



Comments of
Consumer Watchdog
on the
Blue Shield of California Life & Health Insurance Company's
Plan to Raise Rates by 9.8%
for 84,979 Californians

Consumer Watchdog
Review of Blue Shield of California Life & Health Insurance Company # HAO-2013-0160
With actuarial analysis prepared by AIS Risk Consultants
November 25, 2013

Consumer Watchdog Review of Blue Shield of California Life and Health Insurance Company Rate Filing #HAO-2013-0160

Blue Shield of California has made great hay of its “2% pledge,” made in 2011 following public furor over double-digit rate increases as high as 59% that the company proposed for California policyholders, and which the insurance company eventually withdrew. The promise, as communicated in letters to policyholders, asserts: “If our net income exceeds 2 percent of revenue, Blue Shield will give back the difference to ... customers and the community as long as we remain financially solvent, with sufficient funds to make the investments needed to stay competitive. When Blue Shield does increase rates, you can trust that we are not doing it to increase our profits, but rather to keep pace with rising costs for healthcare services.”

The public and policyholders have questioned the value of this pledge, however, in light of massive reserves held by Blue Shield and a string of rate increases reduced or found to be unreasonable by state insurance regulators.

The “non-profit” Blue Shield of California, the parent company of Blue Shield of California Life and Health Insurance Company (“Blue Shield Life”) – the subject of this rate filing – has amassed a total net worth of \$3.86 billion. At the end of 2012 Blue Shield of California had excess surplus of about \$3.39 billion – an amount that is 1561% more than the state requires.

Blue Shield Life, also a “non-profit,” has a record of excessive administrative costs. In 2012, Blue Shield Life paid \$380 million to its parent company for “management” costs, an amount that, as outlined below, accounted for the bulk of what this review found to be excessive administrative expenses.

Executive Summary

On October 8, 2013, Blue Shield Life filed a plan to increase rates on its grandfathered PPO plans affecting 58,777 individual policies with 84,979 enrollees. The rate increase would take effect January 1, 2014, and would raise prices for policyholders by an average of 9.8% for the year. As a result of the rate increase, Blue Shield Life’s premium will increase by \$18.5 million – or an average increase per family of about \$2,312 annually.

With the assistance of the actuarial firm AIS Risk Consultants, Consumer Watchdog has reviewed Blue Shield Life’s January 1, 2014 rate hike for its grandfathered PPO products. ***We find Blue Shield’s rate increase to be unreasonable.***

As the attached actuarial memo explains in more detail, we find three fundamental flaws in Blue Shield Life’s proposed rate increase:

1. Excessive medical loss trend factor of +11.1% a year
2. Inflated administrative expenses of 26.3% of premium
3. Unsupported values for numerous aspects of the filing

1. Excessive Medical Loss Trend Factors

Blue Shield's projected 11.1% annual medical trend is excessive and unreasonable, as well as being unsupported and inconsistent with other health care cost trend indications.

For example, Blue Shield cites increasing doctor and hospital contracting costs as one reason for its excessive medical loss trend. However, these numbers do not match national cost trends, and neither the contracts, nor any data from those contracts, were provided as part of the rate filing to support these claims.

With no reliable data from Blue Shield to support its assertion of increased costs, the growth of health care costs nationally is instructive: Health care cost growth has reached historic lows in recent years, a fact that Blue Shield's projections do not reflect.

Data from the Centers for Medicare and Medicaid and Services, released this month by the White House Council of Economic Advisors, found that health care spending increased an average of just 1.3% annually from 2010 – 2013, the lowest rate of increase for a three-year period in history, and less than one-third of the long-term historical average growth rate of 4.5%. Health care price inflation is similarly at record lows. The health care price index increased just 1% from August 2012 to August 2013.

A previous proposed rate increase by Blue Shield Life was deemed unreasonable by the Department of Insurance based in part on the company's unsupported projections of medical trend.

Blue Shield Life has also failed to support its 2014 medical loss ratio projection. Under federal health reform, companies must spend at least 80% of the premium they collect from individual policyholders on medical care. If they do not, they must refund the difference to consumers.

In 2012, Blue Shield Life failed to meet the 80% medical loss ratio threshold and had to return \$13.3 million to California individual and family policyholders. By failing to support its medical loss ratio projection for 2014, it is unclear that Blue Shield Life is on target to meet these requirements of the federal law.

