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

IN RE: BLUE CROSS AND BLUE SHIELD OF MAINE 1999 NONGROUP RATE FILING FOR HEALTHCHOICE, HEALTHCHOICE STANDARD AND BASIC, AND INDIVIDUAL HMO STANDARD AND BASIC PRODUCTS Docket No. INS 99-9	)	DECISION AND ORDER

INTRODUCTION

On June 8, 1999, Blue Cross and Blue Shield of Maine (BCBSME) filed proposed rate increases for certain of its nongroup products. The average rate increase requested for the HealthChoice products is 15.9% and the increases range from 10% to 26% depending upon deductible level and type of contract. The average rate increase requested for the Individual HMO products is 27.3% and the increases range from 18% to 35% depending upon the type of contract and whether it is a Standard or Basic policy. The requested effective date for the increase is October 1, 1999.

A hearing was held on August 11, 1999, in which BCBSME and the Attorney General participated as parties. BCBSME was represented by MaryAustin Dowd, Esq. and Beth Dobson, Esq. Christina Hall, Assistant Attorney General, represented the Attorney General. The Superintendent received testimony and exhibits from the parties as well as written closing statements following the hearing. Additional documentation and analysis, which was not available at the hearing, was provided posthearing at the request of the Superintendent. The Attorney General was provided an opportunity to review the late-filed material and cross-examine the individual who prepared the documents. Following review of the documents, the Attorney General chose not to avail himself of the opportunity for cross-examination.

Testimony from the public was presented at the hearing by Dennis Fortin, a current BCBSME subscriber of an individual product, and Evelyn Pierce, a subscriber to one of BCBSME's individual HMO products. Both individuals clearly articulated the concerns of subscribers regarding whether adequate notice, either before a hearing or before a rate increase is effective, is provided potentially impacted subscribers. Further, Ms. Pierce and Mr. Fortin expressed

dismay over the continued increase in rates for individual products. In addition to the testimony at the hearing, the Superintendent received a number of letters from subscribers expressing similar concerns. Copies of those letters were provided the parties and made part of the hearing record.

STANDARD OF LAW

BCBSME is required by 24 M.R.S.A. § 2321 to file with the Superintendent every proposed rate, rating formula, and proposed modification to a rate or rating formula for, among other things, its nongroup product line. In reviewing such rate filings, it is incumbent upon BCBSME to prove by a preponderance of the evidence the proposed rates are not excessive, inadequate, or unfairly discriminatory. In assuring rates are not inadequate, the Superintendent must approve a rate which allows BCBSME to recover reasonably anticipated claims and administrative expenses and make reasonable contributions to reserves. 24 M.R.S.A. § 2321-A

FINDINGS AND ANALYSIS

In support of its rate filings, BCBSME presented the testimony of John C. Kelly, F.S.A., M.A.A.A., who is the Director of Actuarial Services for BCBSME. The testimony of Sharon Ware, Manager of Individual Sales, also was presented. Rick Marone, Vice-President of Sales, provided limited testimony regarding administrative expenses although no prefiled testimony had been filed for Mr. Marone by BCBSME.

Mr. Kelly testified as to the basis for the rate increase request as well as the assumptions underlying the rates and the methodology used in developing the proposed rates. Specifically, Mr. Kelly identified four reasons for the proposed increases:

1. Current premiums for the individual HMO products are inadequate to cover current claim costs. Although current HealthChoice premiums appear adequate to cover current claim costs, they must be updated to account for continuing increases in claim costs.

2. Current individual HMO premiums are inadequate to cover current administrative expenses. Although current HealthChoice premiums are adequate, they will be inadequate for the next rating period due to BCBSME's continuing loss of enrollment.

3. Financial losses in past years have seriously depleted BCBSME's reserve position.

4. Current HealthChoice rates include no provisions for contribution to reserves; a contribution to reserves is needed in order for BCBSME to continue to meet its obligations to subscribers. Current individual HMO rates include a small contribution to reserves but that is offset by inadequate claim trend and administrative expense provisions.

