



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

Request of:

**EMPIRE BLUE CROSS AND BLUE SHIELD**

To:

**THE DEPARTMENT OF INSURANCE**

**of the STATE OF NEW YORK**

*FOR APPROVAL OF DIRECT PAY COMMUNITY RATE INCREASES*

**Filed July 8, 2011**



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## **NARRATIVE SUMMARY**

### **I. OVERVIEW**

Empire Blue Cross and Blue Shield (Empire) has made application to the Superintendent of Insurance to adjust Direct Pay (individual) premium rates for health insurance for its Empire HealthChoice Assurance, Inc. and Empire HealthChoice HMO, Inc companies. The actual rate increases requested are provided below. Empire's proposed rates are subject to review and approval by the New York Department of Insurance, with the determination by the Department supported by sound actuarial assumptions and methods. The rate application was filed with the Department on July 8, 2011. 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 January 1, 2012.

The proposed rates are expected to be implemented for individual plans effective January 1, 2012. The rate for any individual will vary based on geographic area and benefit plan selected. Rates for the HMO and HMO/POS products will be applied to the members upon their enrollment anniversary between January 1, 2012 and December 1, 2012; while rates for all new entrants will change on January 1, 2012. .

Empire is required by New York State insurance law to use an actuarially sound methodology to develop rates that project at least 82% of premium revenue will be spent on healthcare costs. The projection must also ensure that premiums levels will cover all costs and risks associated with the book of business as well as allow for a contribution to the surplus of the company which protects our policyholders in case of adverse or unexpected claims experience.

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 the claims experience of our policyholders, 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.

While historically Empire's two statutorily mandated HMO and HMO/POS products (also known as the standard products) have experienced loss ratios well in excess of 90% which had resulted in considerable losses for the company, over the last several years Empire's MLR on the individual plans has varied widely due to the declining enrollment in these policies. For example, in certain recent years, Empire's loss ratio has exceeded the minimum MLR to such a degree that Empire experienced operating losses on these policies while in other years Empire has been able to avoid such losses and actually contribute a surplus to the reserves of the company. Even with the proposed rate adjustments, we project that Empire's overall MLR for the individual products will remain above the 82% minimum. In the event Empire's MLR does not meet the required minimum, in accordance with New York State insurance law, Empire will refund the

difference to policyholders.

Periodic rate adjustments are necessary to secure the ability of Empire, or any insurer, to assure continued coverage and claim payments for current healthcare needs, and for potential catastrophic cost situations.

In filing our rate application we were sensitive to the fact that individuals struggle to afford higher premiums. However, it is clear that an increase in premiums is necessary to preserve the financial integrity of the Plan and assure the future viability of these products.

Claims costs for Empire's individual market products are increasing at a higher rate than average cost increases. This is due to many factors that are exacerbated by the downturn of the economy, leading many healthy individuals to avoid purchasing coverage or to drop coverage altogether. These factors include:

- Increased utilization costs that are affected, in part, by the deteriorating health of the population enrolled in these products
- Use of new, expensive prescription drugs; and
- Rising cost of advanced technologies.

We understand that these are difficult economic times, and we are committed to working to moderate the impact of rate increases on our members while continuing to provide access to high quality, affordable health care. In addition, we are investing in many initiatives to reduce the cost of care, promoting wellness and preventive care for our members and communities, and working with providers to encourage high-quality, evidence-based care, which costs less over time.

We are dedicated to working with our members to find health coverage plans that are the most appropriate, beneficial and affordable for their needs. Also, to help our members manage costs, we continue to attempt to negotiate the best possible rates for covered products and provider services and are making more tools available to help members better manage health and out-of-pocket costs.

## **II. FACTORS CONTRIBUTING TO THE PROPOSED RATE INCREASE**

### Increasing cost of medical care;

The requested increase to rates is due primarily to the annual increases in the cost of medical care and the anticipated increase in utilization of services. For our HMO and HMO/POS policyholders, enrollment has declined significantly putting upward pressure on rates from the loss of healthy members and less membership over which to spread the costs. Likewise, the size and quality of Empire's hospital network has historically attracted a less healthy population. For our indemnity (Hospital only, Basic Med, Wrap & Comp) policyholders, there is also significant volatility in the experience of non-comprehensive coverage specifically from the risks of large claims.

### Adverse selection puts upward pressure on rates when healthy members lapse;

Significant claim volatility and adverse selection by individual policyholders is putting additional pressure on the cost of providing care for our individual policyholders.

Statutory reinsurance and stop loss mechanisms help offset some of the volatility due to large claims, but the impact of adverse selection on the claims cost trend remains. Adverse selection occurs as younger, healthier members choose to drop out of the pool or seek coverage from plans that have a more healthy community pool. The enrollment in Empire's two standard products has dropped to under 7,000 members as of April 2011, leaving fewer members over which to spread the cost of claims.

