthy is 24-A M.R.S.A. §2736-C(5)'s mandate that the aggregate benefits estimated to be paid under policies in a contract period return to policyholders at least 65% of the aggregate premium collected for those policies. MEGA bears

the burden of demonstrating that, in fact, the proposed rates are not excessive, inadequate, or unfairly discriminatory and otherwise meet applicable standards.

DISCUSSION

Following is a summary of observations regarding some of the principal arguments and evidence weighed by the Superintendent in rendering her final agency action.

I. Claim Costs

A. *Completion Factors*

The Attorney General recommended different completion factors for MEGA's base plans, resulting in claim costs higher than those MEGA used. The Advocacy Panel had done its own analysis of the completion factors but did not say what it found with regard to the base plans. The Attorney General used MEGA's claim costs in its rate calculation for the base plans.

For the four riders with the largest volume, the Advocacy Panel calculated its own completion factors, which resulted in claim costs lower than those MEGA used. The adjusted claim costs calculated by the Attorney General and the Advocacy Panel are more reasonable than those used by MEGA, because they use completion factors that reflect separate base plan and rider experience.

B. *Trend*

The Attorney General initially recommended trends lower than those used by MEGA for both the scheduled and non-scheduled plans. However, based on data provided by MEGA after the hearing, the Attorney General agreed with MEGA's 16% trend for the non-scheduled plans. In fact, 16% was at the low end of the Attorney General's range, and there are some indications that that range may be too low, as explained below.

The Attorney General based trend analysis on the combined experience of the base forms and riders, resulting in lower trends. If this approach were to be used, in order to be consistent it would be necessary to use the same combined trends in pricing the riders. However, The Attorney General made no recommendation regarding the riders. The trends used for the riders by MEGA, as well as those recommended by the Advocacy Panel, are lower than the non-scheduled base policy trends. For the ambulatory care rider, MEGA used 12% while the Advocacy Panel recommended 11%. For all other riders, both used a zero trend. In light of the lower trends on the riders, it is not appropriate to use combined trends for the base policies.

The Attorney General did not include experience for June through August 2007, claiming a need for updated national triangles in order to determine completion factors. At the hearing, however, when discussing the data MEGA was to provide after hearing, the Attorney General suggested that only the claims on a Maine basis were of interest. The Attorney General used only two of the additional five months of experience provided by MEGA, which may explain why the Attorney General concluded that lower trends were appropriate. Even

adding only two additional months was enough to increase the Attorney General's trend range from 13.6% - 16.0% to 16% - 19%.

A graph included in the Attorney General's post-hearing trend analysis indicates "Large Claims Trend at 30%," but the actual calculation uses 25%. The actual trend in large claims appears to be higher than either 25% or 30%. A higher trend assumption for large claims would result in a higher trend assumption overall.

In light of the foregoing considerations, it would be overly optimistic to use the lower end of the 16% - 19% range for trend. It would be more reasonable to use the midpoint of 17.5%.

For the scheduled plans, the Attorney General increased an original 7.1% trend recommendation to 8%, still lower than the 10% used by MEGA and the Advocacy Panel.

The rates developed by the Attorney General reflect two errors. First, for the non-scheduled plans, the premium used for the experience period excluded application fees. Those fees are part of the premium and should be included. Excluding them overstates the needed rate increase. Second, the Attorney General applied the 0.73% savings offset payment ("SOP") factor to claims. While the SOP is based on claims, the 0.73% factor reflects an adjustment to a percent-of-premium basis. The factor should therefore be applied to premiums. Applying it to claims understates the needed rate increase.

The Advocacy Panel used a slightly lower trend, 11% rather than MEGA's 12%, for the ambulatory care rider. This reflects the modified completion factors discussed above. The lower 11% trend is therefore appropriate.

For the accident rider, the doctor's office visit rider, and the emergency room rider, the Advocacy Panel calculated trends of -4%, 3%, and 4%, respectively, in the same manner it calculated the 11% trend for the ambulatory care rider. However, it did not apply those trends in determining rates for these three riders, instead using the zero trend used by MEGA. At hearing, MEGA provided its Exhibit 7 showing higher trends for the three riders, which it said were based on recent experience. However, since Exhibit 7's trends reflect the completion factors based on combined base plan and rider experience, they are not reasonable. The trends calculated by the Advocacy Panel are more reasonable than either the zero trend used by MEGA or the higher trends shown in MEGA's Exhibit 7.