See Kelly prefiled testimony, page 3, lines 14-17; page 4, lines 1-19; page 5, lines 1-3.

Mr. Kelly testified that BCBSME developed the proposed rates in reliance upon a number of assumptions - claim trend, administrative expenses, commissions, investment income, and contribution to reserve. The methodology used in developing the proposed rates first determined what the incurred claims were for the twelve month experience period ending March 31, 1999. The next step was to determine annualized incurred claims for the rating period of October 1, 1999 to December 31, 2000. Annualized incurred claims were estimated by applying a claim trend assumption of 13.5% to the actual incurred claims.

Additional costs for administrative expenses and commissions are estimated and added to the figure resulting from the previous calculation. An estimated interest credit is calculated as a reduction to costs and then a component for contribution to reserve is added. BCBSME ends up with an estimate of its annualized revenue requirements during the rating period assuming the product's enrollment, including the product mix, does not change relative to the experience period. Mr. Kelly stated in his prefiled testimony that it was ascertained by BCBSME the revenue requirements determined by the above calculations exceed the revenue produced by the current rates by 12.9% for HealthChoice and 51.3% for nongroup HMO.

The Attorney General presented the testimony of Thomas J. Stoiber, F.S.A., M.A.A.A., and Paul T. Swoboda, a health policy and health finance consultant. Through the testimony of Mr. Stoiber and Mr. Swoboda, the Attorney General raised questions as to the following:

1. The suitability of the rating period selected by BCBSME;

2. the appropriateness of the claim cost methodology used by BCBSME in developing the proposed rates including the appropriateness of the 13.5% claim trend used and the credibility of the experience data;

3. the appropriateness of the methodology used to calculate and the resulting amount of administrative expenses;

4. the reliability of the investment income methodology used by BCBSME;

5. the appropriate level of contribution to reserve; and

6. the propriety of having HealthChoice subscribers subsidize the nongroup HMO rates in order to moderate nongroup HMO premiums.

INVESTMENT INCOME METHODOLOGY

Following the hearing, the Attorney General withdrew his objection to the investment income methodology utilized by BCBSME in developing the proposed rates.

RATING PERIOD

BCBSME filed rates for a fifteen month period commencing October 1, 1999 and ending December 31, 2000. The purpose of the fifteen month period is to get all nongroup products on the same calendar year rating cycle as of January 1, 2001. While BCBSME and the Attorney General agree that all nongroup products should be on the same cycle for rating purposes, the Attorney General favors deferring implementation of the current rate request to January 1, 2000 with a twelve month rating period.

In the event that the increase is implemented October 1, 1999, the Attorney General argues that using the twelve month period would moderate the magnitude of the rate increase and would provide a better basis for projecting pricing needs for the subsequent rating period. See Summary argument of the Attorney General to Superintendent Iuppa dated August 16, 1999. BCBSME counters that subscribers are best served by bringing the rating periods in line with a January 1 effective date and that a delay in the effective date will result in losses to BCBSME of approximately $475,000 per month.

There is no dispute as to the benefit of having all nongroup products on the same rating cycle with an effective date of January 1. In order to accomplish that goal, either some rating period will have to be other than twelve months or BCBSME will have to continue to endure losses on these products for the additional months needed to bring them in line. The current rates were designed to be in effect only through September 30, 1999. The current rates for HealthChoice and nongroup HMO combined are inadequate, another point which does not appear to be in dispute. To require BCBSME to use existing rates through December 31, 1999 would be to require BCBSME to suffer additional losses on these products in contravention of the statutory mandate that BCBSME be permitted to charge rates which are not inadequate. Therefore, an effective date of November 1, 1999 is justified.

Moreover, the rating period should run from November 1, 1999 to December 31, 2000 thereby placing all nongroup products on the same rating cycle. The change in effective date from October 1, 1999 to November 1, 1999 will necessitate modifications to the filed rates. The rate should be recalculated using the new effective date, as opposed to simply multiplying the proposed

increase by a factor of 15/14, and in a manner consistent with other provisions of this Decision and Order.

