One Liberty Plaza, New York, NY 10006, Telephone (212) 476 1000

Request of:

EMPIRE BLUE CROSS AND BLUE SHIELD

To:

THE DEPARTMENT OF FINANCIAL SERVICES of the STATE OF NEW YORK

FOR APPROVAL OF COMMUNITY RATE INCREASES

Filed November 8, 2012

One Liberty Plaza, New York, NY 10006, Telephone (212) 476 1000

NARRATIVE SUMMARY
[DFS and policyholder – for public posting]

I. OVERVIEW

Empire Blue Cross and Blue Shield (Empire) has made an application to the Superintendent of Financial Services to adjust premium rates for health insurance available to small groups of 2 to 50 eligible employees; as well as large groups with the HMO product and Healthy New York customers.

These groups' employees and their covered dependents are combined, by long standing New York law, in what is known as a community rated pool. All members enrolled in the pool plans are guaranteed issuance of coverage and are charged the same premium rate as any other member for the health insurance product they select regardless of health status, age, sex, or other demographic factors other than the region of the State where they reside.

All medical, hospital, pharmacy, and other covered care and necessary administrative costs are also combined, by law, for this pool in order to determine appropriate premium rates. These premium rates must support sufficient, sustainable revenue and reserves for both current and future coverage costs related to community pool products on a stand alone basis. Current approved rates for Empire's community pool products are inadequate for the rising costs incurred as provider charges continue to rise and utilization of services increases. In the small group market, the change in utilization is driven increasingly by fewer small group employees being offered or selecting coverage through their employer. Those that continue to purchase coverage are disproportionately in need of covered care causing sharp increases in the overall cost incurred under Empire's and other insurers' community pool products.

In the aggregate, Empire's overall proportion of small group premium revenue paid out in care benefits has historically been well above the State required minimum of 82 percent. However, this historical performance is unsustainable. The more recent rising costs and utilization noted above have produced results that far exceeded the expected claim cost for these products and have driven a significant proportion of the increase needed in premium. Empire pays for care to levels that jeopardize the sustainability of coverage. Moreover, the unexpected state reductions to the subsidy for Healthy New York have led to significant losses in that product as well. Critical changes in the short term include appropriate premium rate adjustments reflecting the actual cost of care of community pool members, and changes in the number of small group plans Empire offers. With these changes, Empire remains committed in the longer term to finding new solutions for the small group market in New York. This will require working with all stakeholders in the development of more affordable plan options for future years, and collaboration on efforts to improve both State and Federal reform initiatives.

For the large group HMO product, experience has not been so dire. The product has run well for some time and we are requesting a more modest increase.

The products specifically impacted by rate increases at this time are the Essential EPO and Empire PPO products sold by Empire HealthChoice Assurance, Inc, (Empire's insurance company; NAIC code number 55093) and BlueChoice HMO, DirectConnection HMO, and Healthy New York products sold by Empire HealthChoice HMO, Inc (Empire's HMO company; NAIC code number 95433). The actual rate increases requested are provided below. Empire's proposed rates are subject to review and approval by the New York Department of Financial Services, with the determination by the Department supported by sound actuarial assumptions and methods. The rate application was filed with the Department on or just after October 12, 2012 (SERFF numbers: AWLP-128690122 for Empire HealthChoice Assurance, Inc and AWLP-128691341 for Empire HealthChoice HMO, Inc). The actual rate increases approved will be communicated to the impacted parties upon completion of the Department's review and are scheduled to be effective beginning on April 1, 2013.

For Essential EPO, Empire PPO, BlueChoice HMO, and Direct Connection HMO, the proposed rates are expected to be implemented for small groups effective between April 1, 2013 and March 31, 2014, upon the group's renewal. The rate for any specific group will vary based on geographic area, renewal date, family tier, and benefit plan selected.

For BlueChoice HMO and Direct Connection HMO, the proposed rates are expected to be implemented for large groups effective between April 1, 2013 and March 31, 2014, upon the group's renewal. The rate for any specific group will vary based on geographic area, renewal date, family tier, and benefit plan selected.

For Healthy New York, the proposed rates are expected to be implemented effective April 1, 2013. The rate for any specific small group or direct payment customer will vary based on geographic area, family tier, and the benefit plan selected.

