DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

200 Independence Avenue SW
Washington, DC 20201

July 22, 2011

Sharon P. Clark
Commissioner of Insurance
Public Protection Cabinet
Commonwealth of Kentucky Department of Insurance
P.O. Box 517
Frankfort, Kentucky 40602-0517

Re: Commonwealth of Kentucky's Request for Adjustment to the Medical Loss Ratio Standard

Dear Commissioner Clark:

This letter responds to the request of the Kentucky Department of Insurance ("DOI"), pursuant to section 2718 of the Public Health Service ("PHS") Act, 42 U.S.C. §300gg-18, for an adjustment to the 80 percent medical loss ratio ("MLR") standard applicable to the individual health insurance market in Kentucky. The DOI has requested an adjustment of the 80 percent MLR standard to 65 percent, 70 percent, and 75 percent for 2011, 2012, and 2013, respectively.

Section 2718 was added to the PHS Act by Section 1001 of the Affordable Care Act ("ACA") and requires issuers in the individual market to spend at least 80 percent of premium dollars on reimbursement for clinical services and for activities that improve health care quality for enrollees. Beginning in 2011, if an issuer does not satisfy the MLR standards, it is required to provide rebates to enrollees.

Section 2718 permits an adjustment to the 80 percent MLR standard for a State's individual health insurance market if it is determined that applying this standard "may destabilize the individual market in such State." The regulation implementing section 2718, 45 CFR Part 158, provides that an adjustment should be granted "only if there is a reasonable likelihood" that application of the 80 percent MLR standard will destabilize the particular State's individual health insurance market (45 CFR §158.301). The regulation also provides the criteria the Secretary may consider "in assessing whether application of an 80 percent MLR . . . may destabilize the individual market in a State that has requested an adjustment" (45 CFR §158.330). These criteria are discussed in Part III of this letter.

The Center for Consumer Information and Insurance Oversight ("CCIIO") within the Centers for Medicare and Medicaid Services ("CMS") has reviewed the DOI's application, as well as the supplemental information provided to us in response to questions raised by the application and the public comments filed with regard to the application.[1] We have carefully examined all of these materials and considered the criteria set forth in the statute and implementing regulation. Based on this, although application of the 80 percent MLR standard in Kentucky in 2011 may lead to the destabilization of the individual market, the MLR standard sought by the DOI exceeds the adjustment necessary to avoid the likelihood of market destabilization between now and 2014, and therefore would deny consumers some of the benefits of section 2718. Consequently, we have determined that the MLR standard in Kentucky shall be adjusted to 75 percent in 2011, with the statutory standard of 80 percent to apply beginning 2012. This letter explains the basis of our decision.

I. Summary of the Kentucky Application

CCIIO received the DOI's request for an adjustment to the MLR standard on February 16, 2011. Among the information the DOI included in support of its request were 2009 enrollment numbers, premium amounts, and market share for the largest issuers in Kentucky's individual market. The DOI also provided supplemental background information describing Kentucky's previous experience in the early 1990s when a large number of issuers left its market.

On March 24, 2011, CCIIO requested from the DOI information needed in order for Kentucky's application to be complete. CCIIO concurrently sent the DOI a separate letter requesting additional information regarding materials the DOI previously submitted. After the DOI responded to these requests, the DOI's application was deemed complete on May 31, 2011. On June 14, 2011, the DOI requested by email that CCIIO delay making a determination on Kentucky's application until the DOI provides additional information that is "integral to its application." In response, on June 24, 2011, CCIIO agreed to the DOI's request and deemed Kentucky's application to be no longer complete. On July 1 and 8, 2011, the DOI provided additional information. On July 11, 2011, CCIIO deemed Kentucky's application to be complete. The 30-day application processing period provided for under 45 CFR §158.345(a) began on July 11, 2011.

In addition, on May 31, 2011, CCIIO posted notice on its website that any public comments regarding Kentucky's application were due by June 10, 2011, as provided in 45 CFR §158.342. After the DOI provided additional information on July 1 and 8, CCIIO reopened the public comment period for an additional ten days, until July 21, 2011. CCIIO received a total of five public comments, which we also address in this letter.

