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Comments on Health Net Health Plan of Oregon's Proposal to Increase Health Insurance Rates

Filing #GH 0664 10

Health Insurance Rate Watch
A Project of OSPIRG Foundation

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The authors bear responsibility for any remaining factual errors. The views expressed in this report are those of the authors, and do not necessarily reflect the views of our funders, advisory committee, or those who provided analysis and review.

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Executive Summary

Health Net Health Plan of Oregon (Health Net) is proposing an average 8.27% rate increase on small business plans impacting 37,872 Oregonians, effective April 1, 2011.

While this overall rate increase is in line with overall market trends, this increase is likely to be unaffordable for a wide range of small businesses and their employees, and there are significant areas where the rate increase request does not appear to be adequately supported by the information in the filing.

1. We are concerned that the insurer's anticipated increase in medical costs of 11.2% is not fully explained in the filing. Health Net's recent third quarter filing with the Securities and Exchange Commission suggests a lower value, 7.5%, for the insurer's expected medical trend across in the West.

2. Health Net estimates a higher-than-expected impact on premium for adding benefits required by the federal health reform law, such as covering preventive services without a co-pay, and allowing parents to keep their children on the family plan until age 26. Independent estimates of the premium impact of the benefit changes required by the federal health reform law cluster in the 1-3% range. Health Net estimates the impact at two to three times this range.

3. Health Net appears to assume that its administrative costs will increase at roughly the same rate as its claims costs. This assumption does not appear to be supported by Health Net's historical data for small group plans, and does not correspond to its company-wide administrative cost trends.

4. The filing states that enrollees will see rate changes ranging from -9% to 30%, but the information in the filing seems to suggest that the maximum reduction an enrollee could experience would be less than 2.5%.

5. There is insufficient information about the efforts of Health Net to reduce health care costs while improving health outcomes.

There may be reasons for the higher costs that Health Net proposes in this rate filing in each of these areas above, and an explanation for how the stated possible 9% premium rate reduction is calculated. Likewise, it would be important to know whether Health Net is conducting robust efforts to reduce costs and improve quality.

We respectfully urge the Insurance Division of the Department of Consumer and Business Services to request more information from Health Net in these areas so that they may be evaluated as part of this rate filing.

Key Features of the Proposal

State tracking # for this filing	GH 0664 10
Name of health insurance company	HEALTH NET HEALTH PLAN OF OREGON, INC.
Type of insurance	Small Grp Hlth Plans (small employers)
Grandfathered under federal health reform?	Non-Grandfathered

Average rate increase	8.27%
Minimum rate increase	-9.00%
Maximum rate increase	30.00%

Number of Oregonians affected	37,872
Anticipated enrollment if approved	38,872

Insurer's history of rate increases in this market	
2010	12.20%
2009	10.32%
2008	7.50%
2007	8.50%
2006	9.62%

Proposed rate	
% premium to be spent on medical costs	84.70%
% premium to be spent on administrative costs	13.60%
% premium to be spent on profits	1.70%

Increases from previous year	
% increase in medical costs	9.30%
% increase in administrative costs	10.71%

Basis for proposed increase	
Increase in medical costs	10.90%
Increase in Rx costs	13.00%
Time over which costs increased	Since 2009

Effective Date of rate increase	4/1/2011
Date rate filing posted	1/6/2011
Date comments due	2/7/2011
Link to rate filing:	http://tinyurl.com/62clzol

Insurer Information Company-Wide

For profit or non-profit:	For profit
State domiciled in:	CA
Parent company:	Health Net, Inc.

Insurer's financial position	
Year	2009
Surplus	$73,677,286
Investment earnings	$1,496,961

Surplus History

Year	**Amount in Surplus**
2009	$73,677,286
2008	$57,423,245
2007	$67,435,509
2006	$59,802,840
2005	$49,628,224

Discussion of the Rate Filing

In each of the sections below, we discuss key questions about the rate filing and its impact on Oregonians.

Medical cost trends

Are the projected medical trends, both cost and usage, supported by the data?