In conjunction with this rate application, Empire intends to discontinue the Total Blue small group product from the New York market. Discontinuances are generally in response to the above noted disparity between premium revenues and the actual claim costs for the products being discontinued. The members in the discontinued product, who continue with Empire coverage, may select one of the products subject to this rate application. We also anticipate that the migration of these members will trigger some adverse selection and potentially have a further adverse rate impact on the remaining products.

As noted above, Empire is required by New York State law to develop rates that are actuarially sound, assume at least 82% of premium revenue will be spent on health care costs, cover all claim costs, and also contribute to claims reserves. The percent of premium attributable to claims is essentially how much of the premium dollar is used to pay claims and is referred to as the Medical Loss Ratio (MLR). The actual MLR may vary over time based on changes in the amounts charged by hospitals, physicians, and other providers, the increase in health care trend or inflation and health care utilization by our members. Overall, Empire's MLR for small groups is currently substantially higher than the 82% statutory minimum and its administrative costs are among the lowest of all health insurers in New York. With the proposed rate adjustments, Empire's overall MLR is expected to continue to remain above the 82% minimum allowable ratio. In the event Empire's MLR does not meet the required minimum, Empire will refund the difference to policyholders.

Empire has attempted to limit the rate increases to the lowest increases possible while preserving the financial integrity of the products. Based on the performance of these products, our current rates were set at an inadequate level and are unsustainable. This rate action is expected to move the rates toward an adequate level to compensate for both anticipated utilization and the annual increases in the cost of medical care (*See description of health care costs below*).

Periodic rate adjustments are necessary to secure the ability of Empire, or any insurer, to produce sufficient revenue and surplus for reserves to assure continued coverage and claim payments both for current healthcare needs and potential catastrophic cost situations. Empire's reserves vary from year to year based on actual healthcare costs incurred and typically vary from 3 to 6 months of claims costs above the minimum required by New York State law. Failing to meet the minimum statutory reserves will deem the insurer as "impaired" under the New York Insurance Law. These reserves are the "insurance" that ensures payment even when costs run higher than anticipated or emergencies or disasters occur, and should not be used as an alternative fund to temporarily reduce rate adjustments.

In filing this rate application we are sensitive to the fact that individuals and businesses struggle to afford higher premiums and we are seeking the premium necessary, as determined by our actuaries, to maintain a viable health plan. In our sound actuarial judgment it is clear that an increase in premiums is critical to ensure the viability of these products. Failure to approve these rates will lead to even greater rate increases and fewer product offerings in the future as claim costs will eventually exceed premiums collected.

II. FACTORS CONTRIBUTING TO THE PROPOSED RATE INCREASE

Escalating Health Care Costs

The cost of health care services, equipment and products continues to be the primary reason for rate increases. Nationally, the growth in the cost of medical care continues to significantly outpace consumer inflation. Total medical cost for a typical American family of four increased 6.9% last year (2011/2012 data). The raw number annual increase of $1,335 is the largest recorded in the previous ten years. Hospital costs continue to rise, with an increase of 7.6% in inpatient care costs in 2011-2012, and an increase of 8.6% in outpatient costs.[1]

These trends reflect underlying changes in the demographics and health status of

[1] 2012 Milliman Medical Index

America’s population. The aging population is driving some of the increase – as people age they use more health services. Between 2000 and 2050, the population aged 65 and older is expected to grow from 12% to 21%, as the “baby boomer” population ages and life expectancy continues to rise. As this population nears Medicare eligibility the proportion of the insured population at older ages increases, thus increasing average costs. Unfortunately, the country’s declining health and the increase in obesity and other health concerns, even at younger ages, forces average costs upward.

In addition, in New York, these increasing costs and the economic pressures on small employers and their workers have caused fewer groups to offer coverage to their employees. These same costs and conditions have caused smaller numbers of the employees to elect to participate in coverage if it is offered. As a result, the remaining community pool of members Empire covers is disproportionately in need of covered care compared to when a larger, more balanced proportion of small company workers were enrolled. This has increased cost substantially for the community pool for Empire, and for other New York insurers who participate in the small employer market.