II. Overview of the Kentucky Individual Health Insurance Market

According to the DOI's application, more than 143,000 Kentucky residents obtained health insurance coverage through Kentucky's individual health insurance market in 2010. There are eight issuers offering coverage in Kentucky's individual market; however, only four

[1] All of the documents and information described in this letter are posted on CCIIO's website at http://cciio.cms.gov/programs/marketreforms/mlr/mlr_kentucky.html unless otherwise footnoted.

issuers have at least 1,000 life-years[2] each: (1) Anthem Health Plans of Kentucky, Inc. ("Anthem"); (2) Humana Health Plan, Inc. ("Humana"); (3) Golden Rule Insurance Company ("Golden Rule"); and (4) Time Insurance Company ("Time"). According to the DOI's application, the number of enrollees and market shares of these issuers as of December 31, 2010, are as follows:

Table 1: Kentucky Individual Market Issuers' 2010 Enrollees and Market Share[3]

	Issuer	Enrollees[4]	Market Share
1.	Anthem	119,830	83.5%
2.	Humana	17,097	11.9%
3.	Golden Rule	3,154	2.2%
4.	Time	1,920	1.3%
	TOTAL FOR 4 LARGEST ISSUERS	142,001	98.9%

According to the DOI, Kentucky does not have an MLR standard that is applicable to all products offered in the individual market. However, the DOI reviews loss ratios as part of the rate approval process. Additionally, the DOI states that issuers have an option of offering individual market products with a guaranteed lifetime minimum loss ratio of at least 65 percent. For such products, issuers are required to refund to policyholders a pro-rated portion of the premium paid by the policyholders if the actual loss ratio for the year is less than the guaranteed loss ratio for that year. Unlike the Affordable Care Act MLR standard that applies to each reporting year and is calculated based on data from up to three reporting years, Kentucky's guaranteed minimum loss ratio is a lifetime loss ratio standard.

Kentucky does not require guaranteed issue in its individual market, except for applicants under the age of 19, and individual market coverage is medically underwritten.[5]

According to the DOI's application, Kentucky has a high-risk pool that provides coverage to individuals with high-cost conditions and those who were unable to obtain a comparable coverage at comparable rates in the individual market. These features are discussed in more detail in Part III below.

Pursuant to KRS 304.17A-240, issuers wishing to withdraw from Kentucky's individual market must obtain the Commissioner's approval and give at least 90 days notice to enrollees, but may reenter the individual market at any time. Issuers wishing to withdraw from all markets

[2] Issuers with fewer than 1,000 life-years are not subject to rebate payments for the first reporting year. 45 CFR §158.230(d). Life-years are the total number of months of coverage for enrollees during the year, divided by 12. 45 CFR §158.230(b).

[3] The numbers shown in Table 1 are from the 2010 Supplemental Health Care Exhibits ("SHCEs") that issuers file with the National Association of Insurance Commissioners ("NAIC"), which were submitted with the DOI's June 8 letter. These numbers differ slightly from the information the DOI submitted with its May 16 letter. However, the differences are immaterial to our analysis.

[4] The number of enrollees is based upon the number of covered lives at the end of the reporting year, and is different than the number of life-years. The number of enrollees is used here to determine market share.

[5] According to the DOI, KRS 17A-0952 provides for a 35% rating band for new and renewal rates in the individual market; and a 20% adjustment limit for health status factors used to determine renewal rates.

in Kentucky must give at least 180 days notice to the Commissioner and enrollees, and may not reenter any market in Kentucky for five years. In response to CCIIO's request for additional information, the DOI stated that the Commissioner has broad discretion to approve or deny withdrawals from the individual market.

III. Application of Regulatory Criteria to the Kentucky Individual Market

Title 45 CFR §158.330 lists six criteria that the Secretary may consider "in assessing whether application of an 80 percent MLR . . . may destabilize the individual market in a State." They are:

a) The number of issuers reasonably likely to exit the State or to cease offering coverage in the State absent an adjustment to the 80 percent MLR and the resulting impact on competition in the State;

b) The number of individual market enrollees covered by issuers that are reasonably likely to exit the State absent an adjustment to the 80 percent MLR;

c) Whether absent an adjustment to the 80 percent MLR standard consumers may be unable to access agents and brokers;

d) The alternate coverage options within the State available to individual market enrollees in the event an issuer exits the market;

e) The impact on premiums charged, and on benefits and cost-sharing provided, to consumers by issuers remaining in the market in the event one or more issuers were to withdraw from the market; and

f) Any other relevant information submitted by the State's insurance commissioner, superintendent, or comparable official in the State's request.

