MILLIMAN RESEARCH REPORT

2014 commercial health insurance

Overview of financial results

March 2016

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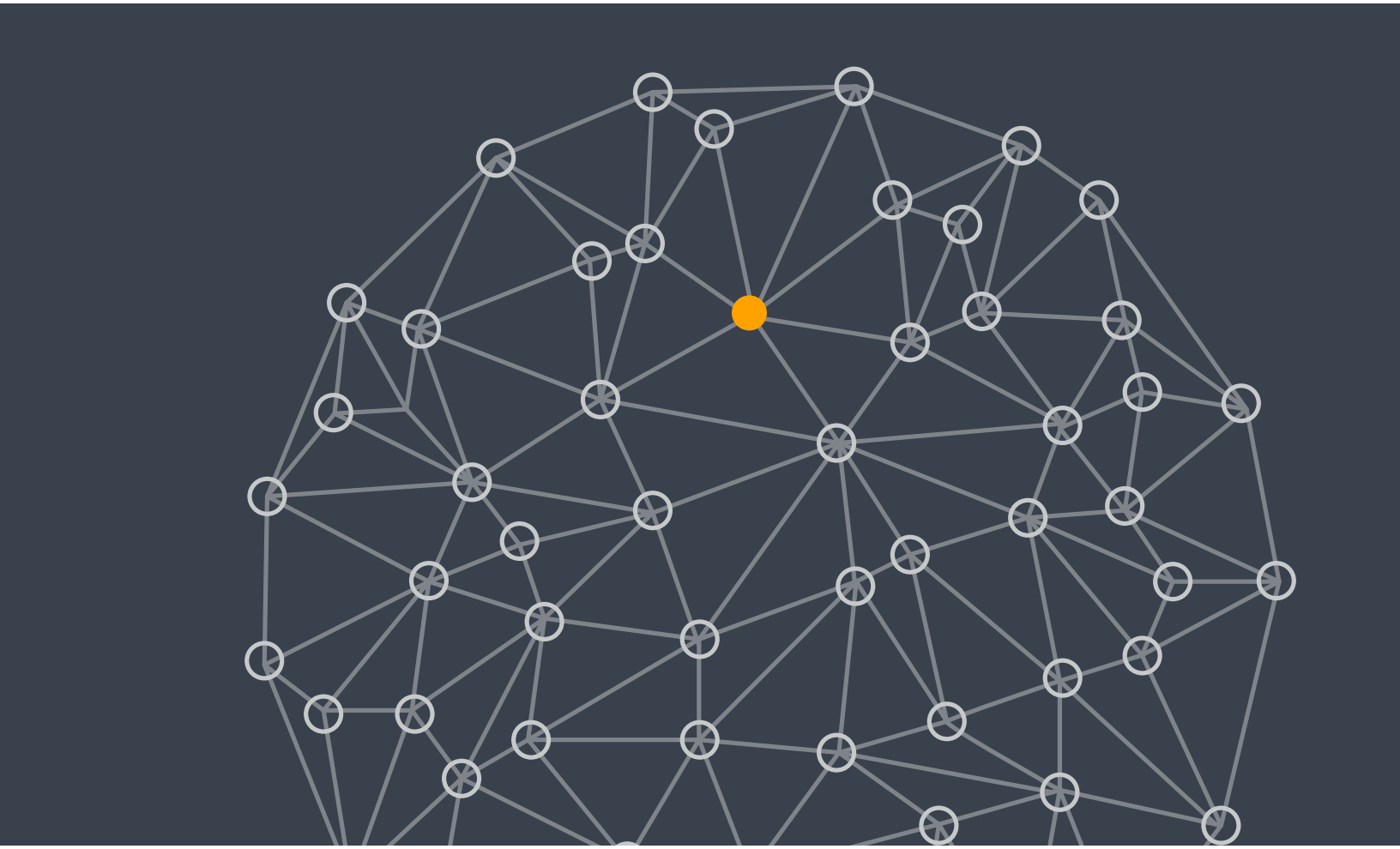

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Executive summary

Given all the changes brought about by the Patient Protection and Affordable Care Act (ACA) in 2014, the commercial health insurance markets in the United States experienced a significant change relative to prior years. These changes were most dramatic in the individual health insurance market, with the conversion from medical underwriting to adjusted community rating in many states, as well as the implementation of the federal and state insurance marketplaces, facilitating premium assistance to many Americans who were previously uninsured.

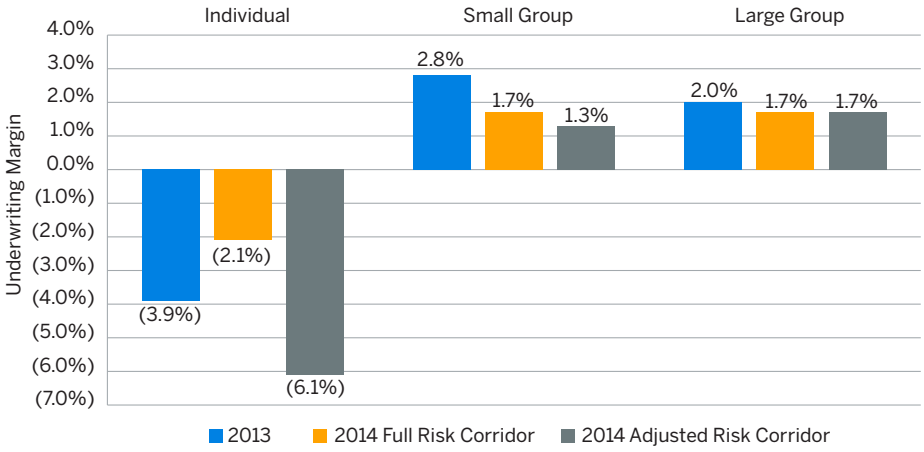
For the 2014 edition of our annual report on the commercial health insurance market, we have chosen to provide an overview of financial results in the individual and group insurance markets, as well as focus on enrollment changes in the individual market and the impact of the ACA's risk adjustment and risk corridor programs. **The financial results presented in this report may differ from 2014 year-end statutory statements, as these results reflect a final accounting of the ACA's "3R" programs rather than insurers' year-end estimates.** 2014 report highlights include:

- **While enrollment in the individual health insurance market increased from 10.9 to 15.0 million covered lives (nearly a 40% increase), overall enrollment decreased in the commercial health insurance markets from 2013 to 2014 by approximately 1.5% as a result of a 5.3 million decline in enrollment in the fully insured group markets.** This decline may be attributable to insurers moving business to self-funded platforms, which avoid adjusted community rating rules (small group market only) and the ACA's Health Insurer Fee (HIF). For 2015, insurers subject to the tax owed amounts equivalent to approximately 3% of their 2014 premium (grossing up for federal corporate taxes).
- **Based on December 31, 2014, national effectuated marketplace enrollment of 6.3 million, marketplace enrollment represented approximately 43% of individual market enrollment during 2014.** In 2014, many insurers likely had portions of their individual market business in transitional or grandfathered coverage. In future years, the insurance marketplaces are likely to represent a larger portion of individual market enrollment. As of September 30, 2015, national effectuated marketplace enrollment had increased to 9.3 million covered lives.[1] Based on CCIIO reporting 12.7 million national plan selections for the 2016 open enrollment period,[2] we would estimate national marketplace effectuated enrollment of approximately 10 million in 2016.
- **Across each of the three commercial health insurance markets, national composite underwriting results deteriorated from 2013 to 2014.** As illustrated in the Figure 1, underwriting results in the individual market were significantly impacted by risk corridor receivables being reduced to 12.6% of fully funded amounts. For carriers that underestimated claims expense for their 2014 individual market business, the lack of available risk corridor funding resulted in reported underwriting results being less favorable than they would have been if the risk corridors were fully funded. Underwriting losses for the individual market increased from 2.1% of premium with full risk corridor payment to 6.1% of premium with the adjusted risk corridor payment (although, for perspective, the 2013 underwriting results sat at 3.9%). As discussed within our report, the reduction in risk corridor payments had a larger impact on average for new individual market entrants and insurers that captured a significant portion of market share within a state. It should be noted that values in this report assume no further collection of calendar-year 2014 risk corridor receivable amounts.