The projected medical cost trends are not adequately supported by the data. The company does not fully articulate and support the basis for the medical trend numbers. In addition, the medical trend listed for the small group line of businesses is significantly higher than the company-wide medical trend Health Net has reported elsewhere, and this discrepancy is not explained in the filing.

Health Net sets their medical cost trend at 11.2%, but the filing does not adequately explain the basis for this choice. The filing does contain general statements about the components of the trend, breaking it down into medical and drug pieces (page 81), and lists Historical Monthly Average Claims Costs (page 82). But Health Net states that it does not rely on claims experience in developing its medical trend, but rather on its “assessment of Commercial trend,” which it does not appear to supply in this filing.

Health Net’s 2010 third quarter 10-Q filing with the Securities and Exchange Commission (excerpt in Attachment A) indicates a “Commercial health care cost trend” in the Western region of 7.5%. This is much lower than the 11.2% value used in the rate filing. Further information is needed to assess the causes of this discrepancy.

Insurer’s efforts to reduce medical costs while improving quality

Is the insurer taking sufficient steps within their power to reduce health care costs while improving quality, and if so, are those steps achieving measurable results?

Health Net’s rate filing does not adequately make the case that the company is taking sufficient steps to reduce health care costs and improve quality. Its cost containment efforts appear to revolve around increased cost-shifting to enrollees, and its description of the insurer’s efforts in the quality arena are too vague to evaluate. More detailed information is needed in this important area.

Experts agree that the rising cost of health care is the main driver of the rising cost of health insurance. There are an increasing number of proven strategies to help reduce costs, not by cutting care, but rather by cutting waste and focusing on prevention that actually improve health quality. Consumers need insurance companies to pursue these strategies, such as improving primary care through the medical home model of care, advancing payment reform, and promoting best-practices in care.

In the rate filing, Health Net lists several cost containment strategies, but these mainly focus on small benefit design changes to reduce access to care. They include changes to benefit co-pays, limits on rehabilitation and ambulance benefits, and an annual benefit maximum of $1.25 million. Each is estimated to bring minimal cost savings amounting to 0.1-0.3% and it appears these savings are obtained by shifting costs to enrollees.

The filing also references Health Net's ongoing efforts to improve care management and disease management, as well as systems upgrades "to improve claims adjudication speed and accuracy" (p. 86), but while Health Net states that it expects these efforts to reduce costs, it does not provide savings estimates or details on these efforts.

Benefits

Is the rate reasonable given the benefits offered?

Health Net has increased benefits in its plans in order to comply with the new mandates contained in the new federal health reform law (the Affordable Care Act, or ACA). It estimates the cumulative impact of these benefit changes to be between 3% and 6% (see page 85 of the filing).

Analysis of the benefit changes mandated in the ACA has estimated that the premium impact of these new benefits should in most cases be between 1-3%.[1] Health Net's assessment of the premium increase attributable to the new benefits mandated by the ACA thus appears significantly higher than independent estimates would have predicted. There may be sound reasons for Health Net estimating higher costs, but these are not articulated in the filing.

Variation in Rate Impact

Will the rate increase be uniform over most enrollees, or will some enrollees experience rate changes that are substantially higher or lower than the overall increase?

Health Net reports that its overall 8.27% proposed rate increase would impact its enrollees in markedly different ways. According to the insurer, some enrollees would see their rates remain stable or even decrease, while 8% would see their rates increase by 20% or more, with some enrollees seeing increases of 30% (see page 50 of the filing).

From the information provided in the filing, it appears that enrollees experiencing these higher rate increases will do so due to the combination of the overall medical trend-driven increase in premium base rates, and higher-than-average increases in the plan relativity of the product they currently purchase (as discussed above, plan relativities in this filing have been adjusted upward to account for new benefits mandated by the ACA, with some products seeing adjustments as high as 5.5%).

In reviewing the filing, however, we are not able to confirm the insurer's statement that some enrollees will see premium reductions of up to 9%. The only rating reduction listed in the filing is a decrease of 5% in one geographic area (Area 4, consisting of Deschutes, Klamath, and Lake counties). Because all products have had their relativities increased by at least 2.7%, it appears from the information provided

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[1] The Lewin Group, as quoted by Factcheck.org, The Truth About Health Insurance Premiums, Nov. 19, 2010, athttp://factcheck.org/2010/11/the-truth-about-health-insurance-premiums/.

that the maximum reduction an enrollee in these counties would see would be 2.4%, even before taking account of the overall increase in premium base rates.