The preamble to the regulation provides that 45 CFR §158.330 "does not set forth a single test" for determining whether application of an 80 percent MLR standard may destabilize the individual market in a State, but rather lists the "main criteria" to be considered in assessing such risk. 75 Fed.Reg. 74887 (Dec. 1, 2010).

A. *Number of issuers reasonably likely to exit the State*

According to the DOI's application, no issuer that has at least 1,000 life-years in Kentucky's individual market has informed the DOI that it intends to exit the individual market.[6]

[6] The DOI indicates that since the passage of the ACA, two issuers had informed the DOI that they would exit the market: Physicians Mutual Insurance Company; and MEGA Life and Health Insurance Company. However, Physicians Mutual's letter to the DOI indicates that it has not issued coverage in the Kentucky individual market since 2005. Therefore, Physicians Mutual's withdrawal occurred long before the passage of the ACA. MEGA's letter to the DOI indicates that, as of October 2010, MEGA has ceased new sales in the Kentucky individual market but would continue its existing block of business. MEGA's letter gave no indication that its decision was related to the MLR or other parts of the ACA. With 229 enrollees and no new sales, MEGA will not reach credibility and will not be subject to MLR rebate requirements.

In its April 7, 2011 response to CCIIO's clarification questions, the DOI declined to identify issuers it believes to be reasonably likely to exit.

Instead, the DOI expresses concern about a possible exit of some of its smaller issuers and new entrants to the market. The DOI explains that "carriers with smaller market share or who have recently entered Kentucky's individual market . . . will be incentivized under the new scheme to keep their market share small . . . or to withdraw from the market." The DOI states that "[i]n 2011, carriers have already entered into agent commission agreements and provider contracts that are binding." The DOI adds that "[f]or established carriers with big blocks of business this is not a concern as they have sufficient business to offset the restriction, but for carriers that are relatively new to our market, who are on the cusp of credibility or who are seeking to grow their current block beyond credibility, the 80% MLR will have a crippling effect on their business model."

Under 45 CFR Part 158, if an issuer's experience in a State's individual health insurance market is less than 1,000 life-years, the experience is not credible, and hence the issuer is not subject to rebates. According to data submitted by the DOI, six issuers have entered or re-entered the Kentucky individual market since 2000: Golden Rule; Aetna; Time; John Alden; American Republic; and World. The DOI did not identify which, if any, of these issuers are seeking to grow their Kentucky individual market block of business. In 2009 and 2010, according to the data provided by the DOI including the issuers' SHCEs, American Republic and World were far from reaching credibility, John Alden consistently maintained enrollment levels below credibility since at least 2003, Golden Rule and Time were already partially credible, and only Aetna, with 731 life-years, was somewhat close to reaching credibility. Therefore, the DOI's concern that "for carriers that are relatively new to our market, who are on the cusp of credibility or who are seeking to grow their current block beyond credibility, the 80% MLR will have a crippling effect on their business model" could conceivably extend to Golden Rule, Time, and Aetna.

However, on July 1, 2011, the DOI informed CCIIO that Aetna has notified the DOI of its intention to exit the Kentucky individual market by December 31, 2011. Therefore, the DOI's concern regarding the potential future impact of an 80 percent MLR standard on Aetna is no longer relevant. Aetna's letter to the DOI gave no indication that its decision was related to the MLR or other parts of the ACA. Nonetheless, Aetna's decision lends some credence to the DOI's concern that smaller issuers may leave the individual market as part of refining their business strategy.

On their SHCEs, Time and Golden Rule reported commissions that were relatively high at 11 percent of earned premium. Therefore, the DOI's concern that "the 80% MLR will have a crippling effect" on smaller issuers' business models due to these issuers having "entered into agent commission agreements and provider contracts that are binding" may reasonably extend to Time and Golden Rule.

