TEXAS PUBLIC POLICY FOUNDATION
PolicyPerspective

January 2012
Center for Health Care Policy

Medical Loss Ratios

by Spencer Harris, Health Care Policy Analyst

In July, the Texas Department of Insurance (TDI) filed a request with Health and Human Services (HHS) Secretary Kathleen Sebelius to adjust the Medical Loss Ratio (MLR) requirements in the Patient Protection and Affordable Care Act (PPACA) for the individual and small group health insurance market in Texas. Under the PPACA, beginning in 2011, all large group plans are required to maintain a MLR of 85 percent and all small group and individual plans are required to maintain an 80 percent MLR. But the PPACA grants authority to the Secretary of HHS to grant waivers to states who sufficiently demonstrate that the MLR regulations would destabilize their insurance markets. The TDI believes that the MLR requirements pose a risk of destabilization in the state's individual and small group insurance markets.

What are MLRs?

An MLR is the percentage of premium dollars spent on providing benefits versus the amount spent on overhead. For example, an 80 percent MLR means 80 cents of every premium dollar spent on an insurance policy is spent on care and 20 cents is spent on administration, profits, etc. MLRs often vary between insurers and plans. In Texas, the top 10 carriers in the individual market, ranked by market share, have MLRs that range from 63.8 percent to 87.8 percent.

Proponents of MLR regulations regard MLRs as a metric of "value" to the consumer. As Healthcare.gov states, "Thanks to the Affordable Care Act, consumers will receive more value for their premium dollar because insurance companies will be required to spend 80 to 85 percent of premium dollars on medical care and health care quality improvement, rather than on administrative costs, starting in 2011."[1] However, using MLRs as a metric for value is an incomplete measurement because it ignores consumer preferences and the value added by administrative spending.

Worse than ignoring the value added by administrative spending, MLRs ignore consumer preferences. Customer's continued enrollment in a company's insurance plan shows their approval of a plan's MLR and the non-benefit spending. MLR requirements restrict consumer preferences concerning the administrative spending, agent compensation, etc. A competitive marketplace allows for consumers to decide which combination of benefit spending and non-benefit spending they prefer whereas MLR requirements restrict their choices.

What is in Administrative Spending?

Administrative spending in health insurance plans can mean a myriad of things many of which add considerable value to the covered individual. The PPACA does exempt expenses "for activities that improve health care quality." This refers to programs that reduce hospital readmission, assist clients in treatment plans, and care coordination. However, some expenses in administrative spending do add considerable value to clients though not necessarily direct patient care.

An important portion of administrative expenses is fraud detection. Ed Haislmaier, Senior Fellow for Health Care Policy at the Heritage Foundation, notes that these MLR regulations, "create a disincentive for insurers to control payment errors and fraud. Under the statute and regulations, money spent on preventing or recovering erroneous or fraudulent claims, counts as 'administrative' expenses, and not 'medical' costs, while erroneous or fraudulent payments count the same as appropriate and legitimate ones in determining whether a plan has paid out a sufficient share of premium income on 'medical care.'"[2] Fraud detection is an important tool for reducing overall health care costs and, thereby, keeping premiums low, but under the PPACA's MLR regulations there is little reason for companies to continue investing in fraud prevention.

continued on back

Another important portion of administrative spending that is not exempted is agent commissions. Insurance agents add considerable value to clients because they are much more than just salespeople for policies. John Goodman, President of the National Center for Policy Analysis, says "Why should you care? Because in today's bureaucratic health insurance system, employers and brokers act as advisors and protectors. They answer questions, correct mistakes, eliminate confusion, etc. If employers begin to drop insurance in large numbers and agents vanish, millions of people will be at the mercy of impersonal insurance bureaucracies."[3] Insurance agents are often the point of guidance when clients have issues with their insurance policy or company. They are also crucial in helping clients evaluate the proper coverage for the small business or individual. Insurance agents assist clients with recommendations that meet clients' financial and medical security needs, and they help their clients with claims issues, service questions, and quality enhancement and compliance matters throughout the life of each policy they sell.[4] The current MLR regulations in the PPACA do threaten Texas insurance agents. As TDI notes, "Without a period of transition, carriers will likely slash agents and brokers' commissions, with the result of diminishing access to health care for many Texans."[5] This is particularly damaging to a state like Texas because rural areas require more outreach efforts by agents.

Do We Need MLR Regulations?

MLRs can be a useful tool to assist consumers in choosing an insurance plan; however, MLR regulations are generally more damaging than useful. Historically, when states institute high MLR regulations it has led to insurers leaving the market, decreasing competition, and rising premiums.