Administrative Costs

Do the administrative expenses seem reasonable?

Health Net's proposal to allow administrative costs to rise by 10.71% does not seem warranted by the information provided in the filing. Historical information provided in the filing and elsewhere for this line of business and company-wide show that administrative costs have been rising more slowly. There may be a rationale for Health Net to anticipate a sharp increase in administrative costs in the coming year, but such a justification is not offered in the rate filing.

Given that administrative costs are not medical costs, they should not, as a rule, increase according to medical inflation. Instead, they should increase more in line with overall inflation rate. The Producer Price Index for Direct Health and Medical Insurance Carriers Industry is a helpful index to compare with an insurance company's proposed increase in administrative costs.[2]

Producer Price Index for Direct Health and Medical Insurance Carriers Industry for 2009	4.90%
Producer Price Index for Direct Health and Medical Insurance Carriers Industry for 2010	not yet available

Source: Bureau of Labor Statistics of the United States Department of Labor

If premiums rise year after year by more than the overall cost of living, then the loss ratio – the portion of premium spent on medical claims – should actually increase over time. This is because the administrative portion of rates should increase at a much slower rate than the medical costs, as described above.

In contrast, below is the increase in administrative expenses proposed in this rate filing:

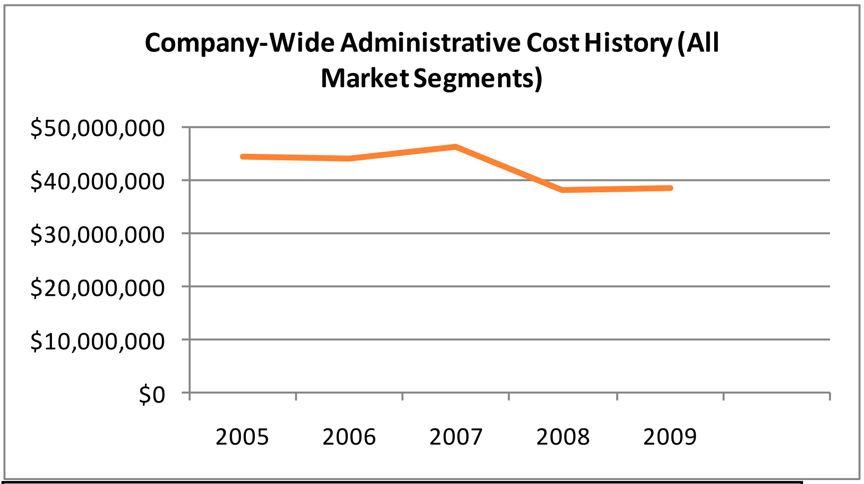
Increase in Administrative Costs for this Market Segment	
Previous year administrative expenses	$17,941,337.31
Proposed administrative expenses	$19,863,245.74
Percent increase in administrative costs	10.71%

Top 3 Administrative Expense Categories 2009	**Amount spent per member, per month**	**% of total non-claim related admin costs**
Commissions to insurance agents and brokers	$12.40	42.66%
Salaries, Wages, Employment Taxes & Other Benefits	$11.65	40.08%
Third Party Administration Expenses or Fees or Other Group Service Expense or Fees	$1.19	4.09%

[2] Oregon rule (OAR 836-053-0475): The director may approve reasonable increases or decreases in administrative expenses supported by the information provided under OAR 836-053-0471. In addition to the materials submitted under OAR 836-053-0471, in order to determine whether the proposed increase or decrease in administrative expenses is reasonable, the director may consider the cost of living for the previous calendar year, based on the Producer Price Index for Direct Health and Medical Insurance Carriers Industry, as published by the Bureau of Labor Statistics of the United States Department of Labor.