The same factors that lead to increased adverse selection also make it difficult to accurately project future experience. The HMO and HMO-based POS products in particular lack full credibility due to declining enrollment. Moreover, the ability of individuals to buy in and drop out of the pool at will has increased the claims and premiums volatility and added additional uncertainty to our projections. As enrollment continues to decrease, the few remaining healthy members are more likely to terminate coverage. While recent claims cost trends have moderated (or dropped) from the levels observed in 2009, the pool has exhibited significant claim volatility over time. As more healthy members leave the pool, this volatility will be exacerbated.

Claims volatility and recent demographic changes in our non-comprehensive plans:

During the most recent calendar year, claim cost trends for the Hospital only product have benefited from younger policyholders entering the pool. However, Empire's loss ratio (MLR) for the Hospital only and non-comprehensive indemnity plans have varied dramatically from year to year even with receipts from the market stabilization pool (Regulation 146). Empire has seen significant enrollment growth in our Hospital only product (TraditionPlus Hospital). While this product provides valuable protection for New York members, it also carries a significant amount of claims cost volatility due to the unforeseen or catastrophic nature of many claims under hospital only coverage. Because the loss ratio on the Hospital only and Basic Medical policies fluctuates widely, Empire is closely monitoring emerging experience in the pool to ensure that premiums keep pace with the long-term claims cost trend.

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 2010 report by Milliman shows the cost of care to be 118.8% of the national average, up from 117.4% in 2009.<sup>1</sup> 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.<sup>2</sup> 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 \$5,910 in 2005 to \$9,833 in 2009. In 2009, New York's cost per inpatient discharge also exceeded the national median value of \$8,638.

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<sup>1</sup> See, 2010 Milliman Medical Index and 2009 Milliman Medical Index

<sup>2</sup> See, Dartmouth Atlas, last accessed 12/15/2010

New York's length of stay (days) is another contributing factor to cost. In 2009, New York's length of stay (days) averaged 4.3, exceeding the national median value of 4.15 days.<sup>3</sup>

Volatile factors impacting New York individual health insurance market:

New York's individual health insurance market is among the most challenging in the country. The statutory structure of the individual market in New York, which requires guaranteed issue and community rating, has caused the pool to shrink over time and has created a dangerous dynamic in which healthier people drop their coverage as premiums rise, leaving behind an increasingly smaller and less healthy group of insured people, which in turn, causes the cost of premiums to increase at a faster rate. In addition, enrollment has increased dramatically in our hospital only coverage option which contributes to significant volatility in expected results.

### **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 implemented a cost-saving process improvement and automation of the claims payment system;
- We reduced staffing and improved efficiencies; and,
- We reduced real estate expenses.

Excluding the amount paid to the State in taxes and assessments, our administrative costs have been steadily decreasing. 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. TAXATION**

New York taxes:

New York collects more insurance taxes than any other state in the country. These consist of both direct taxes and a number of "hidden" 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 Metropolitan Transit Authority service area). For 2010, Empire paid \$103.9 million to the State in premium taxes.
- Covered Lives Assessment – this "hidden 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 \$2.67 to \$15.36 per individual contract per month and from \$8.80 to \$50.70 per family contract per month. For 2010, Empire paid \$301.9 million in covered lives assessment.

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<sup>3</sup> See, 2010, Ingenix, Almanac of Hospital Financial and Operating Indicators

- 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 2010, Empire paid approximately \$381.0 million in HCRA surcharges.
- NYS Insurance Department “332” Assessment – while this assessment is legitimately intended to fund the cost of the Insurance Department’s regulatory activities, there is a “hidden tax” whereby a large portion of the revenue generated by the assessment is used to fund other programs not directly related to insurance regulation. This assessment is charged to insurers based on the number of New York insured members they cover. Empire paid \$54.8 million in 332 assessments for 2010.

**V. DETAILS OF THE PROPOSED RATE INCREASE**

Empire provides health insurance protection to over 5 million persons in 28 counties in eastern and southeastern New York State. The proposed premium rates affect approximately 23,000 Empire individual members.

HMO and HMO-based POS Products:

The rates we have filed with the Department reflect the fact that healthcare costs continue to escalate faster than the growth of premiums. These new rates underwent rigorous peer review by internal certified actuaries who are independent of our Individual business actuaries.

Premium rates for individual contracts are regulated by the Superintendent of Insurance pursuant to Section 4308 and 3231 of the Insurance Law. Empire Individual policyholders with a next anniversary in the following periods will receive the indicated rate adjustments.

Next Policyholder Anniversary	HMO and HMO/ POS
1/1/2012 - 3/1/2011	17.9%
4/1/2012 - 6/1/2012	17.9%
7/1/2012 - 9/1/2012	17.9%
10/1/2012 - 12/1/2012	17.9%

Because these particular products have a high MLR the failure to approve these rates will only lead to the need for even greater rate increases in the future as claim costs will eventually exceed premiums collected.

Indemnity Products:

Rates for TraditionPlus Hospital, TraditionPlus Premier, TraditionPlus Wraparound, TraditionPlus Comprehensive, and Executive Indemnity I and II are not changing for January 1, 2012; there is no rate increase proposed for these products.