Massachusetts Division of Insurance

Analysis of the Impact of Small Group Rating Rules Applying to Employer Groups with Between 51-100 Employees

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Analysis in this report was based on data provided by carriers in the Massachusetts health insurance markets. Gorman Actuarial has not audited this information for accuracy. We have performed a limited review of the data for reasonableness and consistency. If the underlying data is inaccurate or incomplete, the results of this analysis may likewise be inaccurate or incomplete.

The assumptions and projections included in this report are based on our understanding of the ACA and the associated regulations as of the report date. Future regulatory and legislative actions may materially change the impact of the ACA and invalidate certain assumptions or projections presented in this report. Therefore this report should be considered time-sensitive and results may change as new information becomes available.

It should be noted that this report is based upon federal rules published at the time of the analyses conducted in the fall of 2012 and may not reflect any rules, regulations or guidance after that time.

Qualifications

This study includes results based on actuarial analyses conducted by Bela Gorman and Jenn Smagula, who are members of the American Academy of Actuaries and Fellows of the Society of Actuaries, and who meet the qualification standards for performing the actuarial analyses presented in this report.

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1. Executive Summary: Key Findings

In CY 2016, when the 51 to 100 Fully Insured Market is defined as part of the Small Group Market, the following will likely occur:

- Average rates will change:
  1) Rates for individuals and employers in the existing 1-50 Market will decrease by an average of approximately two percent.
  2) Rates for employers with between 51 and 100 employees will increase by approximately seven percent.

- Many employers with between 51 and 100 employees could experience rate shocks as premiums increase or decrease from the application of small group rating factors:
  1) With the standardization of rating factors, many existing rating variables will no longer be permitted.
  2) Younger groups likely will see premium increases, while older groups likely will see premium decreases.
  3) Modeling indicates that:
     - 23 percent of the market, or approximately 58,000 members, will experience premium decreases greater than ten percent; approximately 5,000 of those 58,000 members will experience premium decreases greater than 30 percent.
     - 40 percent of the market, or approximately 99,000 members, will experience premium changes between minus ten percent and plus ten percent.
     - 37 percent of the market, or approximately 93,000 members, will experience premium increases greater than ten percent; approximately 28,000 of those 93,000 members will experience premium increases greater than 30 percent.

- Employers with between 51 and 100 employees who may be healthier than average may choose to self-insure, thereby removing themselves from the merged market risk pool, which will lead to moderate increases in rates over time.

- Employers with between 51 and 100 employees may lose access to their existing health benefits as they will be required to obtain the same types of coverage available for those in the existing 1-50 Market.

2. Introduction

With the implementation of provisions of the ACA, states such as Massachusetts need to understand the impact of various components of the law on their health insurance markets. This will allow states to make policy decisions to best implement the ACA in their own area.

The ACA requires that, no later than January 1, 2016, a state's small group market must be defined as groups of 1 to 100 eligible employees. This means that all small group market rules must apply to employers with between 1 and 100 eligible employees. This definitional change will result in a merging of the 1 to 50 Market with the 51 to 100 Market. The ACA further permits states to make this definition change as early as January 1, 2014.

Merging market segments requires insurance carriers to pool the claims experience from each market when establishing premium rates for the merged market. When markets with differing health experience, or morbidity, and administrative costs are merged into one rating pool, the healthier and lower cost market segment may subsidize the less healthy, higher cost market segment. This means that the healthier market segment will experience premium increases while the less healthy market segment will experience premium decreases.

In addition to the pooling of experience, those employers in the 51-100 Market will be subject to the current 1-50 Market rules. As such, coverage will be available on a guaranteed issue basis and groups will be charged premiums according to the rating factors permissible in the 1-50 Market. In addition, the product offerings available to the 51-100 Market will be the same ones currently available to the 1-50 Market. The rating formula change will cause premium "winners and losers"; that is, some of the 51-100 Market groups with older employees will receive premium decreases and some with younger employees will receive premium increases due to the rating formula changes.

The Massachusetts 1-50 Market rules currently apply to health coverage issued or renewed to individuals and small employers with between 1 and 50 eligible employees. The Division has engaged Gorman Actuarial, LLC to understand the impact of expanding this market to include individuals and small groups with between 1 and 100 employees. Gorman Actuarial also has analyzed the potential market impact of groups from this segment that may elect to self-insure, or otherwise drop coverage.

3. Small Group Market Law

The rules that apply to the 1-50 Market in Massachusetts are defined in M.G.L. c. 176J and 211 CMR 66.00.

Existing State Law for Small Group Coverage

Since 1992, pursuant to M.G.L. c. 176J and 211 CMR 66.00, insurance carriers that offer insured health plans to eligible small employers must offer them on a guarantee issue basis. The law and regulation also require that premiums charged only be based on certain permissible rating factors, which limit the range of premiums charged to be within a mandatory rating band. Chapter 176J was amended in 1996 to expand what was then limited to a 1 to 25 eligible employee market to a 1 to 50 eligible employee market, as well as to modify the permissible factors that could be used to develop premiums. Chapter 176J was further modified in 2006 to merge a separate guarantee issue individual market into the existing 1 to 50 eligible employee market, as well as to make further changes in the allowable factors that could be used in developing individual premiums.