Health Net's proposal to allow administrative costs to rise by 10.71% does not appear supported by the information provided in the filing. The insurer expects that non-claims costs will consume 17.6% of each premium dollar, split as 13.7% for expenses and 4.0% for Contingency/Profit (page 83)[3]. This differs from the company-wide expense ratios reported by Health Net in 2008 and 2009, which were 11.5% and 11.95%, respectively, somewhat lower than the 13.4% used in the filing (see page 88).

In terms of dollar amounts, Health Net has reported administrative costs declining over that past several years, company-wide:



Year	Company-Wide Admin Costs	Admin Cost Increase from Previous Year
2005	$44,568,225	N/A
2006	$44,245,406	-0.72%
2007	$46,278,452	4.59%
2008	$38,050,711	-17.78%
2009	$38,411,992	0.95%

Not only do the administrative cost increases proposed in this filing differ significantly from administrative cost trends reported company-wide, they also differ significantly from the insurer's historical trend of administrative costs in this specific market segment. Health Net's administrative expenses in the small group market segment have had a much slower increase over the period from 2005 to 2009, as shown in the following table:

[3] These do not add up to 17.6 in the insurer's filing due to rounding.

Administrative Expenses Per Member Per Month			
Year	Claims	Non-Claim	Combined
2005	4.16	32.75	36.91
2006	4.85	34.49	39.34
2007	5.57	36.65	42.22
2008	6.82	28.56	35.38
2009	9.07	29.07	38.14
Average Annual Trend (Based on Exponential Curve)			
	20.90%	-4.20%	-0.40%

Source: Rate Filing, Page 95

Finally, the filing discusses activities that the insurer expects to result in administrative savings, but these savings do not appear to be factored into the proposal. In the Quality Improvement document, Health Net references administrative systems upgrades, and states, "[c]ost savings are expected to reduce our G&A but we have not quantified an estimate" (page 86).

With regard to each of these three items – the selected expense ratios, the implicit administrative expense trend, and the lack of reflection of reduced expenses – the Health Net filing appears to assume higher administrative expenses than the data supports.

Does the loss ratio seem reasonable?

Health Net's proposed loss ratio seems reasonable, and appears to be improving over time. The loss ratio is the percentage of premium spent on medical claims, as opposed to administrative costs or profits. As discussed above, the filing appears to overstate Health Net's administrative expenses, but because it expects a decrease in the percentage of premium going to profit, from 2.8% to 1.7%, this potential overstatement is not reflected in the loss ratio.

In fact, the proposed loss ratio of 84.70% falls in the normal range for the small group market, and for the past several years, Health Net's loss ratio in this market segment has been slowly increasing (increasing from 75.16% in 2007 to 81.01% in 2008, 83.10% in 2009, and 83.90 in 2010).

Does any particular expense seem unreasonable, and why?

Several categories of administrative expenses appear to be increasing very rapidly, and merit monitoring.

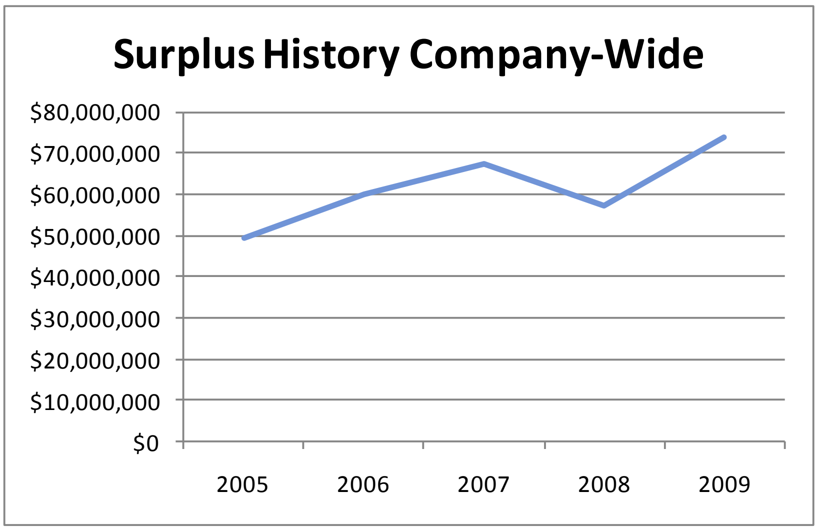
Fees for third party administration or other group services expenses were (combing claims-related and non-claims-related costs) $0.83 per member per month (PMPM) in 2007, $2.34 PMPM in 2008, and $3.60 PMPM in 2009. Similarly, legal and consulting fees (again, combining claims-related and non-claims-related costs) increased from $0.32 PMPM in 2007 to $0.75 PMPM in 2008 and $1.06 PMPM in 2009.

