Health Insurers' Efforts to Shift Admin Costs to Medical Costs

Senator Rockefeller recently came out with a report cautioning about health insurers efforts to shift Selling, General and Administrative (SGA) expenses to medical costs. A shift would increase medical loss ratios (MLR) allowing insurers to keep more earnings. Two uncertainties affect predictions. First is how plans are grouped and second is how one computes "medical costs" and "premiums". Below are reasonable interpretations of the new law that favor consumers, not insurers.

HOW ENROLLEES ARE GROUPED

The first order is to define "group." The more groups are combined, the greater the opportunity for balancing out gains and losses, which is the whole idea of insurance. Under the new law, there are no reimbursements on losses but there are rebates on gains where MLR's are less than minimums.

Insurers are thus incented to combine into the largest groups possible to have profitable plans offset unprofitable ones. Yet for decades, insurers have taken the exact opposite tack in breaking the market into smaller and smaller groups to minimize losses on bad blocks of business while holding onto profitable business.

The law states that enforcement is on a state-by-state basis. Yet it also notes the federal mandate is the minimum, and if states have stricter laws, those laws apply. This means MLR's are enforced by state so insurers' profitable areas do not subsidize less profitable ones.

Another factor is insurers consolidating results which again would combine groups in insurers' favor. If insurers operate under several legal entities in a state, they should be bound by legal insurance entity and not be allowed to combine results. After all, insurers separated entities to limit liabilities. Now they should not be able to combine entities' MLR's to increase consolidated profits.

Insurers gain one advantage under the new law. Currently, small groups are 50 employees or less. The new law raises that definition to 100 employees. Since small groups have more generous MLR maximums, this definition change will move groups of 51-100 from large to small groups with 5% greater MLR allowance, providing additional insurer margins.

HOW MLR'S ARE CALCULATED

MLR's are simply direct medical costs divided by premiums. Uncertainty occurs in the definition of "medical costs" and "premiums" and how to define those can impact insurers' earnings.

Premiums are fairly well defined except for taxes. Some states tax premiums, and in order to maintain a level playing field with tax exempt markets, premiums should be defined excluding any additional tax.

Medical costs are fuzzier. Insurers will try to load (SGA) expenses onto medical costs to improve MLR's. Measured against accounting practices for other industries, no additional costs merit inclusion into "direct" medical costs." At least two types of costs that insurers may try to include but should not be allowed:

- Programs like wellness that promote healthy living and lead to lower medical costs. Though arguable, these are essentially R&D efforts by companies that are never included in direct costs.
- Information Technology spending leads to more streamlined operations, fewer mistakes and duplication and lowers medical costs. Like R&D, no company includes these as direct costs.