<u>Hospital</u>

Hospitals (inpatient and outpatient care) account for the largest share (45% to 55%) of the health care premium dollar in New York and their share continues to grow. Factors driving this growth include increasing demand for care, rising costs to hospitals of the goods and services needed to provide care, growing intensity of care needs, and the shifting of costs of Medicaid and Medicare hospital payment cuts to insurers. As hospitals see higher and higher costs, and payments from Medicaid and Medicare do not keep pace, hospitals have demanded higher and higher reimbursement from private insurers.

Nationally, increasing costs to hospitals for the goods and services purchased to provide care accounted for 63% of overall growth in spending on hospital care from 2006 to 2010, while rising demand for care accounted for 29% of the overall growth in spending during the same period [2] . The increase in labor costs is the most important single driver of spending growth for hospitals, accounting for about 35% of overall growth and more than half of the growth in the costs of purchased goods and services.

The increase in cost is also attributed to other factors including increased intensity of hospital care, i.e., hospitals are using more resources to care for each patient. Increased intensity can be attributed to a variety of factors, including sicker patients with more complex conditions.[3]

The increase in cost for hospital inpatient care in Empire's operating area surpasses the rate for the rest of the country. An approximate 7% to 8% rate of increase due solely to increases in the contracted hospital reimbursement level is currently projected for both 2012 and 2013.

The trend toward higher inpatient costs is tempered somewhat by a projected slowing of

[2] American Hospital Association, The Cost of Caring, June 2012
[3] See, American Hospital Association, The Cost of Caring, June 2012

utilization growth compared to 2009.

For hospital outpatient benefits, utilization increases are expected to slow, but such increases have been high in recent years.

<u>Medical</u>
Costs per member for medical professionals have experienced only moderate increases over the past year and are projected to trend at a rate of 5% to 8% per year over the coming years.

<u>Prescription Drugs</u>
Over the past year, drug cost increases have been tempered by the recent shift of some popular drugs off of patent. With the continued approval and introduction of expensive specialty medications, we expect the cost increase to return to higher levels over the coming years.

Since the reenactment of prior approval in New York effective October 1, 2010, and despite Empire's small group pool results at overall MLR's above 90 percent, requested rates reflecting the actual costs of Empire's plans were reduced materially for both 2011 and 2012 driving significant and continuing overall losses for Empire's small group pool. The resulting significant losses in these products have forced Empire to reduce plan choices available to the market and the cancellation by groups and members who otherwise preferred Empire plans to other insurers.

III. ADMINISTRATIVE SAVINGS

Recognizing the impact the rate increases will have on our customers, Empire has attempted to mitigate their impact by vigilantly reducing selected administrative costs to offset increases that are necessary or beyond our control. Some of these efforts included:

- We are trained and practice Continuous Improvements in all areas of the company for administrative savings and continuous improvement of members and customer services;
- We implemented a cost-saving process improvement and automation of claims payment system;
- We reduced staffing and improved efficiencies; and,
- We reduced real estate expenses.

As a result of these efforts and other cost savings measures, Empire has among the lowest administrative costs in the industry, currently at approximately 10.2% of revenue. Excluding the amount paid to the State in premium taxes, our administrative costs have been reduced to 8.2% for the small group segment. While we continue to strive to reduce administrative costs further, we want to avoid sacrificing customer service, which we believe would be at risk by further cost reductions.

IV. HISTORICAL FACTORS

New York Health Care Cost

New York stands out as an especially costly state in which to purchase healthcare. New York City remains the second most expensive major metropolitan area in the country with respect to healthcare costs. A 2012 report by Milliman shows the cost of care to be 118.4% of the national average.[4] New York's dubious distinction as a high cost state is also borne out in Dartmouth Atlas data which shows the State outpacing national average costs in a wide variety of indicators.[5] As a ratio to national average cost, New York State registered 1.15 in overall Medicaid reimbursements; 1.31 in professional and laboratory reimbursements; and 1.37 in short stay inpatient reimbursements.