2. Inflated Administrative Expenses

Blue Shield Life's rate filing provides that 26.3% of the premium will go to administrative expenses. That value is high and Blue Shield Life has not explained the basis for such high expenses.

The California Department of Insurance previously found a Blue Shield Life rate increase was unreasonable, in part because of inflated administrative expenses. At that time, the

Department of Insurance found that Blue Shield Life's 20.2% administrative expense was the highest among major health insurers in the individual market.

Blue Shield Life's \$380 million payment to its parent company, Blue Shield of California in 2012 was about 20% of the Blue Shield's premium for 2012, and hence represents the vast majority of its projected administrative expenses.

We note that Blue Shield Life's payments to Blue Shield of California may include a hidden profit transfer, however Blue Shield Life did not provide any information about the management services provided or the market value of those services.

3. Unsupported Values For Numerous Aspects Of The Filing

In general, Blue Shield's rate filing was sparse on details. In addition to the deficiencies identified above, other values and projections in Blue Shield Life's filing were unsupported, including "Drivers of 2013 Revenue and Cost of Healthcare," and "Drivers of 2014 Revenue and Cost of Healthcare." For example, plan and region mix factor was cited as one driver of the cost of healthcare, yet the only explanation of this factor was: "Represents the impact of membership shifts between plans and between regions. Please note this includes the mix impact of a shrinking or growing HIPAA GI book relative to the UW book of business." The data to back up these tables was not provided.

Conclusion

Blue Shield of California is in a position of notable financial strength, its projections for medical cost increases are unsupported and do not match national trends, its administrative expenses fall outside the norm and it has failed to provide basic data to support the values in this rate filing. For these reasons, we find Blue Shield Life's proposed 9.8% rate increase on nearly 85,000 Californians is unreasonable.

Consumer Watchdog
Santa Monica, California

AIS RISK CONSULTANTS, INC.

Consulting Actuaries • Insurance Advisors

4400 Route 9 South • Suite 1200 • Freehold, NJ 07728 • (732) 780-0330 • Fax (732) 780-2706

Date: November 25, 2013

To: Consumer Watchdog

From: Allan I. Schwartz, FCAS, ASA, MAAA

Re: Review of Blue Shield of California Life & Health Insurance Company
H15I Individual Health Rate Filing Dated October 8, 2013
SERFF Tracking #: BCCA-129238123 State Tracking #: HAO-2013-0160

As you requested, we have reviewed the above captioned filing submitted by Blue Shield of California Life & Health Insurance Company (“Blue Shield”), as well as other relevant information.^{1,2,3} Blue Shield proposes an average rate change for an “Overall % Indicated Change” of +11.7% and an “Overall % Rate Impact” of +9.8%.⁴ The range of rate impacts varies from a minimum of +8.7% to a maximum of +9.9%.⁵ The estimated annual premium change for this program based upon the proposed rate change requested by Blue Shield is about \$18.5 million.^{6,7} The estimated average annual premium increase per policyholder is about \$2,312.⁸

¹ This analysis was provided to assist Consumer Watchdog (CWD) in its evaluation of the Blue Shield filing, including submitting this document to the California Department of Insurance (CDI). It should not be relied upon for any other purpose or by any other entities. If this analysis is provided to any other entity the following conditions apply: (i) it should only be done after obtaining the written consent of AIS, (ii) the entire analysis should be supplied and (iii) that entity should be informed that AIS is available under appropriate circumstances to discuss the analysis.

² My analysis is based upon the information currently available. My analysis and conclusions may change if additional relevant information becomes available. Furthermore, my lack of comment on particular aspects of the filing should not be taken to mean that I agree with those procedures.