1 Centers for Medicare and Medicaid Services (December 22, 2015). September 30, 2015 Effectuated Enrollment Snapshot. Retrieved March 7, 2016, from **https://www.cms.gov/Newsroom/MediaReleaseDatabase/Fact-sheets/2015-Fact-sheets-items/2015-12-22-2.html**.

2 Centers for Medicare and Medicaid Services (February 4, 2016). Health Insurance Marketplace Open Enrollment Snapshot—Week 13. Retrieved March 7, 2016, from **https://www.cms.gov/Newsroom/MediaReleaseDatabase/Fact-sheets/2016-Fact-sheets-items/2016-02-04.html**.

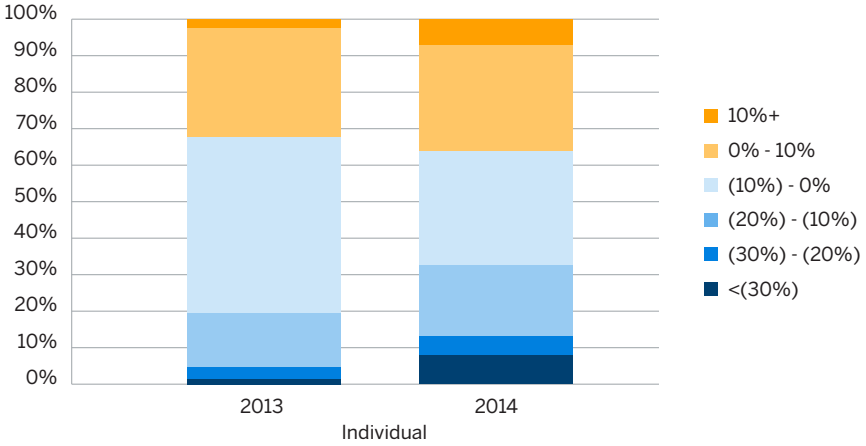
FIGURE 1: 2013 VS. 2014 AGGREGATE UNDERWRITING RESULTS – COMPREHENSIVE EXPERIENCE



Note: Large group business is not subject to the ACA's risk corridor program.

- **While the portion of the individual market experiencing an underwriting gain actually increased from 32% to 36% from 2013 to 2014, the percentage of the market experiencing underwriting losses greater than 10% of premium also increased from 19% to 33%.** Figure 2 indicates that the decrease in aggregate underwriting margins in the individual market from 2013 to 2014 was driven by severe losses by a material portion of the market, rather than deteriorating financial results marketwide.

FIGURE 2: 2013 VS. 2014 INDIVIDUAL MARKET DISTRIBUTION OF UNDERWRITING RESULTS



Note: 2014 underwriting results reflect adjusted risk corridor receivables.

- **Risk adjustment transfers in the individual and small group markets represented a material portion of earned premium for many insurers.** In the 2014 individual and small group markets, insurers representing 57% and 19% of national market share, respectively, had risk adjustment transfers of greater than 2% of total earned premium. On average, risk adjustment transfers were more volatile for insurers with lower state market share in the individual and small group insurance markets.

With substantial changes occurring in 2015 and 2016 with regard to marketplace enrollment, premium rate fluctuations, and changes in the competitive landscape within many states, we anticipate that the individual health insurance market will exhibit continued volatility in the near term. Insurers assessing future changes in their specific markets may benefit from analyzing historical changes that have occurred in market share and insurer profitability in other states exhibiting similar market dynamics.

Introduction

Due to the ACA enactment in March 2010, health insurers have had to comply with minimum loss ratio requirements, more stringent rate reviews, removal of annual benefit limits, first-dollar coverage of preventive care services, and other requirements prior to January 1, 2014. However, January 1, 2014, marked the implementation of the biggest changes to the commercial insurance market under the ACA. Whereas many states permitted medical underwriting, non-coverage of essential health benefits (EHBs), and no limitations on the insured member's maximum cost sharing in the pre-2014 individual and small group insurance markets, the ACA implemented adjusted community rating, essential benefit requirements, and standardized actuarial value requirements.

Furthermore, for coverage beginning January 1, 2014, new financial assistance became available to millions of Americans who purchase coverage in the individual market via premium assistance in the federal or state marketplaces. This expected influx of new enrollment into the individual market resulted in new companies offering individual products, including traditional Medicaid managed care health plans and consumer-operated and oriented plans (CO-OPs).

Adding complexity to the financial results of insurers in calendar year 2014, the ACA's "3R" programs (transitional reinsurance, risk adjustment, and risk corridors[3]) increased uncertainty related to 2014 financial performance. Because risk adjustment and risk corridor results in the individual and small group markets are tied to the performance and reporting of other insurers within a specific market, financial results reported in year-end statutory statements were based on estimated results for these programs. Additional headwinds were introduced on October 1, 2015, when the Center for Consumer Information and Insurance Oversight (CCIIO) announced that insurers would only receive 12.6% of risk corridor receivables due to a lack of available funding for the program.[4]

Data used in this report was provided by health insurers in their Medical Loss Ratio Reporting Forms (MLR forms) submitted to CCIIO for 2011 through 2014, along with 2010 Supplemental Health Care Exhibit (SHCE) data, to summarize financial results in the commercial health insurance markets.[5] For 2014, the MLR data is unique because it provides a final accounting of ACA 3R results for insurers, rather than estimated revenue or charges that were included in statutory annual statements, including the SHCE.

This report provides an overview of health insurer financial results in 2014 and evaluates changes in the health insurance industry's expense structure and enrollment relative to prior years. Additionally, we explore impacts to the insurance markets from the introduction of the individual marketplace and the ACA 3R programs.

3 For more information on the basic structure of the risk corridor program, see Norris, D, van der Heijde, M. and Leida, H. (October 2013). Risk Corridors under the Affordable Care Act—A Bridge over Troubled Waters, but the Devil's in the Details. Health Watch. Retrieved March 7, 2016, from **http://us.milliman.com/uploadedFiles/insight/2013/Risk-corridors-under-the-ACA.pdf**.

4 Katterman, S. (October 5, 2015). Headwinds cause 2014 risk corridor funding shortfall. Milliman healthcare reform briefing paper. Retrieved March 7, 2016, from **http://us.milliman.com/insight/2015/Headwinds-cause-2014-risk-corridor-funding-shortfall/**.

5 See appendix for more information on these data sources.

2014 markets and financial results overview

Figure 3 illustrates the aggregate insured lives and composite reported premium and expenses in the individual, small group, and large group health insurance markets on a per-member-per-month (PMPM) basis and as a percentage of premium for key financial measures in 2014. Figure 4 provides the same measures but reflects the changes in enrollment and financial metrics from 2013 to 2014. The appendix of this report provides additional detail on insurer financial results from 2010 through 2014.

FIGURE 3: AGGREGATE REPORTED 2014 COMPREHENSIVE EXPERIENCE

MEASURE	INDIVIDUAL (DIRECT)	SMALL GROUP	LARGE GROUP
COVERED LIVES	15,000,000	16,000,000	43,200,000
EARNED PREMIUM	$ 302.96	$ 388.99	$ 404.79
FEES AND TAXES	$ 15.99	$ 23.07	$ 20.10
CLAIMS EXPENSES	$ 252.10	$ 310.95	$ 342.88
MLR REBATES	$ 1.31	$ 0.73	$ 0.17
TOTAL ADMINISTRATIVE EXPENSES	$ 48.55	$ 48.49	$ 32.66
UNDERWRITING GAIN (LOSS)	$ (18.54)	$ 5.09	$ 7.01
PRELIMINARY MEDICAL LOSS RATIO	88.9%	85.9%	89.9%
REBATE EXPENSE RATIO	0.43%	0.19%	0.04%
UNDERWRITING MARGIN	(6.1%)	1.3%	1.7%
ADMINISTRATIVE EXPENSE RATIO	16.0%	12.5%	8.1%

