



Perhaps one of the most immediate and significant impacts of health care reform is the establishment of minimum Medical Loss Ratios (MLR). There are numerous implications and unanswered questions to insurers due to these new MLR restrictions. What we do know is that the industry will soon be operating under a new playbook, which will result in companies fundamentally changing how they compete, operate and make business decisions. Health reform winners will consist of insurers who implement both aggressive short term actions and innovative long term strategies to turn the reform changes including MLR restrictions into competitive strengths. Implementation lead time requirements do not allow health plans to shadow competitors' actions as they prepare to position their future business portfolio.

We believe leading plans will actually use the minimum medical loss ratios to their advantage to maintain profitability, grow market share and deliver lower premiums to their customers. Strategic execution in this area will help build a competitive advantage over the competition.



Three pronged approach

Background

Insurers offering group or individual health insurance coverage will be required to report their medical loss ratio, at the very least, for their large, small and individual segments. Insurers will be required to report the percentage of total premium revenue spent on for all other non-claim costs¹.

Quick Fact:

Wall Street Analysts have estimated the impact for the top 4 for-profit health plans could exceed \$2.4 B²

Consequences of not meeting required MLR ratios (80% for individual and small groups, 85% for large groups and Medicare Advantage) include premium rebates, inability to raise premiums and potential exclusion from the American Health Insurance Exchange.

Medical Loss Ratio Observations

The definition of "clinical services" and "activities that improve health care quality" will be critical to determine how much (if any) health plan administrative expenses will be classified in the numerator of the calculation. Although the final federal definitions of what should be included as medical loss expenses have not been defined, other sections of the Senate bill may provide some clues as to the

potential definition. For example, Section 2717, “Ensuring the Quality of Care” requires the reporting of quality information by health plans and issuers and defines quality as:

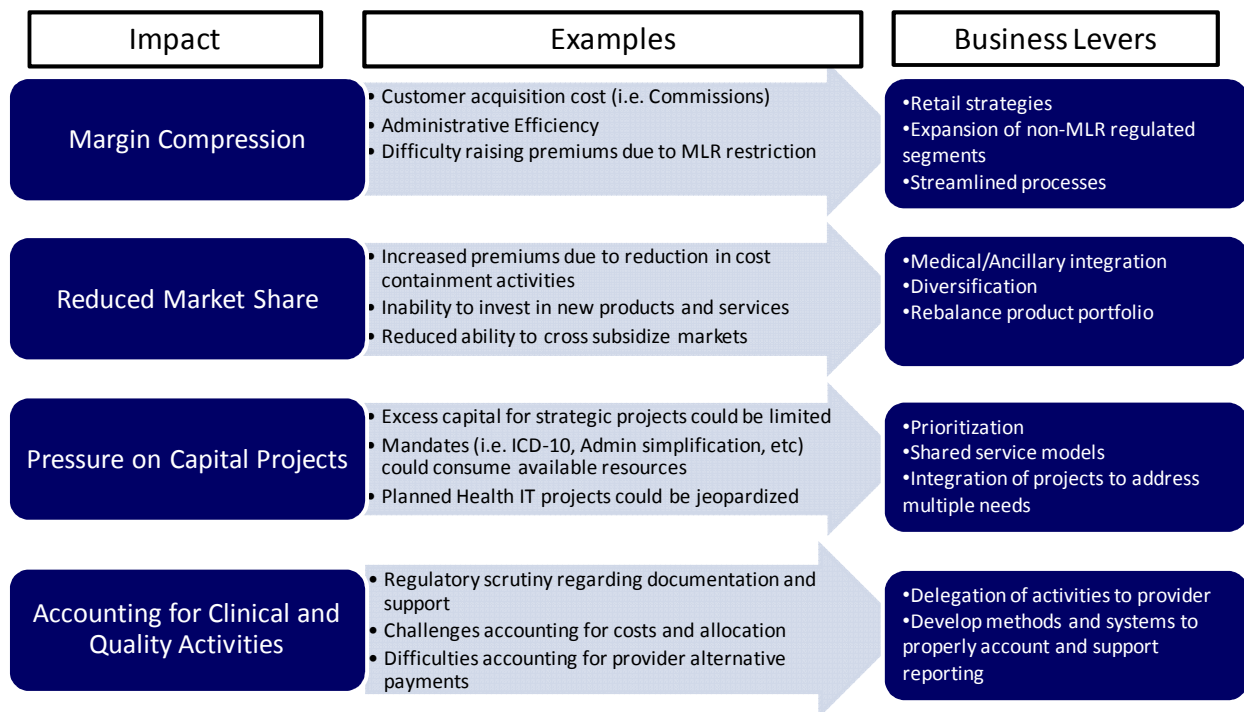
“improve health outcomes through the implementation of activities such as quality reporting, effective case management, care coordination, chronic disease management, and medication and care compliance initiatives...”³