While these line items are comparatively small relative to total PMPM administrative costs of $29.07 in 2009, their rate of increase is sufficiently high that if this trend continues, there could be a noticeable impact on enrollees' premiums.

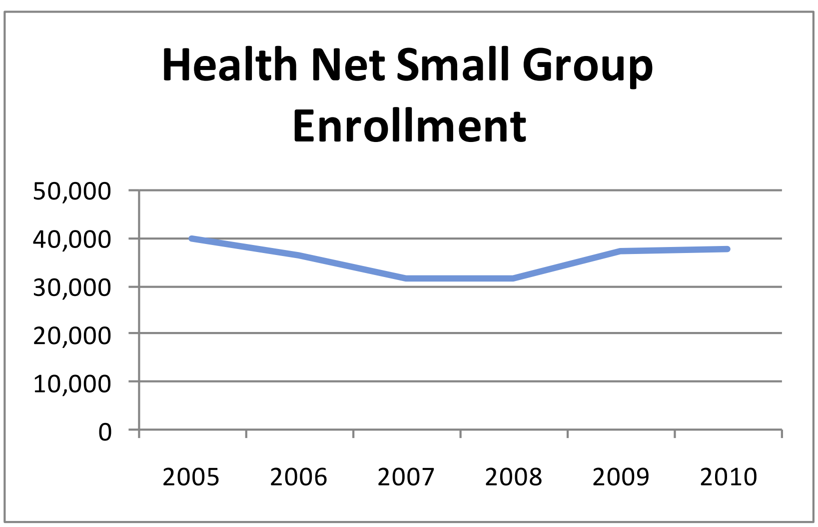
Stability of the Plan and the Insurer

Looking at the historical context of the insurer's rate filing, does it appear the requested rate maintains rate stability and operates in a way to prevent excessive rate increases in the future? Are enrollment numbers stable, increasing, or decreasing?

It does not appear that the proposed rate increase is necessary to prevent the insurer from becoming insolvent. Company-wide, Health Net's surplus levels are steadily growing:



Over the last five years, enrollment has fluctuated somewhat between 30,000 and 40,000 in the small group Health Net plans:



Health Net expects that approval of this rate increase would result in an enrollment increase of 1,000 covered lives.

The insurer's proposal to increase rates by 8.27% in this market segment is somewhat lower than its approved rate increases in previous years (12.2% in 2010, 10.32% in 2009). As enrollment has been steady or growing over that time period, these trends do not suggest that the proposed rate increase would pose a significant risk to enrollment or plan stability. That said, this average rate increase has widely varying impacts on businesses depending on their specific rating factors, and it is unclear whether Health Net has factored in the likely consequence that businesses receiving above-average rate increases will drop coverage.

Affordability

Are the rates and out-of-pocket costs affordable for a range of Oregonians?

The premium rates proposed under this rate filing are not affordable for Oregonians, especially in this economic climate.

Oregon has been hard hit by the recession, with exceptionally high unemployment. Oregon median income has been fairly stagnant since 2005. In this economic climate, health insurance rates rising much faster than the rate of inflation has significant impacts on employers' ability to offer coverage, and employee's ability to take up that coverage.

Economic Trends

	Annual CPI increase (Portland-Salem OR-WA)	Unemployment Rate - OR	Median Household Income - OR	Median Income - individual*	Median Income - two person household*	Median Income - family of 3+*
2005	2.56%	6.20%	44,159	22,963	34,886	60,498
2006	2.60%	5.30%	47,091	24,487	37,202	64,515
2007	3.71%	5.10%	50,236	26,123	39,686	68,823
2008	3.28%	6.50%	51,727	26,898	40,864	70,866
2009	0.12%	11.10%	49,098	25,531	38,787	67,264

*Note: Estimates of income for individuals, 2-person households, and 3+ person households derive from U.S. Census data, Table H-11AR, which provides median income data by size of household. Taking a five-year average, individual income is estimated at 52% of total median household income; income for a two-person household is estimated at 79% of the overall number; and for families of 3+, income is estimated at 137% of overall median household income. This data is available at http://www.census.gov/hhes/www/income/data/historical/household/index.html.