CLAIM COST METHODOLOGY

In developing its trend assumption of 13.5% for claim costs, BCBSME analyzed observed trends in incurred claims for each quarter going back to the second quarter of 1997. The data shows that annual trend has been in the range of 11.6-14.9% with the assumed trend for the pending filing falling in the middle of that range. The 13.5% is well below the 54% trend for individual HMO since October, 1998 and does not provide for any additional risk deterioration in response to the proposed rate increases.

The Attorney General asserts that BCBSME's methodology for determining claim costs ignores the continuing changes in the mix of nongroup business by deductible. BCBSME counters that no adjustment is required because each deductible is priced at a self-supporting level so that a shift from one deductible to another will impact revenues and expenditures equally. However, neither the filing nor the testimony presented provide any support for rate relativities by deductible. Since the Attorney General concludes that the rate relativities relied upon by BCBSME are not correct as evidenced by retrospective analysis of last year's filing and subsequent experience, he argues that the shift from one deductible to another will not impact revenues and expenditures equally.

BCBSME responds to the Attorney General's argument regarding rate relativities by pointing out that discrepancies between projected and actual expenses are due to a conservative trend factor and not to deductible relativities. The Attorney General's consultant, Thomas Stoiber, testified that the discrepancy appears to be more than statistical fluctuation, however, he offers no support for this conclusion. In fact, Mr. Stoiber's conclusion appears to contradict his testimony that the trends show enormous volatility and the experience, therefore, is not credible. Prefiled Testimony of Thomas J. Stoiber, F.A.A., M.A.A.A. at page 9, lines 16-17. Since the Attorney General offers no direct analysis of the deductible relativities and bases his conclusion only on a retrospective analysis which could have other explanations, the Superintendent cannot conclude that BCBSME's claim cost methodology is faulty. However, in future filings, BCBSME should provide support for the rate relativities used.

ADMINISTRATIVE EXPENSES

Included in any rate calculation is a component for administrative expenses. BCBSME proposed that the administrative expense component for the pending nongroup rate filing be equal to the average administrative component in the pricing of its group products. See Prefiled Testimony of John C. Kelly at page 13, line 14-17 and page 14, line 1. The justification put forth by BCBSME for calculating the administrative expense component in this way is that: 1) the methodology is the same as that used in last year's rate filing approved by the

Superintendent; 2) the proposal is more favorable to individual subscribers than the industry standard of assuming higher administrative expenses for individual business; and 3) the expense allocation accounting system used by BCBSME has proven inaccurate and unreliable.

The Attorney General asserts the Superintendent is not required to accept the assumptions underlying last year's filing by BCBSME particularly with respect to administrative expenses. Moreover, the methodology used, according to the Attorney General, does not permit a reasonable assessment of whether the nongroup products are being charged for group expenses. For example, in the view of the Attorney General, significant differences in claims processing expenses exist between nongroup and group products with fewer expenses attributable to high deductible nongroup products than low deductible group products. With regard to the statements of BCBSME asserting serious deficiencies in its accounting system, the Attorney General contends the filing contains insufficient information to accept the significant increases for costs even assuming the deficiencies asserted. The figures and assumptions relied upon by BCBSME for administrative expenses are faulty and result in unlikely data patterns, according to the Attorney General.

As correctly noted by the Attorney General, BCBSME's rate filing does not utilize data generated by its expense allocation accounting system to determine the administrative expense component of the proposed rates. It is BCBSME's belief that the results generated by the system are not reasonable because the results indicate lower expenses per member for nongroup products than for group products. Thus, the filing relies, instead, upon the average expenses for group and nongroup combined (excluding Medicare Supplement) on the assumption that nongroup expenses should be at least as much as the average of group expenses.

The consultant for the Attorney General, Mr. Swoboda, testified that given the much higher deductibles for nongroup, it may not be unreasonable for nongroup expenses per member to be less than group. Mr. Swoboda's theory is that since high deductible policies generate far fewer claims, the cost of claims administration is less. As a result of Mr. Swoboda's testimony, the Superintendent requested that BCBSME prepare and file an expense analysis showing expenses as a percentage of premium rather than a fixed amount per member. One would expect that allocating by percentage of premium automatically would attribute less expense to a high deductible policy since the policies have lower premiums.