Furthermore, in its application, the DOI alludes to the possibility of Time ceasing to offer coverage in the individual market. In response to CCIIO's request for clarification, the DOI submitted a letter from Assurant, Time's parent company. Assurant indicates that it supports a waiver of the MLR altogether until 2014 and that it will review options such as discontinuing sales of certain products and/or exiting select markets. In its response to inquiry from CCIIO, the DOI has indicated that there have been no additional communications regarding a possible departure by Time from Kentucky's individual market.

Under 45 CFR §158.321(d)(2)(iii), applicants requesting an adjustment to the MLR standard are asked to calculate the estimated MLR for issuers in the State using the methodology that is provided for in the ACA and implementing regulation. The DOI's application calculates the estimated MLRs using data from calendar year 2010. These data will have a one to three year lag relative to each issuer's 2011 through 2013 results, the reporting years for which the DOI is requesting an adjustment to the 80 percent MLR standard.

The 2010 estimated MLRs are an imperfect proxy for the actual results issuers may generate if held to the 80 percent standard in 2011-2013. One reason for this is that the ACA was enacted at the close of the first quarter of 2010, presumably after pricing and other business decisions affecting MLRs had largely been made and implemented. Another reason historical data may constitute an imperfect proxy is that there can be year-to-year variability in issuers' claim experience, financial performance, and reported MLRs. Notwithstanding these limitations, the historical data remain the best available basis upon which to estimate the impact of the 80 percent standard in 2011-2013.

As required by 45 CFR §158.321(d)(2)(iii), the DOI submitted the estimated MLRs of issuers in Kentucky's individual market, based on the MLR definition in the ACA and implementing regulation. The DOI's estimates are shown in the chart below. Four issuers in the Kentucky individual market each had at least 1,000 life-years in 2010 and were thus at least partially credible (as defined in 45 CFR §158.230(c)). Therefore, these four issuers could be expected to be subject to rebate payments beginning in 2011 if their MLRs fall below the statutorily mandated 80 percent standard.

Table 2: Kentucky's Estimate of 2010 Federal Medical Loss Ratios

Issuer	Life Years	MLR Before Credibility Adjustment	Credibility Adjustment	MLR After Credibility Adjustment
Anthem	122,812	78.2%	0.0%	78.2%
Humana	17,606	69.0%	2.1%	71.1%
Golden Rule	3,187	66.3%	4.8%	71.1%
Time[7]	2,122	68.8%	6.0%	74.8%

At credibility-adjusted MLR of 78 percent, Anthem, the dominant issuer in the market, is very close to meeting the 80 percent MLR standard. The remaining three issuers had MLRs that ranged from 71 to 75 percent after the credibility adjustments.

These issuers must adjust some combination of their operations and financial targets in order to satisfy an 80 percent MLR standard. In its basic form under the ACA and implementing

[7] The DOI's estimates were not updated to reflect Time's revised SHCE submitted with the DOI's June 8 letter. Time's MLRs shown in Table 2 are based on this latest SHCE, and are consequently 1.1% lower than the DOI's estimates.

regulation, the MLR is the ratio of monies spent on incurred claims and quality improvement activities to premium revenue (as adjusted for certain State and Federal taxes and fees). See 45 CFR §158.221. Therefore, the issuers with MLRs below the 80 percent standard would either need to lower premiums or increase expenditures on claims or quality improving activities, or otherwise risk paying rebates to enrollees. Either of these actions could lead to deterioration in profitability, which is likely a consideration for each company in assessing whether to remain in the Kentucky individual market.

The chart below shows, for each issuer with at least 1,000 life-years, the issuer's estimated rebates based on 2010 MLRs and an 80 percent MLR standard, estimated 2010 pre-tax net gain in the individual market before payment of rebates, and estimated 2010 pre-tax net gain in the individual market if the issuer would have had to pay rebates in 2010.[8]

Table 3: Estimated 2010 Rebates and Pre-Tax Net Gain ($ in millions)[9]

Issuer	Estimated Rebates	Pre-Tax Net Gain Before Rebates	Pre-Tax Net Gain After Rebates
Anthem	$5.7	$23.2	$17.5
Humana	$2.5	($0.1)	($2.6)
Golden Rule	$0.5	$1.1	$0.6
Time[10]	$0.3	($0.3)	($0.5)

As noted above, Anthem is very close to meeting the 80 percent MLR standard. Furthermore, according to the DOI, Anthem has indicated that it does not expect to owe any rebates because it intends to adjust its business model. Therefore, Anthem is unlikely to leave the market due to implementation of an 80 percent MLR standard. Of the three issuers expected to owe rebates, two – Humana and Time – operated at a loss in Kentucky's individual market and payment of rebates would increase their loss. Only Golden Rule would be expected to remain profitable after payment of rebates, although rebates would consume over 40 percent of its of pre-tax net gains. The potential impact of rebates on the financial performance of Humana, Golden Rule, and Time (particularly in light of Assurant's statement that it may consider leaving the market) supports the DOI's concern that immediate implementation of the 80 percent MLR standard could lead to market destabilization.