No carrier offering coverage in the 1-50 Market may use any individual's or small group's prior or projected medical treatment needs in developing premiums; carriers only are permitted to vary premiums by applying certain rating factors to the base premiums developed across the merged market for a particular product. According to M.G.L. c. 176J, § 3 and 211 CMR 66.08, carriers may develop and use the following rating factors within a 2-to-1 rating band: age, industry, employee participation rate, participation in wellness programs and tobacco usage. Carriers also are permitted to apply the following rating factors outside the 2-to-1 rating band: geographic location, the relative level of benefits in a health plan, group size, use of an intermediary or group purchasing cooperative to obtain coverage, or rate basis type of the family.[1]

Changes Required Under Federal Law

When fully implemented between 2014 and 2016, the ACA will require that all state insurance markets meet the small group market guarantee issue and rating rules defined in federal law, regulations and associated guidance. Although most rating rules are effective on January 1, 2014, the required expansion of states' small group markets to include groups with between 51 and 100 eligible employees may be postponed until January 1, 2016. This report examines the impact of this definitional change in the Commonwealth.

Transition Rules January 1, 2014 to December 31, 2015

On April 5, 2013, the federal Center for Consumer Information and Insurance Oversight ("CCIIO") granted Massachusetts permission to continue the use of certain state rating factor adjustments during a January 1, 2014 through December 31, 2015 transition period. CCIIO has allowed a transition period for certain rating factors that are otherwise disallowed under the Affordable Care Act. For policy years beginning on or after

[1] Premiums usually are offered as individual, dual, family, parent and child rate basis types.

January 1, 2016, issuers must be in full compliance with the rating rules under the Public Health Services Act section 2701.[2]

4. Market Segment Comparisons

For data we have received from specific information requests to the carriers, we have obscured each carrier's identity throughout this report so that data associated with a particular carrier cannot be identified. Not only have we used labels such as "Carrier A", "Carrier B", etc., we also have used these labels inconsistently so that carriers' identities cannot be discerned. For information that is publicly available, we did not obscure the carrier's identity.

Membership

Membership by carrier for the 1-50 Market, as reported to the Division by the carriers[3] is shown in Table 1. As of December 31, 2011, there were approximately 719,000 total members in the 1-50 Market.

[2] Commonwealth of Massachusetts, Division of Insurance, Bulletin 2013-05

[3] Note that the membership BCBSMA reported to the Division was approximately 30,000 greater than the membership collected as part of this examination.

Table 1 – 1-50 Market Membership as of 12/31/2011

Massachusetts Individual & Small Group Membership by Carrier		
	Covered Lives as of 12/31/2011	Percentage of Total
Blue Cross Blue Shield of Massachusetts HMO Blue, Inc.[3]	295,228	
Blue Cross Blue Shield of Massachusetts, Inc.	10,913	
Total BCBSMA	**306,141**	**43%**
Fallon Community Health Plan, Inc.	42,639	
Fallon Health & Life Assurance Company	2,799	
Total Fallon	**45,438**	**6%**
Harvard Pilgrim Health Care, Inc.	167,585	
HPHC Insurance Company, Inc.	11,581	
Total HPHC	**179,166**	**25%**
Health New England, Inc. (HNE)	**22,734**	**3%**
Neighborhood Health Plan, Inc. (NHP)	**38,718**	**5%**
Tufts Associated Health Maintenance Organization, Inc.	102,898	
Tufts Insurance Company	2,925	
Tufts	**105,823**	**15%**
All Other Carriers	**21,064**	**3%**
Grand Total	**719,084**	**100%**

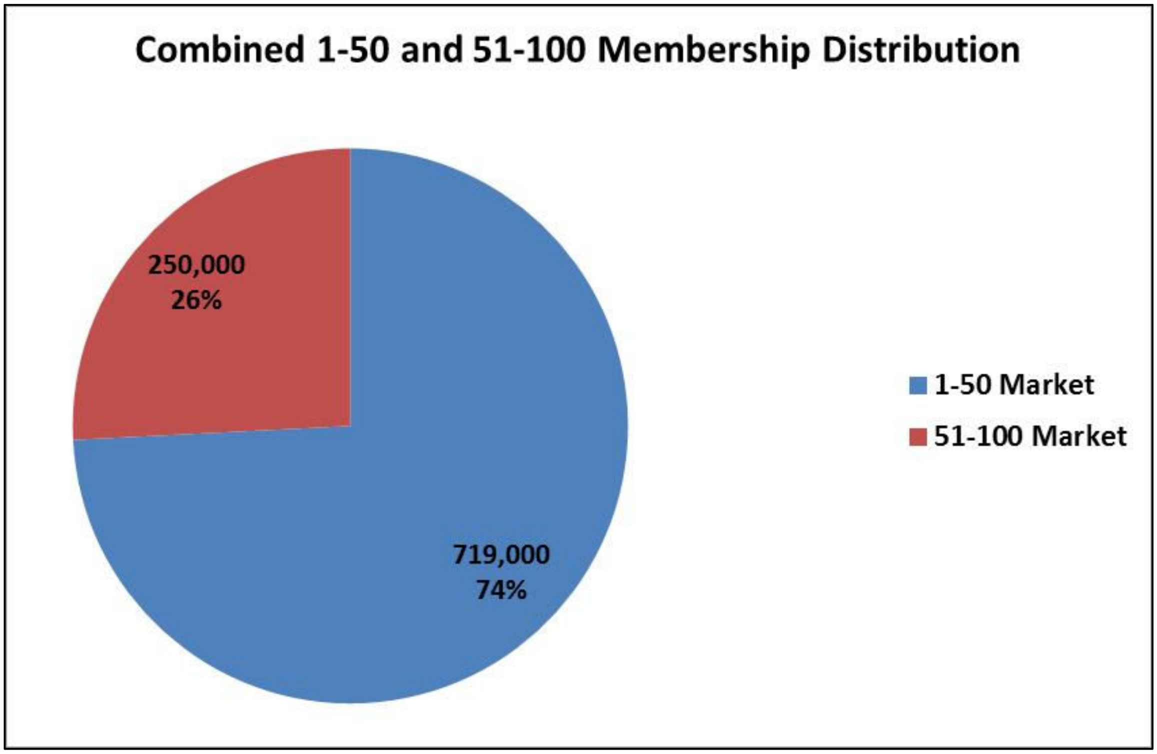
Gorman Actuarial requested and received data from the six largest Massachusetts small group carriers that are responsible for 97 percent of the coverage in this market. These six carriers are:

- Blue Cross Blue of Shield of Massachusetts HMO Blue, Inc. and Blue Cross Blue Shield of Massachusetts, Inc. (collectively referred to as "BCBSMA")
- Fallon Community Health Plan, Inc. and Fallon Health & Life Assurance (collectively referred to as "Fallon")
- Harvard Pilgrim Health Care, Inc. and HPHC Insurance Company, Inc. (collectively referred to as "HPHC")
- Health New England, Inc. ("HNE")
- Neighborhood Health Plan, Inc. ("NHP")
- Tufts Associated Health Maintenance Organization, Inc. and Tufts Insurance Company (collectively referred to as "Tufts")

Information was collected for each carrier's existing 1-50 Market business, as well as estimates for business from employers with between 51 and 100 eligible employees. The information collected included financial information, demographics, actuarial values of benefit plans, rating methodologies and rating factors for each market segment.

It is estimated that there are 250,000 covered persons in the 51-100 Fully-Insured Market. As such, the 51-100 Market represents 26 percent of an expanded merged market that includes employers with 1 to 100 eligible employees, as shown in Figure 1.

Figure 1 – Membership by Market Segment as of 12/31/2011



Claims and Financial Experience

In analyzing the experience in the two markets, Gorman Actuarial examined the historical differences in claims and premium between the 1-50 Market and the 51-100 Market. As noted in Table 2, the overall allowed[4] claims per member per month ("PMPM") for the 1-50 Market is five to six percent higher than the 51-100 Market, and the incurred[5] claims PMPM for the 1-50 Market is two to five percent higher than the 51-100 Market. The relative claims difference between these two market segments varies by carrier, where the allowed claims PMPM in the 51-100 Market ranges from being ten percent lower to nine percent higher than the allowed claims PMPM in the 1-50 Market. The loss ratios combined across all carriers for the two segments (which for Table 2 is defined as incurred claims divided by earned premium) is within two percentage points for each of the two time periods.

[4] We define allowed claims as paid claims by the insurance carrier plus member cost sharing.

[5] We define incurred claims as claims paid by the insurance carrier for services incurred within a given time period.

Table 2 – Financial Information for 1-50 and 51-100 Markets[6]

	CY 2010		
	1-50 Market	51-100 Market	Difference (1-50 compared to 51-100)
Allowed Claims PMPM	$406	$382	6%
Incurred Claims PMPM	$354	$339	5%
Premium PMPM	$392	$386	2%
Loss Ratio	0.90	0.88	2%
	CY 2011		
	1-50 Market	51-100 Market	Difference (1-50 compared to 51-100)
Allowed Claims PMPM	$421	$401	5%
Incurred Claims PMPM	$364	$356	2%
Premium PMPM	$421	$413	2%
Loss Ratio	0.86	0.86	0%

Distribution of Membership

Gorman Actuarial examined the age distribution in the 1-50 Market, as compared to the 51-100 Market segment. The age distributions are fairly similar, as shown in Table 3. The overall average age in the 1-50 Market is nearly identical to the 51-100 Market, at 35 years. The age distribution and average age of the 1-50 Market and the 51-100 Market also is fairly similar within each carrier.

Table 3 – Membership Distribution by Age Band as of 12/31/2011

Membership Distribution as of 12/31/2011		
Age Band	1-50 Market	51-100 Market
0-18	24%	24%
19-34	22%	23%
35-49	26%	26%
50+	28%	26%

Formulas Used to Derive Premiums

The rating formula for the 51-100 Market generally is more complex than that for the 1-50 Market. Table 4 shows the different rating adjustments used by carriers in the 1-50 Market and Table 5 shows rating adjustments used in the 51-100 Market.

[6] One carrier was not able to report on CY 2010 information. For purposes of this table, this carrier is excluded from the financial information for both CY 2011 and CY 2010.

Table 4 – 1-50 Market Rating Practices September 2012

	1-50 Market Rating Practices by Carrier					
Carrier	Age	Geography	Group Size	Industry	Participation	Intermediary Discount
A	Yes	No	Yes	No	No	Yes
B	Yes	Yes	Yes	Yes	Yes	No
C	Yes	Yes	Yes	Yes	No	No
D	Yes	Yes	Yes	Yes	No	Yes
E	Yes	Yes	Yes	Yes	No	No
F	Yes	Yes	Yes	Yes	Yes	No

As shown in Table 4, in the 1-50 Market the variation among carriers is primarily due to the use of participation factors and intermediary discounts. There also is variation among carriers as to how age and conversion factors are applied, which will be examined by Gorman Actuarial in a companion analysis and report.

Table 5 – 51-100 Market Rating Practices

	51-100 Market Rating Practices by Carrier					
Carrier	Age	Gender	Geography	Group Size	Industry	Specific Experience / UW Judgment
A	Yes	Yes	Yes	Yes	Yes	Yes
B	Yes	Yes	Yes	No	Yes	Yes
C	Yes	Yes	Yes	No	No	Yes
D	Yes	Yes	Yes	No	Yes	Yes
E	Yes	Yes	Yes	No	Yes	Yes
F	Yes	No	Yes	No	Yes	Yes

As shown in Table 5, there is not significant variation among carriers as to which rating factors are used in the 51-100 Market. There is, however, variation as to the range of factors used and how these factors are applied. For example, there is variation among each carrier's use of account-specific claims experience or underwriting judgment in their rating formula, which is difficult to quantify.