BCBSME submitted the requested analysis which showed nongroup expense estimates slightly less than those in the filing, but still significantly greater than those from the expense allocation system. The percentage of premium allocation method seems to support BCBSME's contention that its expense allocation system does not produce reasonable results. It is imperative that BCBSME identify and correct the problems with its expense allocation system;

however, it would not be prudent to delay action on the pending rate filing until accurate expense information is available.

Because the expense allocation system is unreasonable, a rough estimate of expenses must be used. Both the method used in the filing and the percentage of premium analysis are based on the overall group and nongroup expenses for the company. Thus, the results of the calculations are appropriate only if those overall expenses are reasonable.

If the overall expenses are excessive, the resulting nongroup expense factors may also be excessive. One way to assess the reasonableness of the overall expenses is to compare BCBSME's expense levels to those of similar companies. While the industry expense information BCBSME was able to provide was somewhat sketchy, there is nothing in the record to indicate that its expenses are out of line with the industry. Nonetheless, BCBSME should provide better information on administrative expenses including industry expense comparisons in future filings.

Since BCBSME's expense allocation system is unable to provide accurate information and a rough estimate must be used, it is appropriate for that estimate to err on the low side. For the reasons noted above, the percentage of premium analysis produced lower expense factors than the per member per month method used in the filing. Therefore, the expense components based on the percentage of premium analysis should be used. For a 15 month rating period, the expense factors should be $24.87 PMPM for HealthChoice and $28.60 PMPM for the individual HMO plans. An appropriate adjustment should be made for a 14 month rating period.

CONTRIBUTION TO RESERVES

BCBSME proposes a contribution to reserves in the pending rate filing of 1.5% for a 12 month rate or 1.0% for a 15 month rate. It is BCBSME's position that a much higher contribution to reserves could be justified. The contribution to reserves was kept lower in order to limit the affect of the rate increase on subscribers.

The Attorney General asserts the proposed contribution to reserves is not justified for two reasons. First, the HealthChoice reserves are more than the three month target generally used to govern nongroup rates. Second, in the opinion of the Attorney General, HealthChoice and individual HMO should be considered separately in determining a contribution to reserves. An appropriate contribution to reserves, according to the Attorney General, would be zero for HealthChoice and 1.0% for individual HMO.

No support has been provided for the Attorney General's position that HealthChoice and individual HMO products should be considered separately for reserve purposes. The two product lines are alternatives offered in the same

market making it likely that some individuals switch between them. There is no more reason to treat HealthChoice and individual HMO separately for reserve purposes than to treat different HealthChoice deductible options separately. Further, since these products are being combined for rating purposes, it follows that the reserves should also be combined. There is no basis in the record for finding that the contribution to reserves proposed by BCBSME is inappropriate.

RELATIONSHIP BETWEEN HEALTHCHOICE AND INDIVIDUAL HMO RATES

According to the calculations completed by BCBSME, the indicated premium increase for individual HMO is much greater than that being requested. Mr. Kelly stated in his prefiled testimony that the indicated increase for the individual HMO was reduced while the indicated increase for HealthChoice was increased. The reason for having HealthChoice subsidize individual HMO is to assure consistency in the pricing of the product options in the individual risk pool which, in turn, should promote greater stability in the pool. Prefiled Testimony of John C. Kelly, F.A.A., M.A.A.A. at page 12, lines 14-18. As a result of the continued deterioration in the individual HMO product, subsidization is necessary in order to achieve the desired price consistency. Additionally, BCBSME does not believe the remaining individual HMO subscribers, of which there are approximately 1,000, should be asked to bear all of the impact resulting from continued deterioration.

While the Attorney General agrees with the basic approach used by BCBSME to achieve consistency in pricing between HealthChoice and individual HMO, he strongly objects to requiring HealthChoice subscribers subsidize individual HMO. See Summary argument of Attorney General dated August 16, 1999. Such a practice, according to the Attorney General, is unfairly discriminatory to HealthChoice subscribers. In the view of the Attorney General, any subsidization should come from the group lines because the offering of a nongroup HMO product occurs as a condition of offering a group HMO product.