B. *<u>Number of enrollees covered by issuers that are reasonably likely to exit the State</u>*

As stated previously, the DOI has declined to identify any issuer as reasonably likely to exit Kentucky's individual market. Instead, the DOI expresses concern about a possible exit of some of its smaller issuers and new entrants to the market.

[8] "Pre-tax net gain" is the net gain or loss as reported in the SHCE plus any Federal, State, or other taxes and fees paid.
[9] Based on data from 2010 SHCEs.
[10] The DOI's estimates were not updated to reflect Time's revised SHCE submitted with the DOI's June 8 letter. Time's estimated rebates shown in Table 3 are based on this latest SHCE, and are consequently $57,211 higher than the DOI's estimates.

The DOI has indicated that Kentucky's dominant issuer in the individual market, Anthem, with a market share of 83.5 percent, does not expect to owe any rebates. Of the three smaller issuers that are expected to owe rebates in at least 2011, two (Humana and Golden Rule) are significantly below an 80 percent MLR, based on 2010 data. The third one (Time) operates at a loss and has indicated that it may consider leaving the market absent an adjustment to the MLR standard. According to the DOI, Humana covers 17,097 enrollees in the individual market and has a market share of 12 percent, Golden Rule covers 3,154 enrollees with a market share of 2 percent, and Time covers 1,920 enrollees with a market share of 1 percent. These three issuers have a combined market share of 15.4 percent.

C. *Consumers' ability to access agents and brokers*

The DOI asserts that without an adjustment to the MLR standard, agents in the Kentucky individual market will see a "further reduction" to their commissions, which will cause a reduction in the number of agents servicing consumers in the individual market. The DOI states that it does not have the necessary resources to meet the need of its consumers if large numbers of agents and brokers no longer service the individual market.

As noted in Part III.A above, the DOI expresses concern that "[i]n 2011, carriers have already entered into agent commission agreements and provider contracts that are binding." Nonetheless, the DOI states that "[a]ll carriers informed [the DOI] that in order to meet the 80 percent MLR, they would be reducing agent commissions in future years." The DOI further asserts that "[m]ost carriers have begun [reducing commissions] in anticipation of the MLR requirements and will likely continue this trend without an adjustment to the MLR requirements." The DOI provides no specific data on the number of agents or brokers who might leave the business, or on the number of Kentucky residents who could be affected.

However, in response to CCIIO's clarification questions, the DOI states that in 2011 Anthem, the dominant issuer with an 83.5 percent market share, has increased first year commission rates and kept most renewal rates unchanged (reducing renewal rates only after a policy is renewed for 11 years or longer). In light of the fact that Anthem has chosen to increase commissions after the passage of the ACA, and in light of Anthem's relatively high MLR, we assume that the DOI's assertions regarding commission rate reductions do not extend to Anthem. Therefore, at least 83.5 percent of the Kentucky individual market is unlikely to experience a loss of agents and brokers. Furthermore, the smaller issuers, according to the DOI's justification for the proposed adjustment to the MLR, are locked into binding agent commission agreements. As discussed above, the two issuers that reported relatively high commissions in 2010 and could be expected to seek to adjust their business model to meet the 80 percent MLR – Time and Golden Rule – cover a total of 5,074 enrollees and have a combined market share of 3 percent. Therefore, even if these smaller issuers are able to reduce commission rates despite being locked into binding commission agreements, any resulting impact on consumer access to agents and brokers would be small.

CCIIO received one comment letter supporting the DOI's concern regarding agents and brokers, and one comment letter asserting that there is no evidence to support the DOI's concern.