The use of account specific claims experience and underwriting judgment also is a key driver of the rating formula differences between the 1-50 Market and the 51-100 Market. Only one of the carriers reported using account specific claims experience directly in their 51-100 Market rating formula by applying a credibility table to the claims. The remaining five carriers use account specific experience as a guide in their underwriting formula to determine if a surcharge or discount is applied to the final rate.

Most carriers were not able to report on the overall surcharge or discount which results from underwriting judgment. When the small group market is expanded in Massachusetts to include employers with between 51 to 100 employees, carriers no longer will be allowed to use account specific claims experience and underwriting judgment in the 51-100 Market. This may lead to premium increases for the younger, healthier groups and premium decreases for the older, sicker groups.

In addition to the differences in the use of account specific claims experience and underwriting judgment, the 51-100 Market rating formula also differs from the 1-50 Market rating formula in other ways. For example, most carriers use gender rating in the 51-100 Market and this is not permitted in the 1-50 Market. Also, some carriers define rating regions differently or use different geographic rating factors in the 51-100 Market than they use in the 1-50 Market.

Relative Benefit Values

Overall actuarial values were collected from the carriers in each of the two market segments. For purposes of this report, actuarial value is defined as the relative value of benefits for a specific plan compared to the value of benefits for the richest plan offered by any carrier, expressed as a ratio. The differences in actuarial value between two plans should only be driven by member cost sharing differences, the breadth of covered services, and any assumptions on induced demand. Network differences were not reflected in actuarial value, nor were differences due to anticipated variation in health status or other demographic differences by plan. Note this definition is different from the federal definition of actuarial value.

Of the carriers that were able to report actuarial value, the overall average actuarial value of the benefit plans in the 51-100 Market was approximately eight percent higher than the overall average actuarial value in the 1-50 Market.[7] For each of the carriers, the actuarial value of benefits was equal or higher in the 51-100 Market when compared to the 1-50 Market and, in two cases, the actuarial value of benefits in the 51-100 Market was as much as ten percent greater than for the 1-50 Market. This difference in actuarial value suggests that the groups in the 51-100 Market are enrolled in more comprehensive benefits as compared to the 1-50 Market. In addition, the 51-100 Market generally has more product customization. When the 51-100 Market is combined with the 1-50 Market, those employers in the 51-100 Market will lose their ability to purchase customized products.

5. Premium Impact of Expanding the Merged Market to Include Employers with 51 to 100 Eligible Employees

As described in the introduction, expanding the definition of the merged market will result in premium changes for a variety of reasons. Some premium changes will take place in the short term and others will take place under a longer time horizon. Some changes that are projected to take place include:

[7] One carrier was not able to report actuarial value. The actuarial value average across all carriers was weighted by membership as of December 31, 2011.

- In the short-term, carriers will be required to combine the claims experience and administrative costs from each market when establishing base premium rates for the 1-50 Market and the 51-100 Market. If the 1-50 Market and the 51-100 Market have differing claims and administrative experience, one market segment will subsidize the other with premium increases in the subsidizing segment and premium decreases in the subsidized segment.

- In the short-term, carriers will be required to use the same rating formula which must adhere to 1-50 Market rating requirements. This will require carriers to change the rating formula of the 51-100 Market, which will create "winners and losers" in that market in which some groups will receive premium increases and other groups will receive premium decreases.

- In the longer term, groups receiving significant premium increases after the market definition change may exit the market, either moving to the self-insured market or possibly dropping coverage. This may result in overall premiums increasing or decreasing, depending on the relative risk of those groups that leave the market.

6. Impact of Combining the Claims Experience of Both Markets

For the purpose of this analysis, Gorman Actuarial assumed that the administrative expenses of both markets are the same and has focused its analysis on the impact of combining claims experience. Gorman Actuarial used claims, membership, benefit and demographic information from the carrier survey data on a carrier-by-carrier basis and then aggregated the results for this report. Incurred claims PMPM were normalized for differences in demographics, geography and benefits using the membership, rating factors, and actuarial values specific to each carrier. Results are driven by differences in normalized paid claims PMPM for each segment as well as each carrier's membership in the 1-50 Market and 51-100 Market.

Figure 2 shows the assumed morbidity difference between the 1-50 Market and the 51-100 Market for each carrier. In all cases, the morbidity difference is greater than or very close to 1.0, meaning the 1-50 Market has a claims morbidity either equal to or higher than the 51-100 Market. The difference by carrier varies from close to 1.0 to a high of 1.17. There is variation among the prevalence of individual market members by carrier, and while it may be assumed that a higher prevalence of individual market members would generate a higher claims PMPM, this does not appear to be the case across all of the six carriers surveyed.