FIGURE 4: AGGREGATE CHANGES 2013 TO 2014 COMPREHENSIVE EXPERIENCE

MEASURE	INDIVIDUAL (DIRECT)	SMALL GROUP	LARGE GROUP
COVERED LIVES	4,100,000	(1,300,000)	(4,000,000)
EARNED PREMIUM	$ 55.55	$ 12.80	$ 36.10
FEES AND TAXES	$ 13.44	$ 10.08	$ 11.51
CLAIMS EXPENSES	$ 42.48	$ 7.79	$ 22.47
MLR REBATES	$ 0.35	$ 0.16	$ 0.04
TOTAL ADMINISTRATIVE EXPENSES	$ 5.46	$ 2.12	$ 2.76
UNDERWRITING GAIN (LOSS)	$ (8.86)	$ (5.58)	$ (0.35)
PRELIMINARY MEDICAL LOSS RATIO	2.2%	1.4%	0.1%
REBATE EXPENSE RATIO	0.04%	0.04%	0.01%
UNDERWRITING MARGIN	(2.2%)	(1.5%)	(0.3%)
ADMINISTRATIVE EXPENSE RATIO	(1.4%)	0.1%	(0.0%)

Notes:

1. Dollar values are illustrated on a PMPM basis.
2. Covered lives equals reported member months divided by 12.
3. Certain values have been rounded.
4. Preliminary medical loss ratio based on statutory guidelines. The sum of the preliminary medical loss ratio, underwriting margin, and administrative expense ratio will not equal 1.
5. 2014 financial results reflect applicable insurers only receiving 12.6% of risk corridor receivables in the individual and small group markets, which is reflected in claims expenses.
6. 2014 individual market values reflect Arkansas' private option Medicaid expansion population (approximately 210,000 individuals as of December 2014).[6]

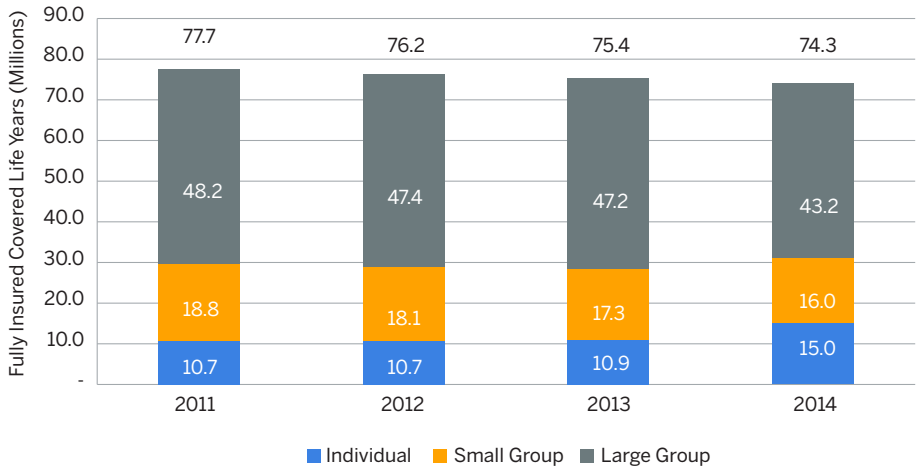
6 Arkansas Department of Human Services (October-December 2014). Arkansas Private Option 1115 Demonstration Waiver: Quarterly Report, October 1, 2014 to December 31, 2014. Retrieved March 7, 2016, from **https://www.medicaid.state.ar.us/Download/general/publicdata/POQrtlyRptOct-Dec.pdf**.

COVERED LIVES

In 2014, 74.3 million individuals were insured across the three insurance markets, which reflects a decline from the 75.4 million individuals insured in 2013. While the individual market grew from 10.9 million in 2013 to 15.0 million in 2014 as a result of newly available premium assistance in the individual marketplace and guaranteed issue under the ACA, this increase was negated by a decline in enrollment in the group markets.

The decline in the group market enrollment, which we have observed since 2011, accelerated in 2014. It is likely that much of the decline in the fully insured group market enrollment was a result of employers moving from fully insured to self-funded coverage. Employers may have had additional incentives to self-fund their employer sponsored insurance coverage in 2014, as doing so could reduce expenses related to the ACA's HIF. Further, small employers wishing to alleviate cost increases due to the ACA's adjusted community rating requirements may benefit from purchasing one of the self-funding products that became available in some states specifically geared toward smaller employer sizes.

FIGURE 5: NATIONAL COMPREHENSIVE HEALTH INSURANCE ENROLLMENT – 2011 TO 2014



Notes:

1. Covered life years defined as insured member months divided by 12.
2. Values have been rounded to the nearest 100,000.

EARNED PREMIUM, FEES AND TAXES, AND CLAIMS EXPENSE

Earned premiums and claims expense increased in each of the three markets from 2013 to 2014, with the individual market experiencing the largest changes. The increases in the individual market may be attributable to changes in populations insured, benefits covered, and member cost-sharing differences relative to 2013.

Fees and taxes levied on insurers increased considerably from 2013 to 2014 as a result of several ACA provisions: HIF, assessments for transitional reinsurance ($5.25 per member per month in 2014), and marketplace user fees (3.5% of premium in the federal marketplace).

Claims expenses in the individual market were reduced by $7.9 billion by the ACA's transitional reinsurance program, relative to the claims experience that would have occurred had the program not been implemented. This represents a nearly 15% decrease in the individual market claims expense in 2014, with a portion of insured lives reflecting transitional or grandfathered coverage not eligible for the transitional reinsurance program. The actual impact of the transitional reinsurance program in 2014 was likely larger than assumed in pricing by insurers, as CCIIO decreased the program's attachment point from $60,000 to $45,000 and increased the coinsurance rate from 80% to 100% for the 2014 coverage period after carriers[7] were required to file individual market premiums.

PRELIMINARY MEDICAL LOSS RATIO AND MLR REBATES

In each of the three markets, the preliminary MLR increased from 2013 to 2014, with the individual market experiencing the largest increase, moving from 86.7% to 88.9%. Since 2010, the individual market has experienced an increase in its composite MLR of more than eight percentage points. The market composite MLR in the group insurance markets has only increased by approximately two percentage points during the same period.

As in 2013, 2014 MLR rebates remained below 0.5% of earned premium in each of the three markets. The individual market experienced the largest change in MLR rebates on a PMPM basis, with the composite market rebate amount increasing from $0.96 to $1.31 PMPM.

ADMINISTRATIVE EXPENSES

While administrative expenses decreased or were flat on a percentage of earned premium basis in 2014, each market experienced increases in administrative expenses on a PMPM basis. The individual market experienced the largest increase, as administrative expenses increased from $40.86 PMPM to $48.55 PMPM, nearly a 19% increase. Note, administrative expenses exclude fees and taxes paid by insurers.

UNDERWRITING RESULTS

Each of the three insurance markets experienced a deterioration in underwriting margins from 2013 to 2014, with the individual market experiencing the largest decrease. For insurance carriers that underestimated claims expense or aggressively priced their 2014 individual market business, the lack of available risk corridor funding resulted in reported underwriting results being much lower than they would have been if the risk corridors were fully funded. The risk corridor shortfall resulted in individual market composite underwriting results decreasing from (2.1%) to (6.1%). As discussed in the Risk Corridors section of this report, the impact of the reduction in risk corridor revenue varied significantly by state.

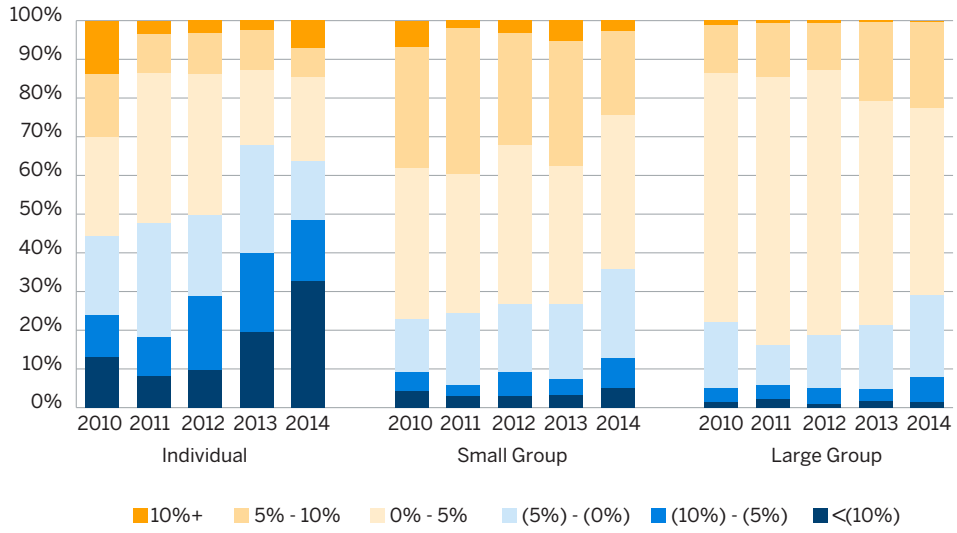
Individual market underwriting results varied widely by state. Of particular interest, California insurers, representing more than 16% of premium volume in the individual market, experienced a composite underwriting gain of 5.4% in the individual market. To the extent that California was excluded from the national composite, the individual composite underwriting loss would increase from (6.1%) to (8.4%) of earned premium.

