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**Part II Preliminary Justification – Written Explanation of Rate Increase
PreferredOne Insurance Company
Individual Product in Minnesota
January 2014 through December 2014**

1. SCOPE AND RANGE OF RATE INCREASE

The purpose of this memorandum is to request a rate increase for PreferredOne Insurance Company (PIC) Individual plans for Minnesota individual policyholders with effective dates of January 1, 2014 through December 31, 2014.

This justification is intended to comply with the requirements of Section 2794 of the Public Health Service Act as added by Section 1003 of the Patient Protection and Affordable Care Act (ACA). This justification may not be appropriate for purposes or scopes beyond those described above and therefore should not be used for other purposes.

From the 2012 baseline experience, PIC is requesting an average rate increase of 17.2% for individual policyholders renewing during 2014, with a minimum estimated increase by plan of -17.6% and a maximum rate increase of 67.8%. As of December 1, 2012, PIC has 8,642 members. The rate changes will bring existing policyholders in compliance with ACA rating requirements.

The proposed rate increase consists of the following changes to the rate development and will vary by policyholder:

- > An annual trend adjustment of 6.0%.
- > Benefit and administrative costs listed below.
- > Morbidity load of 17.3%. We expect significant morbidity changes in the insured population when the health insurance Exchange opens in 2014. We performed the following steps to estimate the morbidity of 2014 insured members.

Step 1: We estimated Minnesota's current total population and their associated health status by insured status. The statewide market estimates are based on the population at the end of 2013, stratified by current insurance status, poverty status (income relative to FPL), health status, and family size. The Current Population Survey (CPS) from the U.S. Census provides state-level data for each of these strata. We adjusted the raw CPS data after reviewing the following additional data sources:

- Carriers' annual statutory financial filings provided to the NAIC. The filings contain reliable sizes of the individual and fully insured group markets.

- The Medicaid Statistical Information System (MSIS) (available through the Department of Health and Human Services), which provides reliable data on Medicaid enrollment in Minnesota.

Step 2: We trended the entire population to 2014 based on projected population growth rates.

Step 3: We projected the number of individuals that will purchase individual insurance in the Exchange and non-Exchange markets (i.e., “take-up” rates) from all population categories. Our Exchange take-up rate assumptions are primarily driven by a person’s current insurance status (i.e., insured or uninsured), limited incentives to purchase coverage when healthy (i.e., the least healthy members will be the first to apply for coverage), and the federal subsidy available (if any) if the member enrolls in an Exchange plan. This resulted in a 2014 population projection by cohort (i.e., age, gender, income, and Exchange status). Finally, we applied a smoothing algorithm to compensate for potential credibility issues. We estimate 2014 average claim costs across the Minnesota market will increase approximately 17.3% vs. the current individual market based on a combination of current population data, various industry studies, and proprietary data.

Step 4: We recalculated the resulting average health status of PIC’s share of the individual market based on the migration described in Step 3. We projected PIC’s expected 2014 individual product enrollment on and off the exchange based on our estimate of the statewide population and PIC’s likely share of the total insured market based on their relative prices and general appeal. We estimated the members that would select each of PIC’s benefit plans based on the plans for which they would qualify (given their age and income level).

- > Age slope changes to be compliant with the HHS default federal age curve prescribed in the HHS’ February 25, 2013 Sub-Regulatory Guidance Regarding Age Curves, Geographical Rating Areas, and State Reporting). The child factor is changed from the federal age curve to 0.89 to comply with Minnesota regulations.
- > Removal of any existing underwriting discounts or loads.
- > Area factor changes to comply with Minnesota’s defined rating areas in PIC’s service area. Area factors were determined by starting with currently approved factors, reviewed for actual experience and adjusted for expected provider reimbursement changes.
- > A 14.0% premium rate load charged at all ages (18 and older) for smoking members. The loading is based on public research regarding the additional medical costs of smokers vs. non-smokers.
- > PIC recognizes that to operate within a single risk pool, issuers are required to make a market-wide adjustment to the pooled market level index rate to account for federal risk adjustment payments. Therefore, PIC must allocate anticipated risk adjustment revenue proportionately across all plans in the risk pool based on plan premiums by applying the risk adjustment transfer as a constant multiplicative factor across all plans. The risk adjustment projection results in a projected PIC payment, which accounts for approximately 20% of the 2014 premium.