Figure 2 – Normalized Claims Relativity by Carrier CY 2011

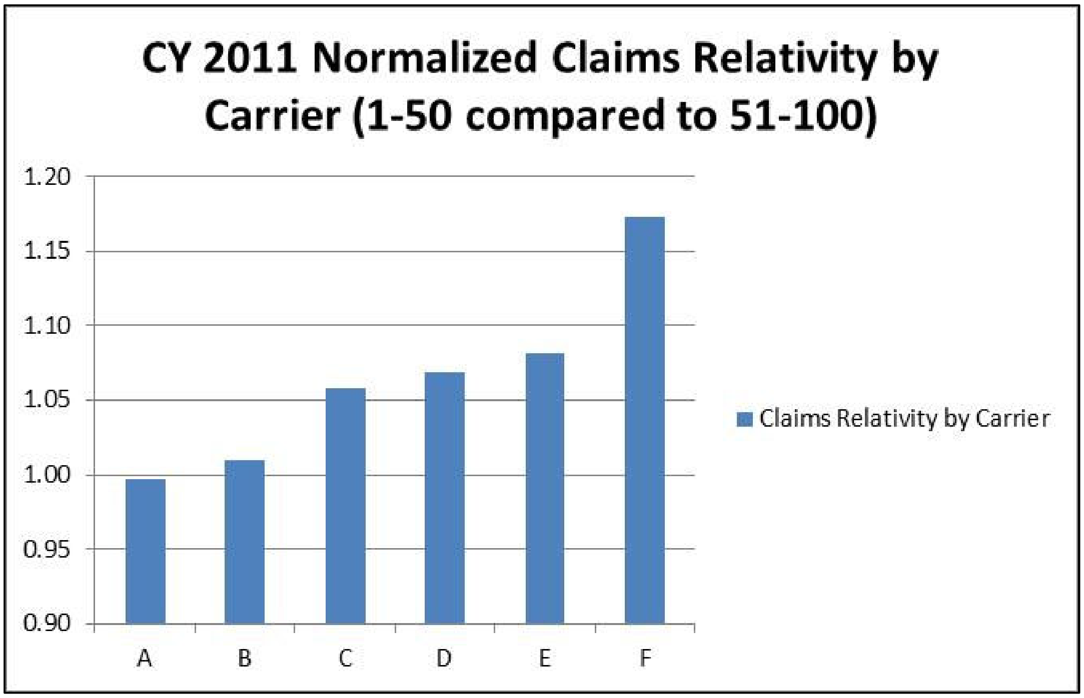


Table 6 shows the premium impact of expanding the Massachusetts merged market to include the 51-100 Market. The impact is related to merging the claims experience from the 1-50 Market with the claims experience of the 51-100 Market. The impact is a two percent decrease for the 1-50 Market and a seven percent increase for the 51-100 Market. By expanding the merged market to include employers with 51 to 100 eligible employees, the 51-100 Market is subsidizing the 1-50 Market and, therefore, the 51-100 Market will experience a premium increase.

The carrier with the largest impact will experience a four percent decrease for its 1-50 Market and a twelve percent increase for its 51-100 Market. The carrier with the smallest impact will experience no premium impact for its 1-50 Market and a one percent increase for its 51-100 Market. The premium impact will vary based on each carrier's relative size in the 51-100 Market, as well as the morbidity differences between the two market segments.

Table 6 – 2014 Premium Impact

Premium Impact		
	Premium Impact to Individual & Small Group Market	Premium Impact to Large Group 51-100
Overall Results:	-2%	7%
Carrier with Largest Impact:	-4%	12%
Carrier with Smallest Impact:	0%	1%

7. Changing the Rating Formula for the 51-100 Market

Carriers will be required to use the same rating formula that applies in the 1-50 Market to the 51-100 Market. As noted above, this change will cause "winners and losers" within the 51-100 Market, in which some groups will receive premium increases and other groups will receive premium decreases.

Table 7 illustrates the rating formula changes within the 51-100 Market when the merged market is expanded to include employers with 51 to 100 eligible employees. Each of these rating variables is discussed further below.

Table 7 – Rating Factors in the 51-100 Market that Will Require Changes When Small Group Rating Rules Apply to the 51-100 Market

Rating Variable	51 to 100 Current use	Future Use Under SG Definition 1 to 100	Examples of Estimated Premium Change
Age	YES	YES Move to 2 to 1	Young Groups: Increase Old Groups: Decrease
Gender	YES	NO	Young to Middle Aged Male Groups: Increase Young to Middle Aged Female Groups: Decrease
Geography	YES	YES but geography will need to be consistent	Premium disruptions as groups move to standard rating
Group Size	YES	NO	Large Groups: Increase Smaller Groups: Decrease
Industry	YES	NO	Professional Trade: Increase Service Trade: Decrease
Account Specific Experience/UW Judgment	YES	NO	Young, Healthier Groups: Increase Old, Sicker Groups: Decrease

Age/ Gender

The age and gender factors currently used in the 51-100 Market have rating bands as large as 6-to-1, which means that the highest rate a carrier charges can be six times the lowest rate due to age and gender. In the 1-50 Market, the age factors in combination with industry, employee participation rate, participation in wellness programs and tobacco use, have a rating band cap of 2-to-1. In addition, beginning January 1, 2014, carriers will be required to use a standardized set of age factors that has a rating band of 2-to-1 in the 1-50 Market. Carriers will be required to use this same set of age factors for the 51-100 Market effective January 1, 2016. Therefore, younger groups that currently are receiving a large discount in the 51-100 Market due to a favorable age factor will experience a premium increase, while older groups which receive a large surcharge in the 51-100 Market due to an unfavorable age factor will experience a premium decrease.

In addition, as shown in Table 5, all carriers except one currently rate using gender in the 51-100 Market. This will cause some disruption as rates for females are often higher than males of the same age at ages below 55. At ages above 55, male rates tend to be higher than female rates. The most significant variation between the male and female age factors occurs between ages 25 and 34, where the female factor is on average 100 percent higher than the male factor at the same age.[8] It also should be noted that four out of the six carriers use five-year age bands in their 51-100 Market rating formula. The current 1-50 Market rating rules require carriers to use one year age bands when applying age factors to premium. In addition, the standardized age factors required effective January 1, 2014 utilize one year bands. One-year age bands result in smaller annual rate increases due to aging, as opposed to five-year age bands, which can cause more significant rate increases when individuals and smaller groups age into older age bands. Thus, there will be some short-term disruption when carriers are required to use one-year age bands in the 51-100 Market as of January 1, 2016.