D. *Alternate coverage options*

As noted in Part II above, the DOI states that Kentucky does not have guaranteed issue protection in the individual market unless the applicant is under the age of 19. As we read Kentucky law, Kentucky does have a HIPAA portability requirement that would reduce or eliminate any pre-existing condition exclusion that might otherwise apply.[11] According to the DOI, the only alternative coverage option offered to all consumers in Kentucky's individual insurance market is its State-operated high-risk pool, Kentucky Access.

According to the DOI, pursuant to KRS 304.17B-015, an individual is eligible for coverage under Kentucky Access if the individual is HIPAA-eligible, or has been a resident of Kentucky for at least 12 months before coverage is sought and meets one of the following conditions:

- the individual has been rejected by at least one issuer for coverage of a health benefit plan that is substantially similar to Kentucky Access coverage;
- the individual has been offered coverage substantially similar to Kentucky Access coverage, but at a premium rate that is greater than the Kentucky Access premium rate; or
- the individual has been diagnosed with a high-cost condition as designated under KRS 304.17B-001.

According to Kentucky Access Plan Benefit Booklets,[12] coverage of pre-existing conditions is excluded for a period of 12 months (except for HIPAA-eligible individuals), although prior creditable coverage can offset this exclusion period.[13]

The DOI states that there are approximately 4,951 individuals currently covered under Kentucky Access. The DOI notes that the premium rates assessed for coverage through Kentucky Access are typically higher due to the disproportionate amount of members with high cost medical conditions. Therefore, the DOI believes that due to high premiums, many of the individuals who might lose coverage in the individual market may not be able to afford coverage through Kentucky Access. The DOI also expresses concern that Kentucky Access would not be able to meet the increased demand for coverage by eligible individuals if one or more issuers were to exit the market. Notably, the DOI points out that under the current cost sharing arrangement, the premiums collected for coverage under Kentucky Access do not fully cover the cost of the program, as the premium amounts assessed are limited under KRS 304.17B-013. The DOI explains that any claims in excess of premium rates must be covered by the Kentucky Access fund.

We note that, based on the DOI's application, the beginning cash balance for Kentucky Access in 2011 is smaller than in 2010 and considerably smaller than in 2008 and 2009. According to the DOI, in 2011 Kentucky Access' expenses are projected to be almost the same amount the fund receives in revenue. The decrease in funding resources for Kentucky Access

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[11] KRS 304.17A-230(1); KRS 304.17A-005(11).

[12] Available at https://www.kentuckyaccess.com/index.cfm?xnode=1003000 (*last accessed* July 5, 2011).

[13] For example, an individual with12 months of uninterrupted coverage who enrolls in a Kentucky Access plan within 63 days of termination of prior coverage would not be subject to a pre-existing condition waiting period.

supports the DOI's concern that the Kentucky Access may not be able to provide coverage for all eligible consumers if one or more issuers were to exit the individual market in Kentucky.

E. *Impact on premiums, benefits, and cost-sharing of remaining issuers*

As stated previously, the DOI has declined to identify any specific issuer as reasonably likely to exit Kentucky's individual market. In its June 8 letter, the DOI states that it agrees with CCIIO's statement that the products offered in the individual market are comparable in design and cost. Therefore, at this time, there is no conclusive evidence that suggests that the premiums, benefits, and cost-sharing of the remaining issuers in the individual market would be impacted if any of the issuers other than Anthem withdraws. As noted in Part III.A above, Anthem is unlikely to leave the market due to implementation of an 80 percent MLR standard, in light of Anthem's 78 percent MLR in 2010, expressed intent to adjust its business model to avoid paying rebates, and significant profitability. Based on this, we do not consider the impact of an 80 percent MLR standard on premiums, benefits, and cost-sharing of issuers remaining in the Kentucky individual market a significant factor in making our determination.

F. *Other relevant information submitted by the State*

According to the DOI, much of its concern about the 80 percent MLR standard stems from its experience in the early 1990s. A market report submitted by the DOI explains that during that time period, Kentucky enacted wide-reaching reform including modified community rating, expanded mandated benefits, guaranteed issue, and guaranteed renewal. Ultimately, 45 of the 47 issuers in the individual market exited the market: by 1996 only Anthem Blue Cross/Blue Shield and Kentucky Kare (Kentucky's self-funded plan for State employees that was made available to the public) remained. Based on Kentucky's previous experience with health reform, the DOI is concerned about the affect of ACA provisions on Kentucky's individual health insurance market.

