

Medical Loss Ratio (MLR)



Items to be Discussed



- The role of actuarial estimates and the MLR
- The federal rebate formula and rating with a single risk pool
- Developing premium rates using an MLR approach – or not
- The disadvantages of using an MLR standard

Impact of Actuarial Estimates on MLR



- Since the MLR is based on a number of actuarial estimates, those estimates can impact the rebate.
 - Incurred but not paid estimates are included in past incurred claims amounts

Current timing for final MLR reporting is June 1, but will be moving to July 31. This equates to up to 3 months of run-out currently and 5 months of run-out using the new MLR reporting date.

- Also, the projected or target MLR used when developing rates is the result of actuarial estimates.
 - Projected incurred claims are all estimates
 - The projected claims for 2014-2016 will be more difficult to estimate than ever – the result will be less accurate MLR estimates than ever

Impact of Actuarial Estimates on MLR



Example of risk adjustment estimate, which must be the same for all plans

	Plan A	Plan B	Total
Projected average incurred claims	\$5,000	\$5,000	\$10,000
Projected incurred claims with selection	\$4,500	\$5,500	\$10,000
Plan specific projected risk adjustment	-\$500	\$500	\$0
Average risk adjustment	0	0	0
Premium	\$6,250	\$6,250	\$12,500
Actual incurred claims	\$4,500	\$5,500	\$10,000
MLR	72%	88%	80%

Impact of Actuarial Estimates on MLR



What if the projected incurred claims with anticipated selection are 5% too high?

	Plan A	Plan B	Total
Projected average incurred claims	\$5,000	\$5,000	\$10,000
Projected incurred claims with selection	\$4,500	\$5,500	\$10,000
Average risk adjustment	0	0	0
Premium	\$6,250	\$6,250	\$12,500
Actual incurred claims	\$4,275	\$5,225	\$9,500
MLR	68%	84%	76%

MLR Rebate Formula and Single Risk Pool



- The products within the single risk pool may have loss ratios that are different than the federal rebate formula
 - What is implied by a single risk pool?
 - What will be the MLR of the single risk pool and/or of the individual products or plans?

The MLR rebate formula is at the same level of aggregation as the single risk pool – market (individual or small group) and state

Products and plans are at a lower level of aggregation

MLR Rebate Formula and Single Risk Pool



- The hierarchy of aggregation in a market is:
 - Market – individual or small group
 - Metal level – EHB of AV of 60%, 70%, 80% or 90% and Catastrophic
 - Products can vary by adding additional benefits
 - Plans can vary by provider network and cost sharing

Rating Process Using an MLR



- a) Project incurred claims – actuarial projection
 - i. Historically trends were the largest driver
 - ii. 2014-2016 there are many other new factors that will be needed
 - i. Population covered – health relative to current population and pent up demand of the currently uninsured
 - ii. Impact of reduced cost sharing due to subsidies and richer benefits in general
 - iii. Risk adjustment and reinsurance from the 3Rs

The application of adjustments for risk adjustment and reinsurance alone will result in projected incurred claims after adjustment that will not equal the actual incurred claims that will be experienced by any product or plan.

Rating Process Using an MLR



- b) Apply loss ratio
- c) Using a loss ratio is as easy as projecting claims and dividing by a loss ratio. There then has to be a number of “reality checks.”
 - 1. Are there regulatory constraints, such as the projected MLR requirement in NJ?
 - 2. What is the competition going to be and will these rates sell?
 - 3. Are the resulting rates affordable?
 - 4. Will rate shock result in the healthier leaving the market (even with the mandate) thereby raising per member per month (PMPM) incurred claims even more?
 - 5. Is the product portfolio priced in a way that makes sense when looking at one set of rates compared to others?

Rating Process Using an MLR



d) Problems of using an MLR to price products

- i. Administrative cost is not % of premium
 - 1. Marketing and sales – percent of premium typically, but can be PMPM
 - 2. Enrollment and billing – PMPM
 - 3. Claims processing – per claim, which equates closely to incurred claims
 - 4. Overhead (accounting, executive compensation, computer systems) – allocated by PMPM or % of premium, but are fixed cost not relative to claims costs
- ii. The formula ignores the actual cost of administering the business, which may be more than the 20% of premiums. Pricing using a loss ratio assumes that the remaining funds will be sufficient to pay for marketing costs, administrative costs, taxes and regulatory fees, risk margins, etc.

Rating Process Using an MLR



d) Problems of using an MLR to price products (cont.)

- iii. If premium is “leveled” to ignore health status, the premium will be the same, but the cost of processing claims will be different. For example, a group of policies that attract a less healthy population will have more claims to process and possibly more complex claims. This requires more resources to process claims; however, because the premium does not reflect the health status, the percent of premium available for administrative cost will not be higher than the administrative cost for healthy populations. An MLR rating method may not provide sufficient administrative dollars for the administration of high cost populations.

Rating Process Using an MLR



Amount left for administrative costs – RA will adjust, but there are issues with timing and effectiveness of RA

	Plan A	Plan B	Total
Projected average incurred claims	\$5,000	\$5,000	\$10,000
Projected incurred claims with selection	\$4,000	\$6,000	\$10,000
Average risk adjustment	0	0	0
Premium	\$6,250	\$6,250	\$12,500
Administrative cost	\$2,250	\$250	\$2,500

Rating Process Using an MLR



- e. What if you do not use an MLR to price – is that better?
 - i. Premium development
 - 1. Project claims as before
 - 2. Administrative cost is based on actual expected cost
 - 3. Profit margins are based on required profits
 - ii. The “reality checks” still must be reviewed, but now the MLR may not meet regulatory standards or be affordable, but it is a better estimate of actual costs.

Disadvantages of an MLR standard



- a. Claims costs increase faster than administrative costs
 - i. Medical inflation and claims cost trend
 - ii. Administrative cost and profit trends
- b. No incentive to manage healthcare costs – ignoring competition and affordability. An 80% MLR equates to 25% of claims available for administrative costs and profits.

If the projected incurred claims are \$8,000, then by using an MLR rating methodology, the premium will be \$10,000 or $\$8,000 / .80$. The amount available for administration or profits will be \$2,000 or 25% of the claim amounts.

Disadvantages of an MLR standard



Medical trends over administrative trends

Impact of 7% medical and 3% administrative trends			
Year	0	5	10
Premium	\$3,750	\$5,260	\$7,377
Claims	\$3,000	\$4,208	\$5,901
Administrative cost and profit	\$750	\$1,052	\$1,475
Administrative cost and profit at 3%	\$750	\$869	\$1,008
Inflated		21%	46%

Disadvantages of an MLR standard



- c. Areas or populations with low claims costs may result in allowances for administrative costs that are too low – not an issue in New Jersey