Geography

The 51-100 Market also will be impacted with the application of geographic rating factors. Three of the six carriers use the same geographic rating regions for both their 1-50 Market and their 51-100 Market, with the factors within a 1.5-to-1 rating band. Two carriers, however, use different geographic rating regions in the 51-100 Market and one carrier does not apply any geographic rating in the 1-50 Market. Of the two carriers that use different rating regions, the rating band for the 1-50 Market is slightly higher than the rating band for the 51-100 Market. There may be some disruption due to geographic rating when the merged market is expanded to include employers with 51 to 100 eligible employees, but this disruption is expected to be minimal.

Group Size

Some carriers charge different administrative charges by different group sizes with larger groups receiving lower administrative charges than smaller groups. Varying administrative charges by group size, or any type of rating factor that varies by group size, will not be allowed under the ACA and this will apply to groups in the 51-100 Market when they are subject to the ACA market rules. When implemented, some of the larger groups in the 51-100 Market may see premiums increase if their administrative charges are the same as applied to all other small groups.

Industry

Of the carriers that differentiate rates by industry in the 51-100 Market, the typical rating band is 1.4 to 1. That is, the highest industry rating factor a carrier charges can be no more than 1.4 times the lowest industry rating factor. The classification of industries vary slightly among carriers, but typically more professional industries such as banking and engineering receive discounts while service industries such as transportation and car dealerships receive surcharges. These industry surcharges and discounts will not be allowed under the ACA and thus will not apply to groups in the 51-100 Market when they are subject to the ACA market rules. When implemented, many employers who currently benefit from industry discounts will see their premiums increase.

Claims Experience

Carriers no longer will be able to use account specific claims experience or underwriting judgment when setting premiums for employers in the 51-100 Market. Gorman Actuarial collected group-specific information from each carrier for their current 51-100 Market

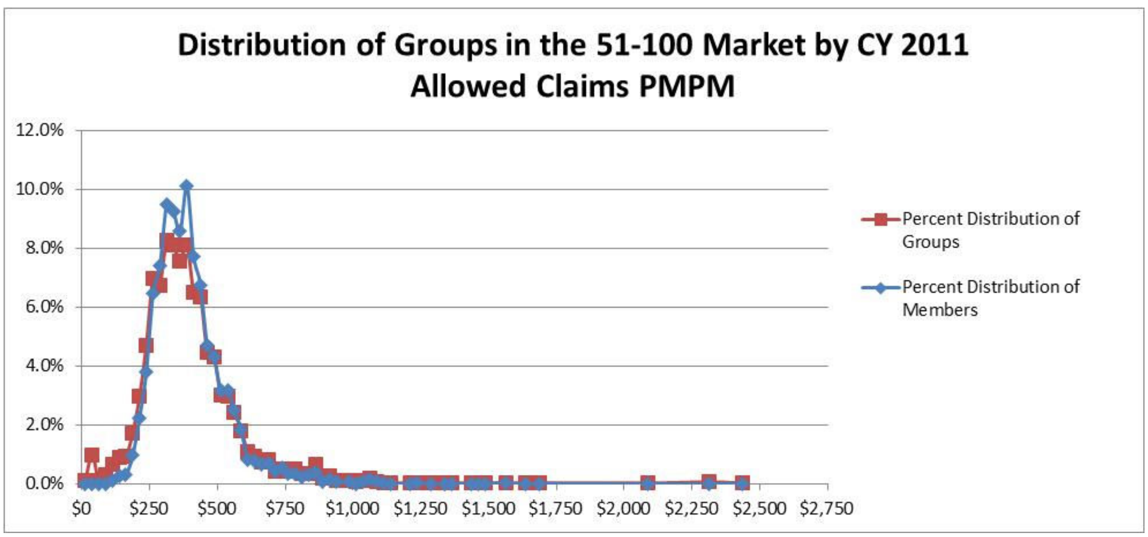
[8] This typically is seen in markets where plan designs include maternity benefits.

segment. Figure 3 shows the distribution of 51-100 Market groups by their calendar year 2011 allowed claims PMPM.

Approximately 27 percent of groups and 22 percent of members have allowed claims less than $300 PMPM. Another 69 percent of groups and 76 percent of members have allowed claims between $300 PMPM and $750 PMPM. The remaining four percent of groups and three percent of members have claims greater than or equal to $750 PMPM. This graph provides a sense of the variation in the 51-100 Market claims experience.

Groups on the far left of the chart are the ones most likely to receive premium increases as they are the healthier groups, while groups on the far right of the chart are the ones most likely to receive premium decreases as they are the higher risk groups. In general, older, less healthy groups that are in the service industry will experience additional premium decreases. Younger, healthier, professional employer groups will experience premium increases.

Figure 3 – Distribution of Groups in the 51-100 Market by CY 2011 Allowed Claims PMPM[9]



Gorman Actuarial simulated the impact of the rating formula changes to the 51-100 Market as shown in Table 8. We have modeled that 21 percent of the 51-100 Market membership will experience a minimal impact as a result of rating formula changes, or between -5 percent and +5 percent. Approximately 40 percent of the 51-100 Market membership will experience premium impacts between -10 percent and +10 percent. At the more extreme ends of the spectrum, 2 percent of the 51-100 Market membership will experience premium decreases greater than 30 percent and 11 percent of the 51-100 Market membership will experience premium increases greater than 30 percent. Note

[9] Only includes groups with allowed claims less than $2,500. Approximately 0.1% of groups have CY 2011 allowed claims greater than $2,500. Allowed Claims were grouped into $25 PMPM increments for purposes of creating this chart.

that while specific groups in the 51-100 Market will experience premium increases or decreases, the overall total premium will not be impacted by the rating formula changes.