7 For more information, see Perlman, D., Norris, D., and Leida, H. (June 24, 2015). Transitional reinsurance at 100% coinsurance: What it means for 2014 and beyond. Milliman healthcare reform briefing paper. Retrieved March 7, 2016, from http://us.milliman.com/insight/2015/Transitional-reinsurance-at-100-coinsurance-What-it-means-for-2014-and-beyond/.

Distribution of underwriting results 2010 through 2014

As we evaluate aggregate market underwriting results from 2010 through 2014, it is important to understand the degree to which underwriting results vary between companies within a market. Figure 6 examines the distribution of underwriting results in these markets separately for each calendar year.

FIGURE 6: COMMERCIAL HEALTH INSURANCE - UNDERWRITING MARGIN DISTRIBUTIONS 2010 – 2014



Note: Distributions weighted by reported member months in each calendar year. Results reflect all companies that reported data in the given year.

While the underwriting distribution has remained remarkably stable in the group insurance markets, the individual market has shown significantly greater volatility, particularly in 2013 and 2014. While the percentage of the individual market with an underwriting gain actually increased from 32% in 2013 to 36% in 2014, underwriting losses became more severe as well. In 2014, nearly one-third of the individual market experienced underwriting losses of more than 10% of earned premium, relative to only 19% in 2013. As discussed in the Risk Corridors section of this paper, the risk corridor shortfall resulted in greater underwriting losses than would have occurred had the risk corridor program been fully funded.

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Individual market enrollment changes

As discussed in the previous section, the individual market experienced a significant increase in enrollment as a result of the implementation of the state and federal insurance marketplaces and available premium assistance. National effectuated enrollment in the individual insurance marketplace totaled approximately 6.3 million lives as of December 31, 2014.[8] Based on the reported number of effectuated lives, approximately 43%[9] of insured lives in the individual market purchased coverage in the marketplace. For the majority of states, marketplace enrollment represented between 30% and 50% of insured lives in the individual market.

In 2014, the insurance marketplaces presented an opportunity for both new and existing insurers to compete in a market with new rating rules, distribution channel, and customers. In many states, insurers with significant existing market share competed against new commercial insurers, including traditional Medicaid managed care plans and CO-OPs.[10]

Figure 7 evaluates shifts in the distribution of national market share for the individual market based on insurers' market share at the state level in 2013 and 2014. The vertical axis classifies insured business based on 2013 state market share, while the horizontal axis reflects 2014 state market share. For example, 2.5% of national market share in 2014 was associated with insurers that had a 2013 state market share exceeding 75% and a 2014 state market share between 50% and 75%. The row labeled "No Members (2013)" reflects insurers that entered a state's individual health insurance market in 2014.

FIGURE 7: INDIVIDUAL MARKET – STATE MARKET SHARE GAIN/LOSS MATRIX – 2013 TO 2014 MEASURE: 2014 NATIONAL MARKET SHARE

	2014 MARKET SHARE						
2013 MARKET SHARE	<5%	5% - 10%	10% -25%	25% - 50%	50% - 75%	75%+	TOTAL (2013 MARKET SHARE GROUPING)
75%+	0.0%	0.0%	0.0%	0.0%	2.5%	7.1%	9.6%
50% - 75%	0.0%	0.0%	0.0%	0.7%	14.3%	5.5%	20.5%
25% - 50%	0.0%	0.0%	4.2%	16.1%	2.7%	0.0%	22.9%
10% - 25%	0.0%	2.3%	12.3%	8.6%	0.0%	0.0%	23.2%
5% - 10%	1.9%	3.5%	4.9%	0.8%	0.0%	0.0%	11.2%
<5%	6.0%	1.7%	0.7%	0.5%	0.0%	0.0%	9.0%
NO MEMBERS (2013)	0.9%	1.1%	1.0%	0.3%	0.2%	0.0%	3.6%
TOTAL (2014 MARKET SHARE GROUPING)	8.7%	8.7%	23.2%	27.1%	19.7%	12.6%	100.0%

Note: Market share classification based on state market share at the parent company level.

Figure 7 provides several key observations:

- **Insurers with dominant state market share in 2013 (exceeding 50%), were generally able to maintain or increase market share in 2014.** For example, 5.5% of 2014 national market share is represented by insurers that increased state market share from 50% to 75% in 2013, to above 75% in 2014. Only 0.7% of national market share is represented by insurers that experienced a decrease in state market share from between 50% and 75% in 2013 to between 25% and 50% in 2014.

8 Jost, T. (June 2, 2015). Implementing health reform: Premium increase requests; agent/broker fees and the MLR (June 3 marketplace enrollment update). Health Affairs Blog. Retrieved March 14, 2016, from http://healthaffairs.org/blog/2015/06/02/implementing-health-reform-premium-increase-requests-agentbroker-fees-and-the-mlr/.

9 Excluding Arkansas Private Option Medicaid enrollees.

10 For more information regarding insurer participation in the insurance marketplace during 2014, see Houchens, P., Clarkson, J., and Sturm, M. (November 2013). 2014 federal insurance exchange: Evaluation of insurer participation and consumer choice. Milliman healthcare reform briefing paper. Retrieved March 7, 2016, from http://us.milliman.com/uploadedFiles/insight/2013/2014-federal-insurance-exchange-insurer-participation.pdf.

- **Insurers entering the individual market or with relatively nominal market share in 2013 were able to increase or capture significant market share in some cases.** Multiple new entrants or insurers with less than 10% state market share were able to capture in excess of 25% state market share in 2014. This may be attributable to price sensitivity of consumers in the individual marketplace. In the federal marketplaces, it was reported that 64% of consumers selected the lowest or second-lowest cost plan across all metal levels in 2014.[11]

While the 2014 individual market provided a growth opportunity for many insurers, there was also a higher degree of uncertainty associated with the number and health status of individuals that would enroll in the market. Figure 8 provides the same layout as Figure 7, but illustrates 2014 underwriting margin rather than national market share. For example, for insurers that had state market share in excess of 75% in 2013 and 2014, their 2014 composite underwriting margin was (1.7%).

FIGURE 8: INDIVIDUAL MARKET – STATE MARKET SHARE GAIN/LOSS MATRIX – 2013 TO 2014 MEASURE: 2014 NATIONAL MARKET SHARE

	2014 MARKET SHARE						
2013 MARKET SHARE	<5%	5% - 10%	10% -25%	25% - 50%	50% - 75%	75%+	TOTAL (2013 MARKET SHARE GROUPING)
75%+	0.0%	0.0%	0.0%	0.0%	0.9%	(1.7%)	(1.0%)
50% - 75%	0.0%	0.0%	0.0%	(4.0%)	(10.5%)	(23.8%)	(13.7%)
25% - 50%	0.0%	0.0%	(1.8%)	(1.9%)	(6.5%)	0.0%	(2.4%)
10% - 25%	0.0%	(2.9%)	1.5%	(3.1%)	0.0%	0.0%	(0.8%)
5% - 10%	(3.4%)	(6.4%)	(7.0%)	0.7%	0.0%	0.0%	(5.5%)
<5%	(9.3%)	(2.2%)	(7.0%)	(33.3%)	0.0%	0.0%	(8.8%)
NO MEMBERS (2013)	(39.4%)	(14.6%)	(40.3%)	(54.5%)	3.8%	0.0%	(29.4%)
TOTAL (2014 MARKET SHARE GROUPING)	(11.8%)	(5.9%)	(3.3%)	(3.3%)	(8.2%)	(10.7%)	(6.1%)

Note: Market share classification based on state market share at the parent company level.

