

August 2005

STANDARD OF LOSS RATIO FOR HEALTH INSURERS - BACKGROUND MEMORANDUM

Section 12 of House Bill No. 1010 (attached as an appendix) provides for a study of the appropriate minimum standard of loss ratio for accident and health insurers and whether that loss ratio is more appropriately set by statute or by rule. The study appears to have originated after the defeat of an amendment that would have authorized the Insurance Commissioner to establish the loss ratio for accident or health insurers.

BACKGROUND

Loss ratio is generally defined as a measure of the relationship between claims and premiums. More specifically, it is the dollar amount an insurer pays in claims compared to the amount the insurer collects in premiums. Loss ratios are an important tool in measuring whether an insurer is allocating a reasonable amount of premiums to the payment of benefits. Regulators of insurers use loss ratios as a means of monitoring and preventing excessive profits and high administrative expenses and in identifying solvency concerns. Commonly, loss ratios are calculated on an annual basis. A low loss ratio generally indicates high profits for the insurer or high administrative expenses.

Loss ratio may be determined in a variety of methods and the ratio will vary according to the insurance product. For short-term products such as medical insurance, an experience loss ratio can be calculated after most of the claims have been paid. Administrative costs and the volume of business are significant factors in determining loss ratio. An insurer with a larger number of policies will be able to decrease the impact of fixed costs that are used in determining loss ratio. In addition, a larger number of policies will generally reduce the degree of fluctuation in loss ratios.

NORTH DAKOTA LAW

In 1993 the Legislative Assembly adopted House Bill No. 1504, which provided for basic health insurance plans for small employer groups. The bill also contained a provision relating to loss ratios which is codified as North Dakota Century Code (NDCC) Section 26.1-36-37.2. That section provides that all policies providing hospital, surgical, medical, or major medical benefit must return benefits to group policyholders in the aggregate of not less than 75 percent of premium received and to individual policyholders in the aggregate of not less than 65 percent of premium received. That section also required the Insurance

Commissioner to adopt rules to establish the minimum standards on the basis of incurred claims experienced and earned premiums for the entire period for which rates are computed to provide coverage in accordance with accepted actuarial principles and practices.

In 1995 the Legislative Assembly amended NDCC Section 26.1-36-37.2 to exclude from the application of that section any contract or plan of insurance that provides exclusively for accident, disability income insurance, specified disease, hospital confinement indemnity, or other limited benefit health insurance.

The Insurance Commissioner has adopted administrative rules pursuant to the directive in NDCC Section 26.1-36-37.2. North Dakota Administrative Code Section 45-06-08-02 provides that the following factors must be considered in determining the experience loss ratio:

1. Statistical credibility of incurred claims experience and earned premiums;
2. The period for which rates are computed to provide coverage;
3. Experienced and projected trends;
4. Concentration of experience within early policy duration;
5. Expected claim fluctuation;
6. Experience refunds, adjustments, or dividends;
7. Renewability features;
8. Interest; and
9. Policy reserves.

During the 2005 legislative session, an amendment to House Bill No. 1010 was proposed which would have removed the provisions in NDCC Section 26.1-36-37.2 that relate to the 75 and 65 percent aggregate loss ratio caps. The amendment would have provided that the Insurance Commissioner determine the appropriate loss ratio. The amendment was defeated during the standing committee deliberations on the bill.

POSSIBLE STUDY APPROACH

In undertaking this study, the committee should seek comment from the Insurance Commissioner, representatives of various health insurance providers, and consumers regarding the establishment and impact of the loss ratio. In determining the appropriate method for setting the loss ratio, the committee should consider the positives and negatives of having the loss ratio established by rule and necessity for maintaining legislative oversight over the process.

ATTACH:1