Table 8 – Estimated Premium Impact to 51-100 Market Due to Rating Formula Changes

Estimated Distribution of Premium Changes to 51-100 Market as a Result of Rating Formula Changes		
	Membership Distribution	**Average Percentage Difference**
less than -30%	2%	-41.3%
-30% to -20.1%	7%	-23.9%
-20% to -10.1%	14%	-14.6%
-10% to -5.1%	9%	-7.5%
-5% to 5%	21%	-0.2%
5.1% to 10%	9%	7.7%
10.1% to 20%	16%	14.5%
20.1% to 30%	11%	24.8%
greater than 30%	11%	39.6%
Total	**100%**	**0.0%**

8. Self-Insured Market

8.1. Self-Insurance in the 1-50 Market

Many employer groups have opted to drop health insurance and self-insure their employee health benefit expenses, as permitted under federal ERISA[10] rules, which exempts self-funded plans from state insurance mandates or premium requirements, as well as certain provisions of the ACA.

Essentially, companies market administrative services combined with stop-loss insurance policies (collectively, "self-insurance products") that operate in ways that look like a high-deductible health plan to the employer and/or its employees. Many stop-loss policies cover claims that are above a $10,000 or $25,000 threshold per employee, and sometimes cover aggregate claims costs above a total claims threshold. The employer pays the premium for the stop loss policy and can either fully fund the deductible, partially fund the deductible or not fund it at all. If the deductible is not funded at all, the employee would be responsible for claims up to the stop loss limit (i.e. $10,000). In these self-insured plans, the employer or employee is responsible to pay an agreed-upon

[10] Employee Retirement and Income Security Act of 1974.

level of claims costs and the stop-loss insurer is responsible for claims in a given year that are above an agreed-upon threshold. This practice is allowed today and will continue to be allowed under the ACA.

Companies marketing self-funded products require employers to complete health questionnaires which are used in developing stop-loss policy premiums. For “healthy” groups, the stop-loss insurer offers relatively low stop-loss premiums. As these self-funded products grow in popularity, “healthier” groups may leave the insured health coverage market, which will increase adverse selection among those continuing to purchase health insurance.

Self-Funded Products Among Small Employers

In the past, employer groups in the 1-50 Market and in the 51-100 Market have been less likely to move from the insured market to the self-insured market because the risks are great and stop-loss premiums may be high. Many small employers do not understand their potential financial exposure to health claims costs below the point at which stop-loss insurance provides some protection. These employers may not be in a position to absorb significant costs if their employees have claim costs that are higher than budgeted and not covered by any other insurance; this could put some self-insured small employers out of business.

There is evidence that companies such as Assurant and Trustmark are actively marketing self-insured products to small groups nationally. There is no reliable source of data on how many small groups currently self-insure in Massachusetts, or in any other jurisdiction. Gorman Actuarial interviewed several insurance brokers who work in the 1-50 Market in Massachusetts and the general consensus is that while there are carriers offering self-insured arrangements in Massachusetts, there are very few small groups willing to take this risk at this time.

There is, however, growing evidence that small employers (some observed to be as small as five-employee companies) are showing interest in becoming self-insured. This primarily includes those in the 1-50 Market and the 51-100 Market with relatively low risk who may be seeking ways to decrease their own health care costs. Certain brokers have indicated that they believe that more employers in the 1-50 Market and the 51-100 Market will buy self-funded products due to the impact of expanding the merged market to include employers with 51 to 100 eligible employees, because of the imposition of certain rating restrictions that currently do not apply to the 51-100 Market. This may siphon the best risks out of the fully insured market, leaving higher health care utilizers behind.

In Massachusetts, Gorman Actuarial observed how Assurant markets its self-funded products as “a great way to control health care costs.” The company’s marketing materials claim that employers may have “immediate monthly savings, overall costs that stay lower year to year and the chance each year to get back the funds you don't use."[11] Assurant markets its product as a "partially self-funded" product which includes a stop-loss policy. It appears that Assurant stop-loss policies have annual specific attachment points that range from $10,000 to $25,000.

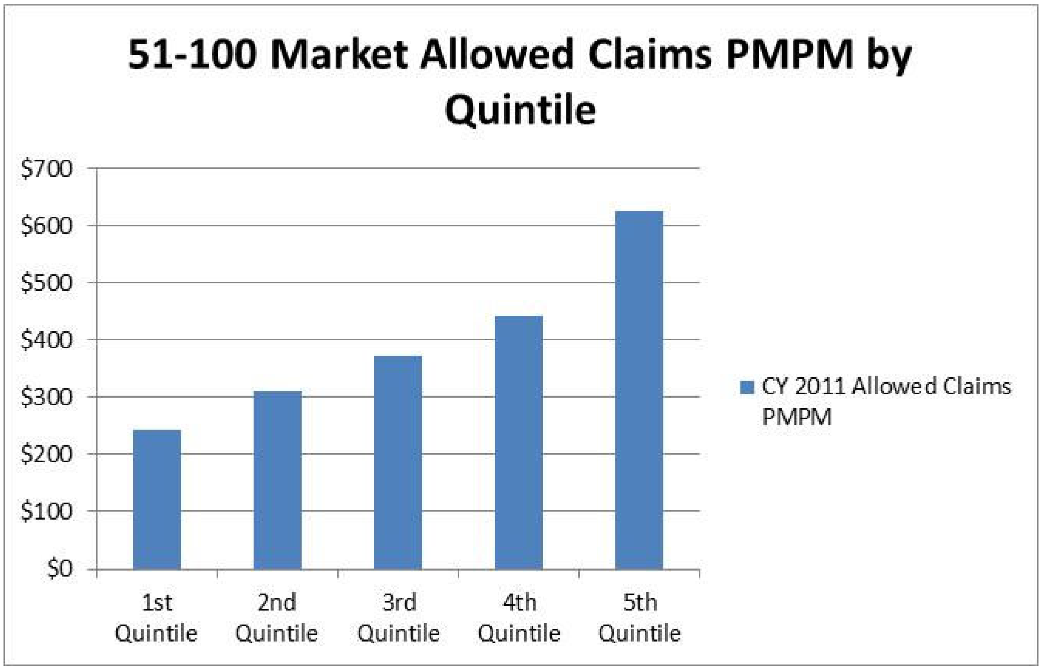
8.2. Impact of Employers in the 51-100 Market Switching to Self-Funded Products