Key observations from Figure 8 include:

- **On average, new market entrants experienced the largest underwriting losses in 2014, a composite (29.4%) underwriting loss.** However, one new market entrant, Maine Community Health Options, was able to capture more than 50% market share and achieve an underwriting gain of 3.8%. Overall, the results shown in Figure 8 for new market entrants reflect the difficulty of these insurers in gaining market share without sacrificing profitability. As discussed in the Risk Corridors section of this paper, many new market entrants were affected adversely by the reduction in risk corridor receivables.
- **Insurers with dominant market share in 2013 and 2014 were not immune from significant underwriting losses.** For insurers with 2013 state market share between 50% and 75%, that increased 2014 state market share above 75% (5.5% of national market share in 2014), underwriting losses in 2014 were in excess of 20%.

11 Burke, A., Misra, A., and Sheingold, S. (June 18, 2014). Premium affordability, competition, and choice in the health insurance marketplace, 2014. Table 4. U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation. Retrieved March 7, 2016, from https://aspe.hhs.gov/sites/default/files/pdf/76896/2014MktPlacePremBrf.pdf.

- **In general, insured business that maintained or experienced decreases in market share was less prone to the more severe underwriting losses.** This may be attributable to more conservative pricing in the insurance marketplaces or larger blocks of transitional or grandfathered business that remained relatively stable from an underwriting margin perspective.
- **Enrollment and market share changes are likely to continue in the insurance marketplace in the near term.** Additional insurers began offering coverage in insurance marketplace in 2015, with the lowest-cost plans in many markets being offered by an insurer that may not have been price competitive in the 2014 market.[12] In 2016, many states experienced average changes to the subsidy benchmark plan in excess of 20%.[13] 2016 also marks the last year of the transitional reinsurance and risk corridor programs, which will not be in place in 2017.

12 Clarkson, J., Gibula, W., and Houchens, P. (February 2015). Federal exchange auto-enrollment: Emerging data and new proposals. Milliman healthcare reform briefing paper. Retrieved March 7, 2016, from **http://us.milliman.com/uploadedFiles/insight/2015/fed-exchange-auto-enrollment.pdf**.

13 Centers for Medicare and Medicaid Services (October 26, 2015). 2016 Marketplace Affordability Snapshot. Retrieved March 7, 2016, from **https://www.cms.gov/Newsroom/MediaReleaseDatabase/Fact-sheets/2015-Fact-sheets-items/2015-10-26-2.html**.

ACA risk corridor program

Insurers faced great uncertainty while establishing premiums for the 2014 individual market. Given the high number of new consumers entering the market, insurers were required to make assumptions related to the population that would enroll in the individual marketplace and the health status of this population. The risk corridor program is only available for qualified health plans (QHPs) offered in the insurance marketplaces (plans sold outside the marketplace that are nearly identical to an insurer's QHP sold in the marketplace are also eligible).[14] While it is available to insurers in both the individual and small group markets, the relative importance of the program to the health insurance industry as a whole is much greater in the individual market.

- **Nationally, insurers reported 54% of membership subject to the risk corridor program in the individual market in 2014.** This ranged from a low of 15% in South Dakota to more than 80% in three states. As previously stated, insurance marketplace enrollment represented 43% of enrollment in the individual market, implying that roughly 20% of the enrollment subject to the risk corridor program was in QHPs outside the marketplace.
- **In the small group market, risk corridor-eligible membership only represented 17% of the market.** In nine states, risk corridor membership represented less than 5% of total market enrollment. The significantly lower percentage of business subject to the risk corridor program is primarily attributable to the Small Business Health Options Programs (SHOP) exchanges having minimal enrollment in 2014, as well as limited purchase of QHPs outside of the SHOP. [15]

Because the risk corridor program offered insurers financial protection against underpricing their marketplace products, the program may have resulted in insurers pricing their individual market products less conservatively than they otherwise would have in light of the substantial amount of uncertainty when setting rates.

Adding complexity to the risk corridor program, the budget neutrality of the program came into question after insurers had begun selling coverage for 2014.[16] This came to fruition on October 1, 2015, as CCIIO announced that insurers would receive only 12.6% of risk corridor receivables for individual market business in calendar year 2014.[17] This announcement indicated that the shortfall could potentially be funded in future years; however, it is still unknown when and if this funding will become available.

Individual market enrollees eligible for premium assistance on the marketplace demonstrated a high degree of price sensitivity when selecting plan designs. This price sensitivity resulted in insurers with the lowest priced plans obtaining high market share. In situations where an insurer offered products on the marketplace with limited conservatism in pricing, high enrollment levels presented larger reliance on the availability of the risk corridors to assist insurers in limiting financial losses.

14 Leida, H. (November 19, 2013). President Obama's transitional policy for canceled plans. Milliman.com. Retrieved March 7, 2016, from http://us.milliman.com/insight/2013/President-Obamas-transitional-policy-for-canceled-plans/.

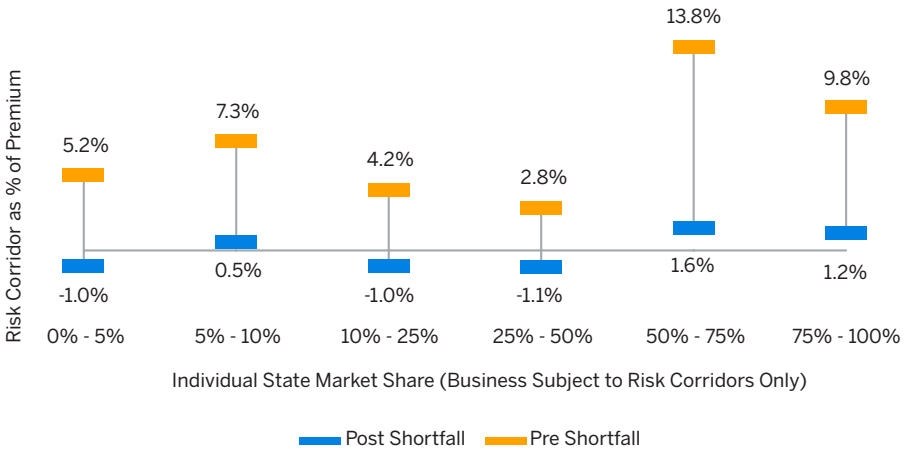
15 United States Government Accountability Office (November 2014). Small business health insurance exchanges: Low initial enrollment likely due to multiple, evolving factors. Report to the Chairman, Committee on Small Business, House of Representatives. Retrieved March 7, 2016, from http://gao.gov/assets/670/666873.pdf.

16 For more background, see Norris, D., Perlman, D., and Leida, H. (December 2014). Milliman healthcare reform briefing paper. Retrieved March 7, 2016, from http://us.milliman.com/uploadedFiles/insight/2014/risk-corridors-no-new-hope.pdf.

17 Katterman, S. Headwinds cause 2014 risk corridor funding shortfall.

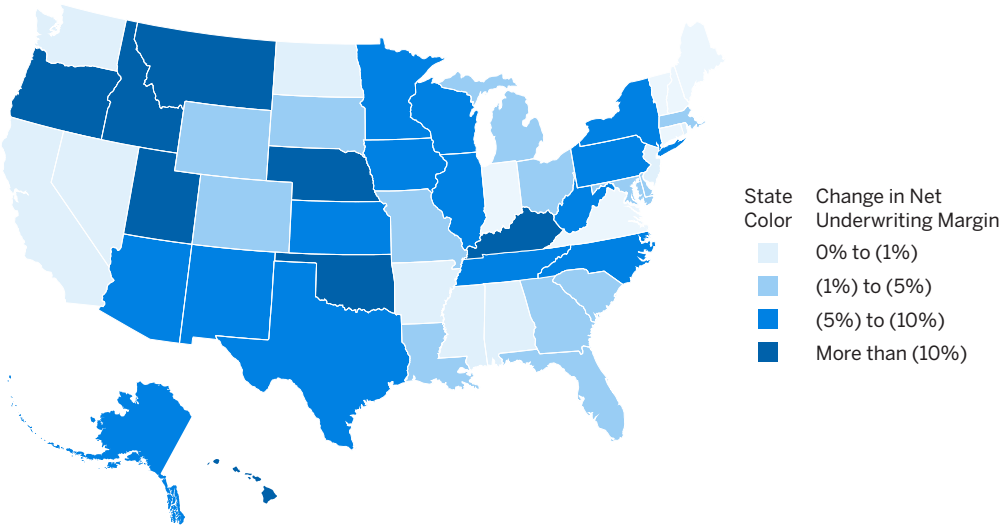
Figure 9 illustrates risk corridor receivables as a percentage of earned premium for business eligible for the ACA risk corridor program. For the purpose of this figure, issuers are segmented based on their state market share of membership subject to the ACA risk corridors. This figure illustrates net risk corridor receivables both before and after reflecting the risk corridor shortfall. Negative percentages reflect insurers with a risk corridor payable.