The information submitted by the DOI suggests that Kentucky's efforts at market reform were unsuccessful for various reasons. A significant factor contributing to issuer exits was the fact that the reform exempted association business from modified community rating requirements. According to the information submitted by the DOI, implementation of guaranteed issue and expanded mandated benefit provisions led issuers to initially set very high rates. Because association coverage (dominated by Anthem) could be experience-rated, and thus made available to healthy people at rates lower than modified community rates, the individual market experienced significant adverse selection. This left issuers writing modified community rated products with an increasingly unhealthy population. While these issuers' costs increased, effective rate increase caps (in form of mandatory rate hearings) prevented these issuers from raising premiums in proportion to their costs, leading them to suffer unsustainable losses and withdraw from the market.

In contrast, the MLR provisions incentivize issuers not to set very high rates, but rather to set rates low enough to meet the 80 percent MLR standard in order to avoid paying rebates. At the same time, the MLR provisions do not impose rate caps, which could result in claims that exceed premium revenue, but instead require rebates only if claims are significantly lower than premium revenue. Additionally, under the MLR provisions, association coverage is subject to the same MLR standard as other individual coverage. Therefore, implementation of an 80 percent MLR standard is not directly comparable to Kentucky's health market reforms of the 1990s.

CCIIO received three comment letters asserting that Kentucky's 1990s health market reforms were significantly different from the ACA MLR provisions and do not constitute a valid basis for the DOI's concerns.

Nonetheless, as discussed in Part III.A above, implementation of an 80 percent MLR standard may have a negative effect on the financial performance of some issuers in the initial years. We take this effect into consideration in making our determination.

The table below shows, for the top four issuers in the Kentucky individual market, the issuer's estimated rebate based on 2010 MLRs and estimated rebates that issuers will owe in 2011-2013 under the DOI's proposed adjustment to the MLR standard, as provided by the DOI.

Table 4: Kentucky's Estimates of 2011-2013 Rebate Requirement ($ in millions)

Issuer	**2010 (80% MLR standard)**	**2011 (65% MLR standard)**	**2012 (70% MLR standard)**	**2013 (75% MLR standard)**
Anthem	$5.7	$0.0	$0.0	$0.0
Humana	$2.5	$0.0	$0.0	$1.1
Golden Rule	$0.5	$0.0	$0.0	$0.2
Time[14]	$0.3	$0.0	$0.0	$0.0
TOTAL	**$9.0**	**$0.0**	**$0.0**	**$1.3**

The total amount of rebates consumers would have received if the issuers offering coverage in the Kentucky individual market had to meet an 80 percent MLR standard in 2010 alone would be $9 million. The combined amount of rebates that consumers would receive over the next three years under the DOI's proposed adjustment to the MLR standard is $1.3 million. Therefore, granting the DOI's request could deprive consumers of a significant amount in rebates.

IV. Summary of Public Comments

CCIIO received five public comments, one from the Kentucky Association of Health Underwriters ("KAHU") and the other four from three different consumer advocacy organizations (one of them submitted two separate comments), in connection with the DOI's request for an adjustment to the MLR standard. The public comments are posted on CCIIO's website at http://cciio.cms.gov/programs/marketreforms/mlr/mlr_kentucky.html.

KAHU supports the DOI's request, stating the number of Kentucky agents and brokers will diminish because issuers have reduced commissions in order to meet the 80 percent MLR

[14] The DOI's estimates were not updated to reflect Time's revised SHCE submitted with the DOI's June 8 letter. Time's estimated 2010 rebates shown in Table 4 are based on this latest SHCE, and are consequently slightly higher than the DOI's estimates.

requirement. However, KAHU does not specify which issuer(s) have implemented such reductions. According to the DOI's application, Anthem has in fact increased first year commission rates. Furthermore, as the Kentucky Equal Justice Center points out in its public comment, data recently provided by the National Association of Health Underwriters ("NAHU") to the NAIC show that none of the eight Kentucky issuers that have submitted data to NAHU have cut compensation in 2011.