The Council for Affordable Health Insurance (CAHI) notes, "A few states have experimented with increasing loss ratios to artificially lower premiums and cut administrative expenses. Both Kentucky and North Dakota passed higher loss ratios as part of a series of reforms in the 1990s. Kentucky's loss ratio bill was part of a larger health reform legislation that decimated the market. Not until the loss ratio was lowered to a more reasonable 65 percent did the individual market finally begin to recover. North Dakota has faced a similar crisis with carriers abandoning the market, few choices and higher premiums. With the passage of Senate Bill 2154, which lowers the group loss ratio from 75 to 70 percent and individual products from 65 to 55 percent, policymakers in North Dakota expect a resurgence in the market. No state has successfully implemented an 85 percent loss ratio."[6] Using MLRs to regulate private insurance premiums is simply a price control that inevitably distorts the marketplace and harms consumers.

Grace Marie Turner, president of the Galen Institute, testified before Congress noting that these MLR rules have already negatively impacted state insurance markets. In New York, Indiana, Colorado, Iowa, New Mexico, Utah, and Virginia, insurers have signaled their intent to stop offering coverage in the individual market or have left altogether.[7] Joshua Raskin, an analyst at Barclays Capital, mentions in a *Wall Street Journal* article, "With health reform, aggregation of these plans is looming because it is getting harder and harder for smaller plans to compete in a more regulated environment."[8]

The Texas Marketplace

The TDI believes that the immediate implementation of an 80 percent MLR in the individual and small group markets would disrupt the state insurance market. TDI has requested a phased in approach to the MLR as shown below.

Proposed MLR Adjustment	
2011	71%
2012	74%
2013	77%
2014	80%

Source: Center for Consumer Information & Insurance Oversight, CMS

TDI claims, "Without an adjustment, the current MLR requirement will force carriers, regardless of size, to make dramatic cuts in their expense structure to remain profitable."[9] In 2010, only 7 of 26 carriers subject to the regulations achieved an MLR of 80 percent. The largest carrier in the state individual and small group market, representing over 400,000 lives or 56.1 percent of the market, had an MLR of 69.9 percent. It is clear that an 80 percent MLR will be a significant adjustment for the Texas insurance market.

Using MLRs to regulate private insurance premiums is simply a price control that inevitably distorts the marketplace and harms consumers.

Texas insurance companies are required to comply with the MLR requirements through a rebate to customers for the difference between the required MLR and their actual MLR. In 2010 these rebates would have totaled $158.1 million. However, total industry underwriting profits were only $158.6 million in 2010.[10] To comply with the MLR requirements and maintain a profitable business model, Texas insurance companies will have to cut more than just underwriting profits.

TDI recognizes that none of the top 8 carriers in Texas have notified the department of their intent to leave as would be required by state law. However, when the PPACA's MLR requirements were applied to historical data, the pressure on insurers becomes clear. Regulations this drastic do not lay the foundation for long-term growth for the Texas insurance marketplace.

Since passage of the PPACA, HHS has received 15 requests from states for MLR requirement waivers. Of these 15 HHS fully approved only one waiver request, granted limited approval to five other states, rejected six other states, and three states, Texas included, await a determination. The state leadership should continue to push for these adjustments to protect the state's insurance market. ✩

---

[1] "Medical Loss Ratio: Getting Your Money's Worth on Insurance" last modified 22 Nov. 2010.

[2] Ed Haislmaier, "Effects of the PPACA's Minimum Loss Ratio Regulations," Testimony before the U.S. House of Representative Committee on Energy and Commerce (15 Sept. 2011).

[3] John Goodman, "Administrative Costs" John Goodman's Health Policy Blog (10 Aug. 2011).

[4] National Association of Health Underwriters, Electronic Transmission to HHS (14 May 2010).

[5] TDI, "Request for Adjustment to the Medical Loss Ratio" (29 June 2011).

[6] JP Wieske, "How High Loss Ratios Undermine Affordable Health Insurance" (May 2007).

[7] Grace Marie Turner, "New Medical Loss Ratios: Increasing Health Care Value or Just Eliminating Jobs?" Testimony before the U.S. House of Representatives Committee on Small Business (15 Dec. 2011).

[8] Avery Johnson, "Principal Financial Quits Writing Health Care Policies" *The Wall Street Journal* (1 Oct. 2010).

[9] TDI, "Request for Adjustment to the Medical Loss Ratio" (29 June 2011).

[10] Ibid.

About the Author

Spencer Harris joined the Texas Public Policy Foundation in 2010 as a Health Care Policy Analyst. His research focuses on identifying patient-centered, free market solutions for our state's health care challenges.

No stranger to Texas public policy, Harris worked in the House of Representatives for Rep. Warren Chisum where he covered health care issues, immigration issues, and the Licensing and Administrative Committee.

Harris is a native Texan, born and raised in Houston. He graduated from Texas A&M University with a degree in History and Anthropology.

Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute. The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas and the nation by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

Funded by thousands of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

900 Congress Ave., Suite 400 | Austin, Texas 78701 | (512) 472-2700 phone | (512) 472-2728 fax | www.TexasPolicy.com