FIGURE 9: 2014 INDIVIDUAL MARKET NET RISK CORRIDOR RECEIVABLE AS A PERCENTAGE OF EARNED PREMIUM BY INSURER MARKET SHARE SUBJECT TO THE RISK CORRIDORS



As Figure 9 demonstrates, on average, insurers with high state market share were impacted by the risk corridor shortfall to a greater degree than insurers with low state market share. This is likely influenced by the price sensitivity of individual market enrollees electing to enroll in plans that were the lowest cost offered in the market. For insurers anticipating to receive risk corridor receivables, the shortfall represented a tangible impact to 2014 net underwriting margins in many cases. Figure 10 illustrates the change in net underwriting margin by state in calendar year 2014 due to the risk corridor shortfall.

FIGURE 10: 2014 INDIVIDUAL MARKET CHANGE IN NET UNDERWRITING MARGIN DUE TO RISK CORRIDOR SHORTFALL BY STATE



As illustrated in Figure 10, the insurer financial impact associated with the risk corridor shortfall varied greatly by state, influenced by both the percentage of individual market business subject to the risk corridor program and the financial performance of insurers under the program.

In 16 states, net underwriting margin experienced a change of less than 1% due to the risk corridor shortfall. In contrast, a total of 20 states experienced a decrease in net underwriting margin of 5% or greater following the CCIIO announcement, with eight states experiencing a greater than 10% decrease in net underwriting margin as a direct result of the risk corridor shortfall.

For new entrants to the individual market, pricing uncertainty was likely greater compared with insurers participating in the pre-2014 market. Many existing insurers had pre-2014 experience data and other sources of information to develop premium rates, whereas new entrants (defined for this purpose as insurers that did not have individual market membership in a given state in 2013) did not always have claims experience to develop premium rates. Additionally, some existing insurers offered transitional or grandfathered policies that were not subject to the ACA and which could assist in stabilizing financial results. Figure 11 illustrates the composite change in net underwriting margin due to the risk corridor shortfall, separately for new entrants and existing insurers.

FIGURE 11: 2014 INDIVIDUAL MARKET CHANGE IN NET UNDERWRITING MARGIN DUE TO RISK CORRIDOR SHORTFALL BY INSURER STATUS

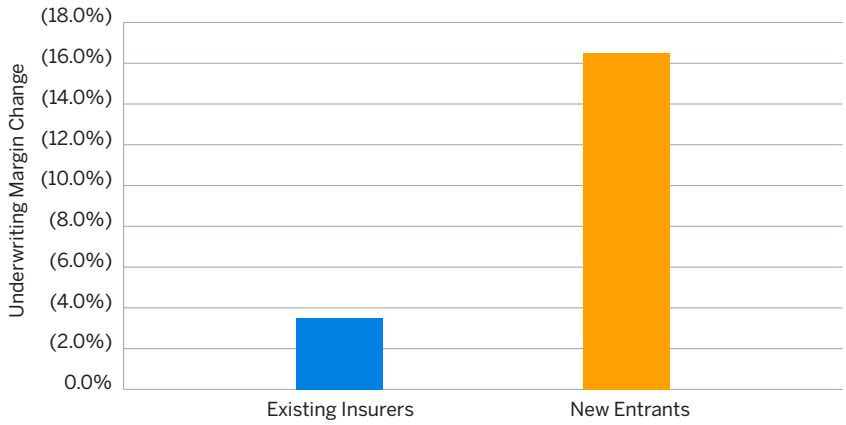


Figure 11 illustrates that the impact of the risk corridor shortfall was almost five times greater for new entrants compared to existing insurers. On average, existing insurers experienced an approximately 3.5% decrease in net underwriting margin, compared with an approximately 16.5% decrease in net underwriting margin for new entrants.

The CCIIO risk corridor shortfall announcement was released after carriers were required to submit both calendar year 2015 and 2016 individual market premiums. Additionally, calendar-year 2015 premiums were established prior to insurers having a complete picture of their calendar-year 2014 financial results. Given the price sensitivity of individual market enrollees, insurers were incentivized to maintain low premiums for the purpose of maintaining or gaining market share. In many regions, the lowest cost plans offered on the individual exchange marketplace decreased between calendar years 2015 and 2014.[18] In the event that the risk corridor shortfall is not funded in subsequent years, there is the potential for the impact of the risk corridor shortfall on insurer financials to be even greater in 2015 relative to the impact observed in calendar year 2014.

18 Avery, K., Gardner, M., Gee, E., Marchetti-Bowick, E., McDowell, A., and Sen A. (October 30, 2015). Health plan choice and premiums in the 2016 health insurance marketplace. Page 20, Table 7. ASPE research brief. Retrieved March 7, 2016, from https://aspe.hhs.gov/sites/default/files/pdf/135461/2016%20Marketplace%20Premium%20Landscape%20Issue%20Brief%2010-30-15%20FINAL.pdf.

ACA risk adjustment program

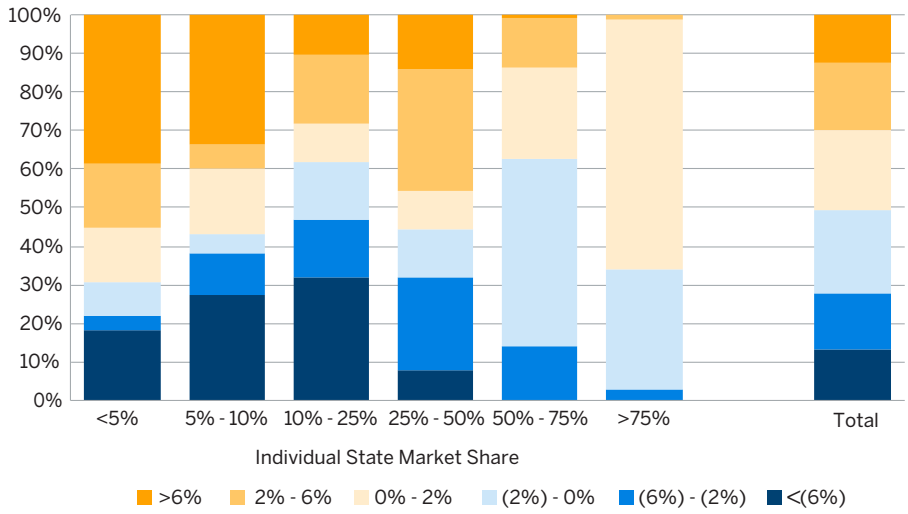
The ACA risk adjustment program, the permanent component of the 3R programs, is intended to normalize for differences in member health risk among insurers. Risk adjustment transfers within the individual and small group markets in each state [19] net to zero, meaning that the payments by insurers with lower-than-average-risk members are equal to the receipts by insurers with higher-than-average-risk members.

For 2014, risk adjustment transfer payments totaled more than $1.75 billion across the individual market and over $600 million across the small group market. These transfer payments represent approximately 3.6% and 0.9% of earned premium for insurers subject to risk adjustment for the individual and small group markets, respectively. We note that many of these insurers also had non-ACA-compliant membership during 2014 to which the risk adjustment program does not apply. Hence, the risk adjustment transfers represent an even larger percentage of earned premium for ACA-compliant membership.

Although the risk adjustment transfers net to zero at the market level, the impact varies by insurer and can materially impact insurer financial results. Insurers with larger market share are less impacted by risk adjustment transfers because the risk of their membership will naturally be closer to the market average risk. Conversely, insurers with smaller market share are typically more impacted by risk adjustment transfers.