The consumer advocacy organizations state that the DOI has not offered any evidence that proves the market would destabilize absent an adjustment to the 80 percent MLR standard, and assert that Kentucky's experience with health insurance reforms in the 1990s is significantly different from the ACA's MLR provisions. One consumer advocacy organization reiterates its opposition to the DOI's application after HHS reopened the public comment period to allow comments on Aetna's notice of withdrawal (provided by the DOI after the end of the initial comment period). The commenter states that Aetna's withdrawal lends no support to the DOI's request for an adjustment because the DOI failed to show that Aetna's decision is related to the 80 percent MLR standard or that the individuals previously covered by Aetna would be unable to obtain replacement coverage.

V. Conclusion

As described in the outset of this letter, section 2718 of the PHS Act permits the Secretary to adjust the 80 percent MLR standard in the individual market if it is determined that applying this standard "may destabilize the individual market in the [the]…State." The regulation implementing section 2718, 45 CFR 158, provides that an adjustment should be granted "only if there is a reasonable likelihood" that application of the 80 percent MLR standard will destabilize the particular State's individual health insurance market (§158.301).

In this case, we agree with the DOI and conclude that, based on the application of the criteria and standard set out in section 2718, there is a reasonable likelihood that immediate implementation of an 80 percent MLR standard may destabilize the Kentucky individual market. We recognize that application of an 80 percent standard and the resulting rebate requirement in 2011 could magnify the losses that Humana and Time already incur in the Kentucky individual market, and lead these issuers to withdraw from that market. Additionally, the fact that Golden Rule and Time report relatively high commissions supports the DOI's concern that these issuers may have entered into binding, multi-year agent commission agreements and require time to adjust their business models to meet an 80 percent MLR standard. Time has in fact indicated that it may consider leaving the market absent an adjustment. An exit by any or all three of these issuers would leave more than 22,000 enrollees temporarily without coverage.

While we agree with the DOI that an immediate implementation of an 80 percent MLR standard in 2011 may risk destabilizing the Kentucky individual market, we do not agree that an adjustment to 65 percent in 2011, 70 percent in 2012, and 75 percent in 2013, as requested by the DOI, is warranted. In our view, adjusting the MLR to such a low number in 2011 and delaying full implementation of the 80 percent statutory standard until 2014 overcompensates for the general risk of destabilization asserted by the DOI.

We note that all four issuers who are expected to be subject to rebate requirements in Kentucky's individual market had 2010 MLRs above 70 percent. Therefore, all four issuers already exceed the DOI's requested adjusted standards of 65 percent for 2011 and 70 percent for 2012. Anthem, with an 83.5 percent market share, does not expect to owe any rebates because it intends to adjust its business model. Time, the issuer that appears to be most at risk of withdrawal, had a 2010 MLR of almost 75 percent. While Humana and Golden Rule both had 2010 MLRs of 71 percent, their expected 2011 rebate liability would be reduced by more than half under an adjusted 75 percent standard.

Consequently, we believe, based on the information provided by the DOI, including the 2010 SHCE data, that establishing an MLR standard of 75 percent for 2011, with the 80 percent standard to apply beginning 2012, reasonably addresses the risk of destabilization presented in the application. An adjustment to the MLR standard in 2011 mitigates the risk of market destabilization while preserving for consumers the intended benefits of section 2718. This approach, which creates a glide path for compliance with the 80 percent standard, balances the interests of consumers, the State, and the issuers in accordance with the principles underlying section 2718.

Accordingly, pursuant to section 2718(b)(1)(A)(ii) of the PHS Act (42 U.S.C. §300gg-18(b)(1)(A)(ii)), the MLR standard applicable to the Kentucky individual health insurance market is adjusted to 75 percent for the MLR reporting year 2011; and the 80 percent statutory standard will apply beginning MLR reporting year 2012.

Pursuant to 45 CFR §158.346, the DOI may request reconsideration of the determination issued in this letter. A request for reconsideration must be submitted in writing within ten days of the date of this letter to MLRAdjustments@hhs.gov, and may include any additional information in support of such request. A determination on a request for reconsideration will be issued within 20 days of the receipt of the request.

Please contact me should you have any questions.

Sincerely,

/Signed, SBL, July 22, 2011/

Steven B. Larsen
Deputy Administrator and Director,
Center for Consumer Information
and Insurance Oversight