Nationally, the cost per inpatient discharge continues to increase. In New York, the cost per inpatient discharge has increased from $9,178 in 2006 to $11, 463 in 2010. In 2010, New York's cost per inpatient discharge also exceeded the national median value of $9,136

New York's length of stay (days) is another contributing factor to cost. In 2010, New York's length of stay (days) averaged 474, exceeding the national median value of 3.97.[6]

New York Taxes

New York adds more insurance taxes and assessments than any other state in the country. These consist of both direct taxes and a number of indirect taxes amounting to a total of over $4.1 billion in taxes passed on to New York healthcare customers in the form of higher premiums. These taxes include:

- NYS Premium Tax – this 1.75% tax is on all HMO and insurance contracts (and there is an additional amount for customers in the MTA service area). For 2011 Empire paid $104.8 million to the State in premium taxes.
- Covered Lives Assessment – this indirect tax is a charge on all fully and self insured "covered lives" The purpose of the Covered Lives Assessment is to raise funds for a variety of state programs and for the state Budget. The Assessment is included in claims costs for purposes of calculating the MLR. This assessment is a charge of from $2.76 to $16.21 per individual contract per month and from $9.11 to $53.49 per family contract per month. For 2011, Empire will pay $308.4 million in covered lives assessment.
- HCRA Surcharge – this is a 9.63% surcharge on all hospital discharges. The purpose of the HCRA Surcharge is to raise funds for a variety of state programs and for the state budget. The Assessment is included in claims costs for purposes of calculating the MLR. For 2011, Empire will pay approximately $429.2 million in HCRA Surcharges.
- NYS Insurance Department "332" Assessment – while this assessment is appropriately intended to fund the cost of the Department's regulatory activities, there is an indirect tax whereby a large portion of the revenue generated by the assessment is used to fund other programs not directly related to insurance

[4] See, 2010 Milliman Medical Index and 2009 Milliman Medical Index
[5] See, Dartmouth Atlas of Health Care, last accessed 9/13/2012
[6] See, 2010, Ingenix, Almanac of Hospital Financial and Operating Indicators

regulation. This assessment is charged to insurers based on the number of New York insured members they cover. Empire will pay $42.1 million in 332 assessments for 2011.

- Insurer and reinsurance fees are new assessments that will have impact on the 2013 rate increases

While there were not any tax increases which have contributed to the rates being increased with this application, each of these taxes is increased regularly by the State and has in the past contributed significantly to the need for annual increases in rates.

<u>Other Factors</u>
There are several federal fees that are contributing to the rates being increased within this application.

V. <u>DETAILS OF THE PROPOSED RATE INCREASE</u>

Empire provides health insurance protection to approximately 5 million persons in 28 counties in eastern and southeastern New York State. The proposed premium rates affect approximately:

- 2,000 Essential EPO members
- 44,000 Healthy New York members
- 16,000 Small group Direct HMO / HMO members
- 5,000 Small group PPO members
- 27,000 Large group Direct HMO / HMO members

Premium rates for community-rated customers are regulated by the Superintendent of Financial Services pursuant to Section 4,308 or 3,231 of the Insurance Law. The following tables show proposed annual rate changes for the indicated community rated products:

Small Group Direct HMO / HMO Medical Standard - All Regions and Tiers	
Policyholder Anniversary / Renewal Date	**Rate Increase Requested**
Between 04/01/2013 - 6/30/2013	26.1%
Between 07/01/2013 - 9/30/2013	27.0%
Between 10/01/2013 - 10/31/2013	27.9%
Between 11/01/2013 - 12/31/2013	27.1%
Between 01/01/2014 - 03/31/2014	28.0%

Small Group Direct HMO / HMO Medical Carve-out - All Regions				
Policyholder Anniversary / Renewal Date	Rate Increase Requested by Tier			
	Individual	Husband/ Wife	Parent / Child(ren)	Family
Between 04/1/2013 - 06/30/2013	36.3%	30.8%	31.6%	29.3%
Between 07/1/2013 - 09/30/2013	37.3%	31.7%	32.5%	30.2%
Between 10/1/2013 - 10/31/2013	38.3%	32.7%	33.5%	31.2%
Between 11/1/2013 - 12/31/2013	37.4%	31.8%	32.6%	30.3%
Between 1/1/2014 - 3/31/2014	28.0%	28.0%	28.0%	28.0%

Small Group Direct HMO / HMO Prescription Drug - All Regions			
Policyholder Anniversary	Prescription Plan	Rate Increase Requested by Tier	
		Individual; Parent/Child(ren); Family	Husband/Wife
Between 04/01/2013 - 6/30/2013	All Prescription Plans	25.2%	
Between 07/01/2013 - 9/30/2013	All Prescription Plans	26.1%	
Between 10/01/2013 - 12/31/2013	$10 Generic Only Plan	27.1%	27.0%
	All Other Prescription Plans	27.1%	
Between 01/01/2014 - 03/31/2014	All Prescription Plans	28.0%	