To examine the real-world impact this rate increase could have if approved, we calculated the premium rate the following hypothetical businesses would experience, based in the information in the filing. We then compared these premiums to the median income in Oregon for individuals, two-person households, and families, evaluating whether premium would exceed 8% of the median monthly income.[4]

Business Profiles

	Eastside Bikes Average Age: 27 # employees = 4 Employee Rate			Al's Garage Average Age: 36 # employees = 8 Employee & Spouse Rate			ABC Accounting Average Age: 50 # employees = 40 Family Rate		
Geographic area:	SW Oregon	Portland	Coast	SW Oregon	Portland	Coast	SW Oregon	Portland	Coast
Total Premium Rate:	**$331.93**	**$276.61**	**$311.18**	**$1,582.00**	**$1,318.33**	**$1,483.13**	**$1,630.46**	**$1,358.72**	**$1,528.56**
8% monthly median income	**$170.21**	**$170.21**	**$170.21**	**$258.58**	**$258.58**	**$258.58**	**$448.43**	**$448.43**	**$448.43**
Rate Calculation Details:									
Base Rate	$429.00	$429.00	$429.00	$429.00	$429.00	$429.00	$429.00	$429.00	$429.00
Age factor	0.6500	0.6500	0.6500	2.0240	2.0240	2.0240	3.1290	3.1290	3.1290
Contribution Factor	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Participation Factor	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Tobacco Factor	1.0000	1.0000	1.0000	1.5000	1.5000	1.5000	1.0000	1.0000	1.0000
Wellness Factor	0.9800	0.9800	0.9800	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Experience Factor	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Plan Relativity	1.0122	1.0122	1.0122	1.0122	1.0122	1.0122	1.0122	1.0122	1.0122
Quarterly Trend	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Area Factor	1.2000	1.0000	1.1250	1.2000	1.0000	1.1250	1.2000	1.0000	1.1250

Across the board, premium rates facing our hypothetical businesses and their employees far exceed 8% of the median income. It is important to note that this is the case even without taking into account the out-of-pocket costs consumers face under these plans. Our analysis suggests that Oregon small businesses and their employees would have difficulty affording these health insurance premiums and out-of-pocket costs.

[4] Calculations made for HMO plan 2020T: $20 office co-pays, $150 ER co-pays, $3,000 out-of-pocket maximum. We assume 80% participation and median experience factor of 1.000 for all businesses. We assume Al's Garage has more than 50% tobacco use, and Eastside Bikes more than 50% engagement with wellness programs. Rates calculated as of the second quarter of 2011.

Conclusion

Is the rate reasonable considering the proposed profit or contribution to surplus and other factors?

While the overall rate increase and loss ratio do appear in line with overall market trends, there are three significant areas where the rate increase request does not appear to be adequately supported by the information in filing.

First, the filing does not sufficiently explain the medical trend figure. While Health Net states what they assess the trend to be for the small group market segment, a recent SEC filing suggests a noticeably lower value for the insurer's expected medical trend across all market segments in the West. The filing does not offer an explanation for this difference, and does not include detailed support for the trend value ultimately chosen.

Second, while independent estimates of the premium impact of the benefit changes mandated by the federal health reform law cluster in the 1-3% range, Health Net's calculation of the impact on its plans in this market segment range from 3-6%, which is substantially higher. As with medical trend, there may be an explanation for this higher number, but it is not included in the filing.

Third, Health Net appears to assume that its administrative costs will increase at roughly the same rate as its claims costs. This assumption does not appear to be supported by Health Net's historical data for this market segment, and differs from its anticipated administrative cost trends company-wide.

Are there areas in the rate filing where DCBS should seek additional information from the insurer?