This definition is adequately broad and would likely encompass most, if not all, of the clinical, wellness and care management activities health plans employ to improve clinical outcomes, reduce readmissions, improve post-acute care recovery and improve ongoing member health. Implementation of a healthcare quality definition similar to this one for the MLR provision would allow plans to continue to improve efficiency of the system through health improvement, but there is no guarantee that this definition will be adopted.

Quick Fact:
In a recent announcement, WellPoint projected a 100 basis point reclassification from administrative to medical expense⁴

Business Implications

Implementation of minimum MLR requirements will have several negative impacts on health plans if left unaddressed:



A Way Forward

We are advising insurers on the following three approaches to mitigate negative financial and operational impacts stemming from minimum MLR requirements:

- 1) **Long-term Transformation through Total Cost Management** – Comprehensive approach addressing both medical and administrative costs to reduce the overall cost of healthcare to the customer. Over the long term, leading plans will focus on increasing efficiencies while investing in programs and activities which deliver overall cost savings through improved clinical outcomes and member health. This approach will allow plans to achieve higher margins in a minimum MLR environment, while controlling long term trend and premium growth to acceptable levels, creating a sustainable competitive advantage.
- 2) **Growth and Margin Expansion through Product Diversification** – Traditional market segments will require reevaluation as historically lower margin segments may become more attractive in a post-reform world. Additionally, plans need to evaluate each of the pricing levers that will exist with customers in both regulated (e.g. Minimum MLR segments) and segments without similar restrictions. Plans that create the right mix and balance of products and markets will be positioned to succeed in the long run.
- 3) **Tactical Assessment of Accounting for Clinical and Quality** – Developing a process and methodology for the treatment of “clinical services” and “activities that improve health care quality” is paramount to remaining competitive in minimum MLR segments. There will be increased regulatory scrutiny into how costs are accounted for and assigned to segments. Many companies will view this solely as a cost allocation issue, when, in fact, the most critical aspects will be to fully capture these costs prior to allocation and ensure that the captured costs meet the regulatory definition that is ultimately adopted. Additionally, plans will need to properly account for alternative payments to providers across segments to a degree that did not exist prior to health reform.

Insurers must begin to understand the financial and operations ramifications MLR will have on their organization. HHS has already demonstrated its desire to accelerate the MLR regulation by requesting that the NAIC provide guidance on definitions by June 1, 2010. Given that the renewal cycle is only months away and there are potential premium refunds in 2011, it is imperative that plans begin to understand and plan for the short term and long term impacts of this requirement.

We invite you to contact us if you have any questions or would like to discuss further.

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¹ Patient Protection and Affordability Act, Title 10, Sec 10101, S. 2718

² “The Average Person Thinks He Isn’t – Minimum Medical Loss Ratio Analysis”, Oppenheimer Report, April 8, 2010

³ Patient Protection and Affordability Act, Title I, Subpart II, S. 2717(a)(1)(A)

⁴ “WellPoint 2010 Financial Outlook”, March 17, 2010