The following section outlines the approach used to estimate the impact of risk adjustment for these products.

Project Statewide Risk Scores for Use in the Risk Adjustment Transfer Payment

Statewide risk scores were calculated by using the Health and Human Services (HHS) risk adjustment methodology. The data used for this analysis was extracted from Milliman's database limited to Minnesota specific commercial insured lives. We calculated a risk score using this population for each metallic tier.

Project PIC's Risk Scores for Use in the Risk Adjustment Transfer Payment

PIC's risk scores were determined in a similar fashion as the statewide risk scores by using their base period experience. The impact of selection between the metal plans was not modeled (even though it is expected to occur) since carriers are not allowed to rate for selection between the metal tiers.

Estimate PIC's Risk Adjustment Transfer Payment

A weighted average PIC and statewide risk score was determined by taking the assumed 2014 membership distribution by metallic tier. PIC's risk adjustment transfer payment was estimated by taking one minus the weighted average PIC risk score divided by the weighted average statewide risk score multiplied the assumed 2014 statewide average Minnesota premium.

The 2014 statewide average premium was approximated by using data from the 2012 premiums for the top ten individual carriers in the state of Minnesota, applying an annual 3.0% trend, multiplying by the 17.3% morbidity load and 2.3% for additional EHBs.

The projected risk adjustment transfer payment is allocated to plans proportionately based on the plan premium.

2. FINANCIAL EXPERIENCE

PIC's financial experience by product for 2011 and 2012 (through March 23, 2012) is shown below:

- > 2011: Premium = \$9,241,530; Incurred Claims = \$4,719,973; Medical Loss Ratio = 51.1%
- > 2012: Premium = \$11,283,195; Incurred Claims = \$5,948,944; Medical Loss Ratio = 52.7%

The premiums listed above are net of paid rebates. In 2011, PIC paid a rebate of \$150,000 and in 2012, approximately \$1,200,000. Please note that 47% of PIC's business was written in 2012 and 16% in 2011.

3. CHANGES IN MEDICAL SERVICE COSTS AND TREND ASSUMPTIONS

The projection of claims from the experience period to the effective period assumes 6.0% annual trend. This claim assumption is based on analysis of the health plan's recent and expected experience and the Milliman *Health Cost Guidelines (HCGs)*.



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4. CHANGES IN BENEFITS

The covered benefits underlying PIC's 2012 individual experience were increased 2.3% to meet the essential health benefits (EHB) mandated in the 2014 covered benefits. These additional benefits include no waiting period on maternity, mental nervous and substance abuse benefits, cochlear implants, eyeglasses for children, increased pharmacy benefits, pediatric dental, and skilled nursing facility care. Policyholders who do not currently meet a qualified metallic plan will be brought into compliance.

5. ADMINISTRATIVE COSTS AND ANTICIPATED PROFITS

PIC targets a federally prescribed medical loss ratio of 83.8% for its individual block of business. This loss ratio allows 16.2% for total health plan administrative costs and anticipated profits. The targeted administrative expense is increased from prior years by 4.7% to account for the new ACA fees to be charged in 2014.

6. ADDITIONAL CAVEATS

This narrative and the attached filing are intended to support PreferredOne Insurance Company's 2014 Individual Rate Filing product in the state of Minnesota. It should not be distributed, in whole or in part, to any external party, other than the State of Minnesota or the Centers for Medicare and Medicaid Services (CMS), without prior written permission. In any event, this information is not intended to benefit any third party. This information may not be appropriate, and should not be used, for other purposes.

Differences between projections and actual amounts depend on the extent to which future experience conforms to the assumptions made for this analysis. It is certain actual experience will not conform exactly to the assumptions used in this analysis. Actual amounts will differ from projected amounts to the extent actual experience deviates from expected experience.

Respectfully Submitted,

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Member of the American Academy of Actuaries
August 1, 2013

2014 PreferredOne Insurance Company Individual Medical Rate Change

Minnesota Department of Commerce Comments:

The Minnesota Department of Commerce agreed to approve rates that were 37% lower than the originally filed rates.