Figures 12 and 13 illustrate this for the individual and small group markets, respectively. For purposes of these figures, insurers are segmented based on their state market share of membership. In the individual market, risk adjustment transfers of greater than 2% of total earned premium was incurred for 57% of national market share. While in the small group market, only 19% of national market share experienced risk adjustment transfers greater than 2% of total earned premium. Over the next few years, we expect risk adjustment transfers to become more impactful to insurers in both markets as all individual and small group business with comprehensive medical coverage becomes subject to the ACA risk adjustment program. Grandfathered and non-ACA-compliant coverage is not subject to the risk adjustment program.

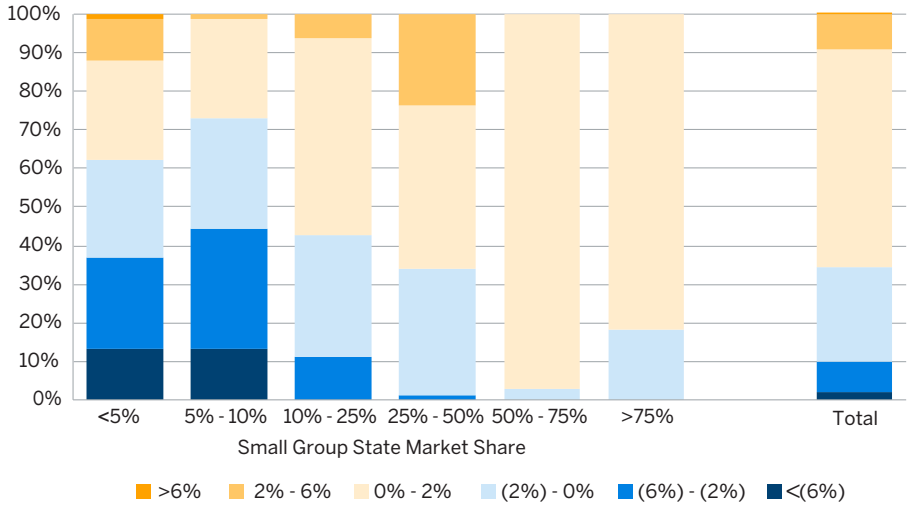
FIGURE 12: 2014 INDIVIDUAL MARKET RISK ADJUSTMENT TRANSFER AS A PERCENTAGE OF EARNED PREMIUM BY INSURER STATE MARKET SHARE



Note: Distribution weighted by reported member months.

19 Massachusetts has a combined individual and small group risk pool, so risk adjustment transfers in Massachusetts net to zero across the individual and small group markets combined.

FIGURE 13: 2014 SMALL GROUP MARKET RISK ADJUSTMENT TRANSFER AS A PERCENTAGE OF EARNED PREMIUM BY INSURER STATE MARKET SHARE



Note: Distribution weighted by reported member months.

Many insurers with smaller market share—both existing insurers and new entrants—had little insight regarding the amount of their 2014 risk adjustment transfers until results were announced by CMS on June 30, 2015. [20] The 2014 risk adjustment transfer amounts gave insurers a quantification of the risk of their members versus the market average risk. This information will be helpful to insurers when estimating transfer amounts to report on 2015 annual statements and 2017 premium rates. However, there will still be uncertainty when developing estimates for risk adjustment transfer amounts, and insurers will need to consider many factors, such as the impact of members entering or leaving the market, movement of members between insurers, and improvements in coding of diagnosis codes on claims, when doing so.[21]

20 Center for Consumer Information and Insurance Oversight (June 30, 2015). Summary report on transitional reinsurance payments and permanent risk adjustment transfers for the 2014 benefit year. Retrieved March 7, 2016, from **https://www.cms.gov/CCIIO/Programs-and-Initiatives/Premium-Stabilization-Programs/Downloads/RI-RA-Report-Draft-6-30-15.pdf**.

21 Perlman, D. & Liner, D. (February 19, 2016). Financial analysis of ACA health plan insurers. Milliman healthcare reform briefing paper. Retrieved March 14, 2016, from **http://us.milliman.com/insight/2016/Financial-analysis-of-ACA-health-plan-issuers/**.

Conclusion

Insurer financial experience from the MLR forms provides a transparent view into the United States' health insurance market. For 2014, the data provides a unique picture of the insurance markets' financial results based on a final accounting of the ACA's 3R programs. The individual market has undergone significant change in terms of enrollment, premium revenue, and claims expense, as well as overall market volatility relative to the group insurance markets. We anticipate continued volatility in the individual health insurance market in the near term as insurers enter and exit the market. For example, CMS has reported that in states using the federal marketplace platform, there were 231 state issuers (insurers) in 2015, with 40 new state issuers in 2016 and 35 state issuers exiting the marketplace.[22]

Financial data from the MLR forms will continue to provide insurers and policymakers with critical information on how the ACA is impacting market enrollment, premium, claims, administrative expenses, and insurer profitability.

Limitations

The analyses presented in this research paper have relied on data and other information from the MLR forms and Supplemental Health Exhibit of health insurers. MLR form data was obtained from the Center for Consumer Information and Insurance Oversight of the Centers for Medicare and Medicaid Services[23] in December 2015. 2010 Supplemental Health Care Exhibit data was obtained using SNL Financial. The data and other information have not been audited or verified, but a limited review was performed for reasonableness and consistency. If the underlying data or information is inaccurate or incomplete, the results of this analysis may likewise be inaccurate or incomplete. Published values subsequent to December 1, 2015, are not included in this report.

The views expressed in this report are made by the authors of this report and do not represent the collective opinions of Milliman. Other Milliman consultants may hold different views and reach different conclusions.

Acknowledgement

David Hayes, FSA, MAAA, peer reviewed this report. The authors appreciate his assistance.

Qualifications

Guidelines issued by the American Academy of Actuaries require actuaries to include their professional qualifications in all actuarial communications. The authors are members of the American Academy of Actuaries, and meet the qualification standards for performing the analyses in this report.

22 Avery, K., Gardner, M., Gee, E., Marchetti-Bowick, E., McDowell, A, and Sen, A. Health Plan Choice and Premiums in the 2016 Health Insurance Marketplace. Page 21, Table 8.

23 Centers for Medicare and Medicaid Services. Medical Loss Ratio Data and System Resources. Retrieved March 7, 2016, from http://www.cms.gov/CCIIO/Resources/Data-Resources/mlr.html.

Appendix 1

Aggregate health insurer financial results 2010 - 2014

FIGURE 14: SUMMARY OF COMMERCIAL HEALTH INSURER FINANCIAL RESULTS - CALENDAR YEARS 2010 - 2014 PER MEMBER PER MONTH PREMIUM AND EXPENSES

INDIVIDUAL MARKET - ALL REPORTED COMPANIES

YEAR	COVERED LIVES	EARNED PREMIUM	CLAIM EXPENSES	MLR REBATES	TOTAL ADMIN EXPENSES	UNDERWRITING GAIN/(LOSS)	PRELIMINARY MEDICAL LOSS RATIO	MLR REBATES AS % OF EARNED PREMIUM	UNDERWRITING MARGIN	ADMIN EXPENSE RATIO
2014	15,000,000	$302.96	$252.10	$1.31	$48.55	($18.54)	88.9%	0.4%	(6.1%)	16.0%
2013	10,900,000	$247.41	$209.62	$0.96	$43.09	($9.68)	86.7%	0.4%	(3.9%)	17.4%
2012	10,700,000	$240.10	$199.47	$1.54	$38.30	($4.78)	86.0%	0.6%	(2.0%)	16.0%
2011	10,700,000	$234.17	$188.47	$3.06	$38.47	($2.55)	83.5%	1.3%	(1.1%)	16.4%
2010	10,100,000	$214.11	$166.14	$0.26	$40.86	($0.67)	80.8%	0.1%	(0.3%)	19.1%