C. *Cost Containment Expenses*

MEGA included cost containment expenses equal to 2.7% of claims as a subcategory of claims and therefore included them in the numerator of the loss ratio. This is not consistent with Rule 940, which defines loss ratio to exclude those expenses. It is appropriate to include those expenses in the premium, but as an administrative expense and not as a claim cost. This means that the target loss ratio used by MEGA to calculate the proposed rates was effectively 63.3%, determined as follows.

Remove SOP: 65% - 0.73% = 64.23%.
Remove cost containment expenses: 64.23%/1.027 = 62.54%.
Add SOP: 62.54% + 0.73% = 63.3%

(The SOP is included with claims in determining the loss ratio pursuant to 24-A M.R.S.A. § 2736-C(5).)

I. Administrative Expense

Administrative expense items included in the proposed rates include 11% of premium for general expenses, 13.3% for commissions, and 2.25% for premium tax. Those items total 27.45% of premium before adding the 2.7% of claims for cost containment expenses discussed above. The Advocacy Panel and the Attorney General found these items reasonable, with the exception of the 0.9% of premium allocated for trips and contests for producers.

MEGA claimed that trips and contests for agents include an educational component. However, from testimony at hearing, it seems clear that their primary purpose is to provide agents with rewards and incentives. MEGA asserts that money spent on these items is more effective than a small increase in commission rates. The Attorney General conceded, "There is no question that the trips and contests are good for the company and good for the agents" but argued that the cost should not be included in premiums because there is little or no direct benefit to consumers. The Advocacy Panel made a similar argument. However, if direct benefit to consumers were a criterion, commissions would not be reflected in premiums either. The amount allocated for trips and contest is a legitimate expense associated with MEGA's products, and it is not unreasonable to include it in premiums.

Generally, the methodology used by MEGA to allocate expenses to various states and policy forms is extremely unsophisticated and includes erroneous assumptions. All expenses are allocated as a percentage of premium, regardless of the nature of the expense. While this is reasonable for items such as commissions and premium tax, it is not appropriate for items such as billing and other expenses not directly related to premiums.

It is impossible to tell whether, if determined by a more sophisticated methodology, the administrative expenses for MEGA's products would be the same, higher, or lower than those set forth in the filing. Since the amounts proposed ostensibly appear reasonable, they can be accepted in this filing. In contrast, the higher 15.2% for general expenses alleged by MEGA in its Exhibit 7 cannot be considered reasonable without better support than that provided by the Company's rudimentary cost allocation system. Because the trend in administrative expenses is likely lower than the trend in premiums, the 11% of premium found reasonable this year for general expenses would not be reasonable next year.

III. Investment Income

Investment income has very little impact on rates for medical insurance, because the lag is relatively short between the time when premiums are received for a given period of coverage and the time when benefits are paid for claims incurred during that period. MEGA included a 0.65% credit in its rate

calculation to reflect investment income. The Attorney General and Advocacy Panel did not dispute this, and it appears reasonable.

IV. Profit and Risk

MEGA's filing included a profit and risk margin of 8.2%. The other parties recommended 3%, the same margin allowed for Anthem Blue Cross and Blue Shield, the largest carrier in Maine's individual market and MEGA's only significant competitor. MEGA raised a number of arguments for a margin higher than Anthem's. It alleged that assumption of a higher risk relative to Anthem, the lack of a group insurance line, and the need for what it considers to be an adequate return to investors justified a higher margin. Even collectively, those alleged factors would not be sufficient to outweigh either the need for equity in the marketplace. A 3% pre-tax margin is appropriate.

Reducing the profit and risk margin to 3% and treating cost containment expenses as expenses rather than claims increases the target loss ratio from the 63.3% calculated above to 68.4% (63.3 + [8.2 - 3.0] / 1.027). (The adjustment is reduced by a factor of 1.027, to reflect the fact that cost containment expenses, which are 2.7% of claims, represent a slightly larger percentage of premium when the loss ratio increases.)

V. Other Issues

A. *State Plans*

There are two issues, with respect to the state plans.

The first issue with respect to the state plans is MEGA's proposal for a 40% rate increase on these forms, far larger than the increase proposed on other non-scheduled plans. The Advocacy Panel and Attorney General argue that the percentage increase should be the same for the state and other non-scheduled plans.

Experience for the state plans is not credible, due to very low volume. Even if experience were credible, it is not reasonable to price each plan on its own experience, if the experience is the result an older or sicker population than that of other plans. To do so would violate the community rating principles embodied in Maine law.