³ The filing is available at the CDI website at:
https://interactive.web.insurance.ca.gov/apex/f?p=102:9:0::NO::P9_RATE_FILINGS_ID,P9_COMPANY_NAME,P9_REFERRING_PAGE_NUM:7967,%5CBlue%20Shield%20of%20California%20Life%20%26%20Health%20Insurance%20Company%5C,4&cs=1C4DB5BCA517B4B54D467415F6216418A
CDI also provided some EXCEL spreadsheets that were not available on the website

⁴ Blue Shield filing, Rate Information Page

⁵ *Ibid.*

⁶ \$18.5 million = \$206.9 million (projected earned premium from Blue Shield filing, Rate Review Detail Page) X [1 – 1 / 1.098]

⁷ The Blue Shield filing has a value of a decrease of about -\$145.1 million as the “Written Premium Change for this Program” (Blue Shield filing, Rate Information Page). It appears that this is based upon a projected decrease in the “# of Policy Holders Affected for this Program” of about -46.5%, or about -27.3 thousand.

Our analysis shows that Blue Shield has not supported the proposed rate increase. The issues with the Blue Shield filing include:

- Excessive medical loss trend factor of +11.1% a year⁹
- Inflated administrative expenses of 26.3% of premium¹⁰
- Unsupported values for numerous aspects of the filing.

Based upon the information contained in the filing, including consideration of the lack of support in the filing for various aspects of the rate calculation, it is our opinion that the proposed rates are unreasonable.

A more detailed discussion of issues with the Blue Shield filing follows.

1. Excessive Medical Loss Trend Factors

Blue Shield uses an annual medical loss trend factor of 11.1% a year. That value is high and inconsistent with other health care cost trend indications.

The CDI previously found a Blue Shield rate increase was unreasonable in part because of the use of an excessive loss trend factor “Core medical trend. The department finds Blue Shield's projected core medical trend of 10.6 percent unreasonable”.¹¹

Various sources of information indicate medical cost trends much lower than this, as the following shows:

⁸ $\$352,026,854$ (Written Premium for this Program) X 9.8% (Overall % Rate Impact) / 58,777 (Number of Policyholders Affected for this Program); Blue Shield filing, Rate Information Page

⁹ Blue Shield Filing, California Rate Filing Form, Item 18

¹⁰ Blue Shield Filing, Milliman Report, page 6, item 15

¹¹ CDI News: 2013 Press Release dated March 7, 2013

In August 2013, the health care price index (HCPI) rose 1.0% above August 2012, one-tenth below the July growth rate, and fractionally below the May 2013 1.0% reading, the lowest value in our database extending back to 1990. The 12-month moving average of 1.5% growth is a new low for our data. The HCPI shows a steady decline from October 2009 (a 3.3% rate), followed by 2 years of oscillating near 2% price growth, with a sharp recent decline.¹²

For 2014, PwC's Health Research Institute (HRI) projects a medical cost trend of 6.5%.^{13,14}

The 6.3% increase over 2012 is the fourth consecutive year of decreasing trends.¹⁵

The basis given by Blue Shield for its selected trend includes the following, "Projected average cost (price inflation) trends are based on expected changes in provider contracts. The Company provided the aggregate projected average cost (price inflation) trend based on changes in their provider contracts."¹⁶ However, neither the contracts, nor any values from those contracts were provided. Hence, that basis for the trends was not supported.

Another statement in the filing regarding trends was "Claims Trend - Reflects the rising cost of healthcare due to unit cost, utilization, and benefit leveraging. Please refer to Exhibit IV for a detailed breakout of the underlying components of this trend."¹⁷ But Exhibit IV simply shows the trends selected by Blue Shield, without giving the basis or justification for those values.

The "2014 Medical Loss Ratio Projection" included in the Blue Shield filing, in addition to relying on the medical loss trend, also is dependent on various other factors used to adjust the

¹² Altarum Institute; "Price Brief"; October 8, 2013

¹³ PwC June 2013 Health Research Institute; "Medical Cost Trend: Behind the Numbers 2014"

¹⁴ PwC projections of medical trend have been overstated by about 1% to 2% a year recently. If this pattern continues, then the 6.5% value could also be too high.

¹⁵ Milliman Research Report; "2013 Milliman Medical Index"

¹⁶ Blue Shield Filing, Milliman Report, page 6, item 15

¹⁷ Blue Shield filing, Actuarial Certification, Section 5

losses such as Duration Trend.^{18,19} The specific values used for those items were also unsupported. The Blue Shield filing instead just included vague non-informative descriptions for those, such as, “Duration Trend - Represents changes in the costs associated with the duration of the member. Generally, longer duration members are associated with higher costs due to the gradual wearing off of underwriting.”²⁰

In summary, Blue Shield’s 11.1% annual medical trend is excessive and unreasonable, as well as being unsupported. Furthermore, various other trends (e.g., duration trend) included in the filing were not supported.