SMALL GROUP MARKET - ALL REPORTED COMPANIES

YEAR	COVERED LIVES	EARNED PREMIUM	CLAIM EXPENSES	MLR REBATES	TOTAL ADMIN EXPENSES	UNDERWRITING GAIN/(LOSS)	PRELIMINARY MEDICAL LOSS RATIO	MLR REBATES AS % OF EARNED PREMIUM	UNDERWRITING MARGIN	ADMIN EXPENSE RATIO
2014	16,000,000	$388.99	$310.95	$0.73	$48.49	$5.09	85.9%	0.2%	1.3%	12.5%
2013	17,300,000	$376.19	$303.16	$0.57	$46.37	$10.68	84.5%	0.2%	2.8%	12.3%
2012	18,100,000	$361.59	$291.54	$0.93	$44.38	$9.81	84.5%	0.3%	2.7%	12.3%
2011	18,800,000	$352.88	$280.86	$1.28	$45.68	$10.54	83.7%	0.4%	3.0%	12.9%
2010	17,600,000	$343.26	$274.66	$0.07	$45.05	$10.93	83.7%	0.0%	3.2%	13.1%

LARGE GROUP MARKET - ALL REPORTED COMPANIES

YEAR	COVERED LIVES	EARNED PREMIUM	CLAIM EXPENSES	MLR REBATES	TOTAL ADMIN EXPENSES	UNDERWRITING GAIN/(LOSS)	PRELIMINARY MEDICAL LOSS RATIO	MLR REBATES AS % OF EARNED PREMIUM	UNDERWRITING MARGIN	ADMIN EXPENSE RATIO
2014	43,200,000	$404.79	$342.88	$0.17	$32.66	$7.01	89.9%	0.0%	1.7%	8.1%
2013	47,200,000	$368.68	$320.40	$0.14	$29.90	$7.36	89.9%	0.0%	2.0%	8.1%
2012	47,400,000	$367.11	$319.45	$0.19	$29.04	$7.91	90.0%	0.1%	2.2%	7.9%
2011	48,200,000	$359.20	$310.49	$0.66	$28.98	$8.27	89.6%	0.2%	2.3%	8.1%
2010	39,200,000	$339.47	$293.55	$0.00	$31.64	$5.74	89.3%	0.0%	1.7%	9.3%

Notes:

1. Covered Lives equals reported member months divided by 12.
2. 2011 through 2014 reported premium and expenses based on MLR form reported values as of March 31st of the following year.
3. MLR form reported values transposed into the same format as the NAIC Supplemental Health Exhibit form.
4. Earned Premium equals Part 1, Line 1.1 of the Supplemental Health Exhibit.†
5. Claims Expenses equals Part 1, Line 5.0 of the Supplemental Health Exhibit.†
6. Total Admin Expenses equals the sum of Part 1, Lines 6.6, 8.3, and 10.5 of the Supplemental Health Exhibit.
7. Underwriting Gain (Loss) equals Part 1, Line 11 of the Supplemental Health Exhibit.
8. Preliminary Medical Loss Ratio equals sum of Part 1, Line 4 + Line 5.0 + Line 6.6 ÷ Line 1.8 of the Supplemental Health Exhibit.
9. 2012/13/14 MLR Rebates as a % of Earned Premium equal reported rebates on Part 4, Line 5.4 (Total Column) of 2012/13/14 MLR form ÷ Earned Premium.
10. 2011 MLR Rebates as a % of Earned Premium equal reported rebates on Part 5, Line 5.4 (Total Column) of 2011 MLR form ÷ Earned Premium.
11. Underwriting Margin equals Underwriting Gain (Loss) ÷ Earned Premium.
12. Admin Expense Ratio equals Total Admin Expenses ÷ Earned Premium. †2014 Values were adjusted by impact of 3R's.

Appendix 2

Methodology

Section 2718 of the ACA instituted minimum medical loss ratio requirements for health insurers in the individual, small group, and large group markets. The CCIIO within the Centers for Medicare and Medicaid Services (CMS) has publicly released the annual Medical Loss Ratio Reporting Data (MLR Data) that was used to fulfill and measure the minimum medical loss ratio requirements under the ACA. We have summarized and analyzed the MLR Data made available through CCIIO's website[24] as of December 1, 2015.

The MLR Data contains health insurance issuer-reported experience at the state and market level. Business under the medical loss ratio requirements is split between comprehensive (annual limit greater than $250,000), mini-med (annual limit at or less than $250,000), and expatriate. Data for comprehensive and mini-med business is split separately between the individual, small group, and large group markets. Individual market values exclude limited benefit plans, dread-disease policies, accident-only coverage, and other policies that are not considered comprehensive health insurance. The small group and large group categories exclude self-funded employers, many of which purchase stop-loss insurance. Business written through an association is included in the MLR Data based on the insured entity's individual, small group, or large group status. Additionally, for 2013 and 2014, student health insurance was separately reported. For the purpose of this report, only comprehensive business has been summarized.

The information contained in the MLR data tracks closely with the Supplemental Health Care Exhibit (SHCE) form that is submitted with the insurer's year-end annual statement. The SHCE, developed by the National Association of Insurance Commissioners (NAIC), was first required in 2010. By comparing the 2010 Exhibit and 2011–2014 MLR Data, health insurance industry trends can be evaluated over the five-year period. A limitation in these comparisons is that several California-based health insurers file with the state's Department of Managed Care, rather than the NAIC, and therefore, do not complete the Exhibit form. However, these companies are required to report data for the medical loss ratio calculation and therefore are contained in the 2011 through 2014 MLR data sets. 2010 SHCE data was summarized using SNL Financial.

The analyses presented in this report were based upon values from the 2011 through 2014 MLR Data and 2010 SHCE data meeting the following criteria:

- Health insurance coverage lines of business.
- Business in the 50 states and the District of Columbia.
- Identified as comprehensive health insurance coverage based upon a review of the reported values by the authors of this report. For example, companies providing solely behavioral health services were flagged as non-comprehensive.

Values for certain affiliate companies were combined for analyses presented in this report in a way to avoid double counting of enrollment values.

24 Center for Consumer Information and Insurance Oversight website: http://www.cms.gov/CCIIO/Resources/Data-Resources/mlr.html.

Figure 15 provides a summary of the number of companies, covered lives, and aggregate premium amounts reported for calendar year 2014 on a national basis (50 U.S. states and Washington, D.C.) for comprehensive health insurance business under the ACA's Medical Loss Ratio requirements that is included in this report. Additionally, the percentage of total premium (based on reported experience in the 50 states and Washington, D.C.) identified as non-comprehensive is illustrated. Data was reviewed for reasonableness and consistency. However, individual company results have not been audited. To the extent that individual company data was not correctly reported, the values presented in this report will not be representative of actual financial results.

FIGURE 15: 2014 COMPREHENSIVE HEALTH INSURANCE REPORTED IN MLR FORM

MARKET	GROUPS (PARENT COMPANIES)	COMPANIES	LIVES[1]	PREMIUMS ($ MILLIONS)	% NON-COMPREHENSIVE
INDIVIDUAL	187	407	15,000,000	$54,695	0.10%
SMALL GROUP	181	382	16,000,000	$74,647	0.00%
LARGE GROUP	170	379	43,200,000	$210,035	0.07%
TOTAL COMPREHENSIVE	226	479	74,300,000	$339,377	0.06%

Notes:
1. Lives represent reported member months divided by 12.
2. Certain values have been rounded.

While a majority of the fields in the MLR data were simply reassigned to the appropriate SHCE report line item, significant adjustments were made to the earned premiums and incurred claims fields to appropriately account for the impact of the 3Rs in applicable markets during 2014. In particular, adjustments related to the reporting of transitional reinsurance recoveries were based on a review of insurers' 2014 annual statement filings, as well as actuarial judgment. Because risk corridor amounts reported in the MLR data were not consistent with values published by CCIIO, we replaced all MLR data risk corridor values with those published by CCIIO.[25] Other adjustments were made to the data for observed reporting anomalies.

If you would like further information on data and information that can be produced from the Medical Loss Ratio Reporting Form data, please contact the authors of this report.

25 Center for Consumer Information and Insurance Oversight (November 19, 2015). Risk Corridors Payment and Charge Amounts for Benefit Year 2014. Retrieved March 7, 2016, from https://www.cms.gov/CCIIO/Programs-and-Initiatives/Premium-Stabilization-Programs/Downloads/RC-Issuer-level-Report.pdf.

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