Healthy New York Medical and Prescription Drug - All Regions and Tiers	
Policyholder Anniversary	Rate Increase Requested
Effective 4/1/2013	24.9%

Small Group PPO Medical - All Regions and Tiers	
Policyholder Anniversary / Renewal Date	Rate Increase Requested
Between 04/01/2013 - 06/30/2013	15.4%
Between 07/01/2013 - 09/30/2013	16.8%
Between 10/01/2013 - 10/31/2013	18.2%
Between 11/01/2013 - 12/31/2013	17.4%
Between 01/01/2014 - 03/31/2014	18.8%

Small Group PPO All Prescription Drug - All Regions and Tiers	
Policyholder Anniversary	Rate Increase Requested
Between 04/01/2013 - 06/30/2013	14.6%
Between 07/01/2013 - 09/30/2013	16.0%
Between 10/01/2013 - 12/31/2013	17.4%
Between 01/01/2014 - 03/31/2014	18.8%

Small Group Essential EPO Medical			
Policyholder Anniversary / Renewal Date	Region	Rate Increase Requested by Tier	
		Individual; Husband/Wife	Parent/Child(ren); Family
Between 04/1/2013 - 06/30/2013	All Regions	13.9%	
Between 07/1/2013 - 09/30/2013	All Regions	14.7%	
Between 10/1/2013 - 10/31/2013	Counties: Nassau, New York, Queens, and Suffolk	15.5%	
	Counties: Dutchess, Orange, Putnam, Sullivan, Ulster, Westchester, and Connecticut	15.5%	15.6%
	All Other Regions	15.6%	
Between 11/1/2013 - 12/31/2013	Counties: Bronx, Kings, Richmond, Rockland, New Jersey, Nassau, New York, Queens, Suffolk, Dutchess, Orange, Putnam, Sullivan, Ulster, Westchester, and Connecticut	14.7%	
	All Other Regions	14.8%	
Between 01/1/2014 - 03/31/2014	All Regions	15.6%	

Small Group Essential EPO Prescription Drug - All Regions and Tiers		
Policyholder Anniversary	Prescription Plan	Rate Increase Requested
Between 04/01/2013 - 06/30/2013	All Prescription Plans	13.1%
Between 07/01/2013 - 09/30/2013	All Prescription Plans	13.9%
Between 10/01/2013 - 12/31/2013	\$50 Rx Deductible; \$10/\$35/35% w/ \$10,000 Rx Out-of-Pocket Maximum	14.7%
	All Other Prescription Plans	14.8%
Between 01/01/2014 - 03/31/2014	All Prescription Plans	15.6%

Large Group Direct HMO / HMO Medical Standard / Carve-Out - All Regions and Tiers	
Policyholder Anniversary / Renewal Date	Rate Increase Requested
Between 04/01/2013 - 6/30/2013	7.0%
Between 07/01/2013 - 9/30/2013	11.1%
Between 10/01/2013 - 10/31/2013	15.2%
Between 11/01/2013 - 12/31/2013	14.4%
Between 01/01/2014 - 03/31/2014	18.7%

Large Group Direct HMO / HMO Prescription Drug - All Regions			
Policyholder Anniversary	Prescription Plan	Rate Increase Requested by Tier	
		Parent/Child(ren)	All Other Tiers
Between 04/01/2013 - 06/30/2013	All Prescription Plans	6.3%	
Between 07/01/2013 - 09/30/2013	$10 Generic Only Plan	10.2%	
	All Other Prescription Plans	10.3%	
Between 10/01/2013 - 12/31/2013	$10 Generic Only Plan	14.3%	14.4%
	All Other Prescription Plans	14.4%	
Between 01/01/2014 - 03/31/2014	$10 Generic Only Plan	18.6%	18.7%
	All Other Prescription Plans	18.7%	

VI. FINANCIAL DATA

Exhibit 1 contains the audited Statement of Financial Condition at December 31, 2011 for Empire HealthChoice Assurance, Inc.