2. Inflated Administrative Expenses

Blue Shield gives a value for administrative expenses as a percent of premium of 26.3%.²¹ That value is high and Blue Shield has not explained the basis for those high expenses.

The CDI previously found a Blue Shield rate increase was unreasonable in part because of inflated administrative expenses “Excessive administrative costs. Blue Shield's 20.2 percent projected administrative costs continues to be the highest among major carriers In the Individual market”.²²

Blue Shield is showing a very large increase in PMPM costs for Other Non-Claim Costs (including Federal and State Licensing and Regulatory Fees) from \$53.10 for March 2013 Pricing to \$83.11 for January 2014 pricing.²³ The reason for this 57% increase in non-claim costs was not explained by Blue Shield.

¹⁸ Blue Shield filing, Exhibit III - 2014 Medical Loss Ratio Projection, Table 3 - Drivers of 2014 Revenue and Cost of Healthcare

¹⁹ These other trend components result in Blue Shield using a “net trend” of 15.4% for 2013 and 14.0% for 2014, which are materially higher than the medical trend of 11.1%. *Ibid.*, Tables 2 and 3

²⁰ Blue Shield filing, Actuarial Certification, Section 5

²¹ Blue Shield Filing, Milliman Report, page 6, item 15

²² CDI News: 2013 Press Release dated March 7, 2013

²³ Blue Shield filing, California Rate Filing Form - Questions 24

The high expenses for Blue Shield may be partly attributable to affiliate transactions. During 2012 Blue Shield of California Life & Health Insurance Company paid about \$380 million for Management Agreements and Service Contracts to Blue Shield of California (California Physicians' Service).²⁴ Blue Shield of California Life & Health Insurance Company is a wholly owned subsidiary of Blue Shield of California.²⁵

The \$380 million payment for management agreements and service contracts was about 20% of the Blue Shield's premium for 2012, and hence represents the vast majority of its administrative expenses.

It is unclear whether the payments by Blue Shield to its parent company for management agreements and service contracts is at a fair price and / or if those payments may include a hidden transfer of profit from Blue Shield to California Physicians' Service. As those affiliate payments could impact the level of expenses included in the rate calculation, inflated values for those affiliate payments could result in an excessive and unreasonable rate level.

According to the financial statements filed with the Department of Managed Health Care, California Physicians' Service (the owner of Blue Shield) had a total net worth of about \$3.86 billion and tangible net equity excess of about \$3.39 billion.

3. Unsupported Values For Numerous Aspects Of The Filing

The "2014 Medical Loss Ratio Projection" in the Blue Shield filing has sections for "Calculation of 2014 PPACA Medical Loss Ratio Requirement", "Drivers of 2013 Revenue and Cost of Healthcare" and "Drivers of 2014 Revenue and Cost of Healthcare".²⁶ Those tables are replete with various components for which the specific numerical values used are not supported.

As one example of the inadequate documentation provided for those values, the following was provided as an explanation of the Plan and Region Mix factor "Represents the impact of membership shifts between plans and between regions. Please note this includes the mix impact of a shrinking or growing HIPAA GI book relative to the UW book of business."^{27,28}

²⁴ Blue Shield 2012 Annual Statement, Schedule Y, Part 2 – Summary of Insurer's Transactions with Any Affiliates

²⁵ Blue Shield 2012 Independent Auditors Report

²⁶ Blue Shield filing, Exhibit III

²⁷ Blue Shield filing, Actuarial Certification, Section 5

Those tables form the basis for various conclusions in the filing regarding the proposed rate increase. Since those values have not been supported, it is clear that the proposed rate increase is also not supported.

Please feel free to contact me if there is anything you would care to discuss.

²⁸ The CDI previously found a Blue Shield rate increase was unreasonable in part because of inappropriate treatment of HIPAA issues “Unfair cost shifting. Blue Shield added 2.3 percent to policyholders' premiums to account for projected losses due to HIPAA/conversion plans. The Department determined this action to be unreasonable because projected losses from people who came out of the group market should not be shifted to and/or subsidized by the individual market.” CDI News: 2013 Press Release dated March 7, 2013