When the merged market is expanded to include employers with 51 to 100 eligible employees, some of the employers in the current 51-100 Market will have higher premiums and may consider dropping their health insurance in favor of self-funding their health benefit costs. As of December 2011, there were an estimated 6,500[12] Massachusetts persons covered under self-funded products and an estimated 250,000[13] persons covered under fully-insured arrangements in the 51-100 Market.

Figure 4 depicts the CY 2011 allowed claims PMPM segmented by quintile for the fully insured 51-100 Market. The 1st quintile's allowed claims PMPM is $243 while the 5th quintile's allowed claims PMPM is $626. This means that the lowest cost 20 percent of groups' 2011 average allowed claims PMPM was $243. Since the highest cost 20% of groups had an average claims PMPM of $626, these costs are slightly more than 2.5 times greater than the lowest cost groups.

[11] http://www.assuranthealth.com/corp/ah/HealthPlans/self-funded-health-insurance.htm and https://www.groupselffunded.com/ , retrieved 9/12/12
[12] Three out of the six carriers surveyed reported membership in the 51-100 Market self-insured segment
[13] Reported by the carriers.

Figure 4 – 51-100 Market CY 2011 Allowed Claims PMPM by Quintile



It is difficult to know how many now fully-insured employers in the 51-100 Market may elect to self-insure in the future. For purposes of our modeling, Gorman Actuarial assumes that between 15 percent and 100 percent of the lowest cost groups[14] will leave the fully insured market. This translates to a 6 to 40 percent drop in the number of groups in the 51-100 Market.

Table 9 summarizes the impact to the 51-100 Market as a result of this modeling.

[14] The lowest cost groups are defined as those in the 1st and 2nd quintiles in Figure 4.

Table 9 – Impact of 51-100 Groups Exiting Market

	Increase in Medical Claims for 51-100 Market	Premium Impact to 1-100 Market
Results if 15% of lowest costing groups exit (6% of total groups):	2%	1%
Results if 25% of lowest costing groups exit (10% of total groups):	3%	1%
Results if 50% of lowest costing groups exit (20% of total groups):	7%	2%
Results if 100% of lowest costing groups exit (40% of total groups):	17%	4%

If 25 percent of the lowest cost groups were to exit the fully insured 51-100 Market, the premiums for the expanded merged market including employers with 1 to 100 eligible employees would increase approximately one percent. If 100 percent of the lowest cost groups were to exit the 51-100 Market, premiums for the expanded merged market would increase four percent. While the 51-100 Market would experience a significant drop in membership and a significant increase in costs (17 percent), since it will be combined with the 1-50 Market rating pool, the increases will be muted. In other words, premium increases due to the shrinking 51-100 Market will be subsidized by the 1-50 Market.

This relatively low overall impact in a rather extreme scenario is principally due to the 51-100 Market's relative size as compared to the 1-50 Market. Currently, we estimate that the 51-100 Market segment represents 26 percent of the combined merged market. If 40 percent of the 51-100 Market accounts exit the merged market, the 51-100 Market will make up approximately 19 percent of the combined segment. Therefore, even in a scenario in which groups in the 51-100 Market experience cost increases of 17 percent, the overall impact to the combined segment is kept to four percent as a result of the decreasing proportion of membership in the 51-100 Market segment.

9. Summary of Premium Change

Table 10 summarizes both the short-term and long-term premium impact to the 1-50 Market and 51-100 Market when the merged market is expanded to include employers with 51 to 100 eligible employees. The first row illustrates the impact due to merging experience and is consistent with the results shown previously in Table 9. The second row illustrates the impact due to rating formula changes in the 51-100 Market. As discussed in Section 7 there will be "winners and losers" as a result of the rating formula changes where the younger and healthier groups will typically experience surcharges and the older and sicker groups will typically experience discounts. The expected increases and decreases from these rating formula changes are projected to be as high as 30 percent. Section 8 illustrates several scenarios used to test the sensitivity of the impact of lower cost groups leaving the market to self-insure. These premium changes are in relation to the expanded merged market.

Table 10 – Premium Impact from Short-Term and Long-Term Factors

<table>
<tr><th colspan="3">Overall Premium Impact</th></tr>
<tr><th></th><th>Premium Impact to Individual & Small Group Market</th><th>Premium Impact to Large Group 51-100</th></tr>
<tr><td>Impact of Merging Experience</td><td>-2%</td><td>7%</td></tr>
<tr><td>Impact of Formula Rating Changes:</td><td>None</td><td>Winners & Losers
+30% to -30%</td></tr>
<tr><td>Impact of Large Group 51-100 Exiting Market:</td><td colspan="2"></td></tr>
<tr><td>15% of lowest costing groups exit (6% of total)</td><td colspan="2">1%</td></tr>
<tr><td>25% of lowest costing groups exit (10% of total)</td><td colspan="2">1%</td></tr>
<tr><td>50% of lowest costing groups exit (20% of total)</td><td colspan="2">2%</td></tr>
<tr><td>100% of lowest costing groups exit (40% of total)</td><td colspan="2">4%</td></tr>
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