We respectfully urge DCBS to request additional information to allow it to better evaluate Health Net's medical trend value, administrative cost increases, and increases due to implementing benefit improvements in accordance with the ACA.

An additional area where we recommend DCBS to request clarification is regarding the range of impacts of the rate increase. The filing states that enrollees will see rate changes ranging from -9% to 30%, but the information in the filing seems to suggest that the maximum reduction an enrollee could experience would be less than 2.5%.

Finally, we urge DCBS to seek additional information from Health Net about their full activities aimed at reducing costs while improving quality, and make this information publically available.

The insurer included a very brief cost containment and quality improvement statement as part of the filing, focusing primarily around limiting benefits to enrollees. Experts agree that innovations in payment and delivery reforms hold the promise of improving patient care while making coverage more affordable. While insurers are only required to list *new* efforts to contain costs and improve quality as part of the rate filing, understanding the efforts that Health Net is in fact undertaking, and their impact on costs, is critical to evaluating the rate request.

Attachment A

Page 37 from Health Net's 2010 third quarter 10-Q filing to the Securities and Exchange Commission

Western Region Operations Segment Results

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands, except per share and PMPM data)			
Health plan services premiums	$2,457,977	$2,467,023	$7,444,617	$7,415,074
Net investment income	19,240	21,182	55,141	43,334
Administrative services fees and other income	5,487	13,662	21,594	27,209
Total revenues	2,482,704	2,501,867	7,521,352	7,485,617
Health plan services	2,122,005	2,143,481	6,476,062	6,453,113
General and administrative	214,286	201,799	650,862	618,299
Selling	58,267	57,966	171,742	174,401
Depreciation and amortization	8,585	9,692	25,654	28,840
Interest	8,150	10,069	26,795	30,790
Total expenses	2,411,293	2,423,007	7,351,115	7,305,443
Income from operations before income taxes	71,411	78,860	170,237	180,174
Income tax provision	26,974	25,073	64,320	62,769
Net income	$ 44,437	$ 53,787	$ 105,917	$ 117,405
Basic earnings per share	$ 0.46	$ 0.52	$ 1.07	$ 1.13
Diluted earnings per share	$ 0.45	$ 0.52	$ 1.06	$ 1.13
Pretax margin	2.9%	3.2%	2.3%	2.4%
Commercial premium yield	7.2%	9.6%	8.3%	9.7%
Commercial premium PMPM (d)	$ 342.63	$ 319.71	$ 339.80	$ 313.75
Commercial health care cost trend	5.2%	8.3%	7.5%	9.6%
Commercial health care cost PMPM (d)	$ 295.73	$ 280.99	$ 293.32	$ 272.76
Commercial MCR (e)	86.3%	87.9%	86.3%	86.9%
Medicare Advantage MCR (e)	89.4%	88.4%	88.7%	87.9%
Medicare Part D MCR (e)	64.6%	65.9%	84.2%	83.8%
Health plan services MCR (a)	86.3%	86.9%	87.0%	87.0%
G&A expense ratio (b)	8.7%	8.1%	8.7%	8.3%
Selling costs ratio (c)	2.4%	2.3%	2.3%	2.4%

(a) MCR is calculated as health plan services cost divided by health plan services premiums revenue.
(b) The G&A expense ratio is computed as G&A expenses divided by the sum of health plan services premiums and administrative services fees and other income.
(c) The selling costs ratio is computed as selling expenses divided by health plan services premiums revenue.
(d) PMPM is calculated based on commercial at-risk member months and excludes ASO member months.
(e) MCR is calculated as commercial, Medicare Advantage or Medicare Part D health care cost divided by commercial, Medicare Advantage or Medicare Part D premium, as applicable.

Revenues

Total revenues in the Western Region Operations decreased slightly less than 1 percent to $2.5 billion for the three months ended September 30, 2010, and increased less than 1 percent to $7.5 billion for the nine months ended September 30, 2010, compared to the same periods in 2009. Health plan services premiums revenues in the Western Region Operations decreased less than 1 percent to $2.5 billion for the three months ended September 30, 2010 and increased less than 1 percent to $7.4 billion for the nine months ended September 30, 2010, compared to the same periods in 2009.