The subsidization of one product by another is entirely consistent with the principles of community rating embodied in Maine's health insurance laws. Based upon principles of community rating, carriers are prohibited from varying rates based on health status. To the extent different product offerings have the effect of segregating insureds by health status, rating each product based on its own experience subverts the intent of the law. By pooling all products and basing rate differentials only on differences in benefits, this is avoided.

As for the Attorney General's assertion that individual HMO should be subsidized by group HMO because BCBSME is required to offer individual HMO as a condition of offering group, such is not the case. The current law does not contain nor imply any requirement for such a subsidy. While the idea of a group to individual subsidy may have merit, such a requirement would have to be implemented by the Legislature on a market wide basis, rather than for just one

carrier, in order to preserve a level playing field. The Superintendent does not have the authority to impose such a requirement.

Given the unreliability of the administrative expense figures included in calculating the rates for this filing, the Superintendent finds the filed rates to be excessive. BCBSME may amend its filing using the percentage of premium analysis which, for a 15 month rating period, would produce expense figures of $24.87 per member per month for HealthChoice and $28.60 per member per month for the individual HMO plans. Additionally, BCBSME originally requested an effective date of October 1, 1999. The Attorney General believes an effective date of January 1, 2000 would be more appropriate. In light of the fact there is insufficient time for the rates to become effective October 1, 1999, and in consideration of the financial difficulties currently being experienced by BCBSME, the Superintendent finds an effective date of November 1, 1999 to be appropriate. BCBSME may amend its filing by recalculating the rates using the effective date of November 1, 1999 as a pricing assumption, instead of October 1, 1999, with a 14 month rating period.

ORDER

Pursuant to 24 M.R.S.A. §§ 2321, 2321-A, and 2323, it is hereby ORDERED:

1. Approval of the filed rates for the HealthChoice nongroup product lines and individual HMO product lines is DENIED;

2. Revised rate filings may be submitted for review on or before September 14, 1999, and shall be APPROVED, effective November 1, 1999, if found to be consistent with the terms of this Decision and Order;

3. BCBSME shall include, in all future rate filings, support for rate relativities by deductible;

4. BCBSME shall include, in all future rate filings, a comprehensive analysis of industry expense information including, without limitation, a comparison between BCBSME and other comparable Blue Cross Blue Shield entities;

5. BCBSME shall identify the problems which exist with regard to its expense allocation system and shall file with the Superintendent, on or before, July 1, 2000, a schedule for correcting the identified problems; and

6. BCBSME shall continue to submit all informational filings required pursuant to prior Decisions and Orders of the Superintendent, including, without limitation, reports on costs containment, cost allocation, efficiency and cost-effectiveness of marketing.

This Decision and Order is a final agency action within the meaning of the Maine Administrative Procedure Act. It is appealable to the Superior Court in the manner provided in 24-A M.R.S.A. § 236 and M.R.Civ.P. 80C. Any party to the hearing may initiate an appeal within 30 days after receiving this notice. Any aggrieved non-party whose interests may be substantially and directly affected by the Superintendent's decision may initiate an appeal within 40 days of the date 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.

NOTICE OF APPEAL RIGHTS

This Decision and Order is a final agency action of the Superintendent of Insurance within the meaning of the Maine Administrative Procedure Act. It is appealable to the Superior Court in the manner provided in 24-A M.R.S.A. § 236, 5 M.R.S.A. § 11001-11007, and M.R. Civ. P. 80C. Any party to the proceeding may initiate an appeal within thirty (30) days after receiving this notice. Any aggrieved non-party whose interests are substantially and directly affected by this Decision may initiate an appeal within forty (40) days of the date 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.

PER ORDER OF THE SUPERINTENDENT OF INSURANCE

DATED: September 8, 1999

ALESSANDRO A. IUPPA
Superintendent of Insurance