MEGA argues correctly that its premiums for the state plans should ideally be comparable to Anthem's. MEGA argues incorrectly that its rates should be higher than Anthem's to reflect its lower loss ratio. MEGA is required by law to market the state plans actively and setting prices higher than the competition effectively thwarts this legal requirement.

It would not always be true that the most appropriate rate increase for the state plans would be that applicable to other non-scheduled plans. However, that is reasonable in this instance, because the resulting rates would be comparable to Anthem's. Unlike Anthem, MEGA uses separate rates for smokers and nonsmokers. Equalizing rate increases for state plans and other non-scheduled plans results in nonsmoker rates lower than Anthem's and smoker rates higher than Anthem. That is a reasonable result.

The second issue with respect to the state plans is MEGA's violation of Bureau of Insurance Rules, Chapter 940. The annualized differences in premium among the four available deductibles exceed the difference in the deductibles, contrary to Rule 940.

B. *Other Riders*

MEGA's filing included rates for four other riders, all having very low volume: the chemotherapy rider, the air ambulance rider, the mental health rider, and the breast reduction and varicose vein rider. Neither the Attorney General nor the Advocacy Panel commented on those riders.

MEGA proposed a 10% rate increase for the chemotherapy rider. This was based on a target loss ratio of 65%, with cost containment expenses included in claims. As discussed above, removing these expenses from claims reduces the 65% target loss ratio to 63.3%. This means that without the 10% rate increase, the expected loss ratio would be 69.6% (63.3 x 1.10). The rate increase needed to reach the target loss ratio of 68.4% determined above is 1.8% (69.6/68.4 - 1).

MEGA proposed a 50% decrease in rates for the air ambulance rider. MEGA proposed that rates for the mental health rider should change by the same percentage as the base plan to which it is attached. MEGA proposed no change in rates for the breast reduction and varicose vein rider. All three of these MEGA proposals are reasonable.

C. *Transition to January 1 Effective Date*

MEGA's contracts allow for implementation of rate increases at any time, with 60 days notice. However, MEGA asserts that in practice, it has delayed implementation for each policy until the policy anniversary. It now proposes to change that practice and implement rate changes on the next premium due date. Both practices – implementation on the next premium due date or on the next policy anniversary – are common in the industry, although most companies follow the practice specified in their contract.

The Advocacy Panel recommends that this change not be allowed and that MEGA be required to amend its contracts to provide that rates can only be changed on the policy renewal date. However, the Panel offered no legal basis for such a requirement. In the absence of contrary legal authority, there appears to be no reason to disallow MEGA's proposed change, provided that all written or verbal guarantees to policyholders are honored. MEGA asserts that in the past, it has guaranteed a rate for the first year by a letter and would honor that guarantee. No other written or verbal guarantees were mentioned, but if any guarantee was or is given, generally or in a specific instance, MEGA must honor it.

FINDINGS and CONCLUSIONS

On the basis of a preponderance of the credible evidence presented and the factors discussed above, the Superintendent CONCLUDES:

1. Appropriate development of allowable rate changes is that set forth in Attachment A hereto, which is made a part hereof; and

2. Resulting acceptable rates are those set forth in Attachment B hereto, which is made a part hereof.

ORDER

Pursuant to the provisions of 24-A M.R.S.A. §§ 211 and 2736-B and authority otherwise conferred by law, the Superintendent hereby ORDERS:

1. MEGA's May 5, 2008 request for approval of rates for individual health products is DENIED.
2. In any revised filing, MEGA must include rates for the state plans that comply with Rule 940 and that reflect an aggregate rate increase that is the same as for other non-scheduled plans.
3. In any revised filing, MEGA shall otherwise take into consideration findings and conclusions made herein.
4. In any filing subsequent to that for 2008, MEGA's rate calculations will employ a methodology for allocation of expenses that recognizes that not all expense items are directly related to premiums.

NOTICE of APPELLATE RIGHTS

This Decision and Order is final agency action as defined by 5 M.R.S.A. § 8002(4). It may be appealed to the Superior Court in the manner provided for by 24-A M.R.S.A. § 236, 5 M.R.S.A. §§ 11001 through 11008, and M.R. Civ.P. 80C. Any party to the proceeding may initiate an appeal within thirty days after receiving this notice. Any aggrieved non-party whose interests are substantially and directly affected by this Decision and Order may initiate an appeal within forty days of the issuance of this decision. There is no automatic stay pending appeal. Application for stay may be made in the manner provided in 5 M.R.S.A. § 11004.

Dated: December 1, 2008

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MILA KOFMAN
Superintendent of Insurance