STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105

NOTICE OF PROPOSED ACTION AND NOTICE OF PUBLIC HEARING

LOSS RATIO REGULATION FOR INDIVIDUAL HEALTH INSURANCE POLICIES

DATE: July 21, 2011 **REGULATION FILE: REG-2011-00005**

SUBJECT OF PROPOSED RULEMAKING

The California Department of Insurance ("CDI", "Department") proposes to amend and adopt the amendments to Title 10, California Code of Regulations, Chapter 5, Subchapter 2, Article 1.9, Section 2222.12 described below, after considering comments from the public.

On January 12, 2011, the Department submitted an emergency rulemaking action, CDI file number ER-2011-00001, OAL file number 2011-0112-01 E, to amend section 2222.12 of title 10 of the California Code of Regulations. This present rulemaking proceeding is a regular, noticed rulemaking action to make the emergency regulations permanent

The proposed amendment was prompted by the enactment of the federal Affordable Care Act, a series of health market reforms, and the Interim Final Rule, 45·Code of Federal Regulations Part 158, which describes the factors, scope, and method used in the calculation of loss ratios. The federal rules provide, among other things, that beginning January 1, 2011, health insurers offering coverage in the individual market must achieve at least an 80% loss ratio. Those insurers that do not meet this standard will be required to provide a refund the following calendar year. As a result of this proposed amendment to the California regulation, insurers in California will have to demonstrate both (1) compliance with the existing 70% lifetime anticipated loss ratio standard prescribed by section 2222.12, so that consumers are assured of receiving reasonable benefit value for their premium dollars on a policy-form basis, as well as (2) compliance with the 80% federal standard on a market-segment basis at the time of the Department's rate review, so that consumers can have the benefit of the federal medical loss ratio from the outset of the rate, rather than having to wait from eight to twenty months for a premium refund.

PUBLIC HEARING - DATE AND LOCATION

Notice is hereby given that a public hearing will be held to permit all interested persons the opportunity to present statements or arguments, orally or in writing, with respect to the proposed regulations as follows

Date and Time	**Tuesday, September 13, 2011** **11:00 A.M.**
Location	**Department of Insurance** **45 Fremont Street, 22nd Floor Hearing Room** **San Francisco, CA 94105**

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at **5:00 p.m. on September 13, 2011**. Please direct all written comments to the following contact person:

Bruce Hinze
Staff Counsel III
California Department of Insurance
45 Fremont Street, 24th Floor
San Francisco, California 94105

(415) 538-4392
(415) 904-5896 (facsimile)
hinzeb@insurance.ca.gov

Questions regarding procedure, comments, or the substance of the proposed regulations should be addressed to the contact person listed above. In the event that contact person is unavailable, inquiries regarding the proposed action may be directed to the backup contact person:

Stesha Hodges
Staff Counsel
California Department of Insurance
300 Capitol Mall, 17th Floor
Sacramento, California 95814

(916) 492-3544
(916) 324-1883 (facsimile)
HodgesS@insurance.ca.gov

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Commissioner, addressed to the contact person at the address listed above, **no later than 5:00 p.m. on September 13, 2011**. Any written materials received after that time will not be considered.

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

Written comments transmitted by e-mail will be accepted only if they are sent to the following e-mail address: HinzeB@insurance.ca.gov. The Commissioner will also accept written comments submitted by facsimile only if they are sent to the attention of the contact person at the following **facsimile number: (415) 904-5896**. Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. **Comments sent by e-mail or facsimile are subject to the 5:00 P.M., September 13, 2011 deadline.**

AUTHORITY AND REFERENCE

The proposed amendment to Title 10, California Code of Regulations, Chapter 5, Subchapter 2, Article 1.9, Section 2222.12 will implement, interpret and make specific the provisions of Insurance Code sections 10293. Insurance Code section 10293 provides authority for this rulemaking.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Law

Insurance Code section 10293, originally enacted during the 1961 legislative session, requires, among other provisions, that the Insurance Commissioner withdraw approval of individual or mass-marketed policies of disability insurance "if after consideration of all relevant factors the commissioner finds that the benefits provided under the policy are unreasonable in relation to the premium charged."[1] The same Insurance Code section also requires that the Insurance Commissioner promulgate "such reasonable rules and regulations…as are necessary to establish the standard or standards by which the commissioner shall withdraw approval of any such policy."[2] As a result, on November 30, 1962, the Insurance Commissioner ordered that a new Article 1.9, consisting of sections 2222.10 to 2222.19, be added to the California Administrative Code.[3] This article adopted a 50% "loss ratio" as the means to determine whether the benefits provided by a policy were reasonable in relation to the premium charged. A "loss ratio" is a measure used to evaluate the reasonableness of the benefits provided by a hospital, medical or surgical policy. Here, the "loss ratio" is the ratio of incurred claims to earned premium. In 2006, section 2222.12 was amended to change the loss ratio standard to 70%, and to permit insurers to consider disease management expenses.

Policy Statement Overview

1) Federal Health Reform

The federal Patient Protection and Affordable Care Act (Pub. L. 111-148) was enacted on March 23, 2010; the Health Care and Education Reconciliation Act (Pub. L. 111-152) was enacted on March 30, 2010. Collectively, these two statutes are referred to as the Affordable Care Act ("ACA"). Among the health insurance market reforms of the ACA, section 2718 (42 USCS §300gg-18), entitled "Bringing Down the Cost of Health Care Coverage," provides that, beginning January 1, 2011, health insurers offering coverage in the individual market must achieve at least an 80% loss ratio. Further, if the insurer does not meet the required minimum loss ratio, it must provide a refund the following calendar year. The Department of Health and Human Services subsequently issued an Interim Final Rule, 45 Code of Federal Regulations Part 158 (Dec. 1, 2010, with technical corrections issued Dec. 30, 2010) which described the factors, scope, and method used in the federal calculation. This Interim Final Rule provides that insurers must report their federal medical loss ratio outcome for a calendar year by June 1 of the following year (45 CFR § 158.110). Thus, for calendar year 2011, the report is not due until June 1, 2012, and premium rebates are not due until August 1, 2012 (45 CFR § 158.241).

The loss ratio calculation method used in the existing California regulation uses a different calculation method than the federal loss ratio. The 70% minimum loss ratio in existing section 2222.12 is a lifetime anticipated loss ratio, which involves projections into the future based on actuarial assumptions regarding factors involved in the ratio, including medical cost inflation, future claims, durational effects, and other factors. The 70% minimum loss ratio is determined at the level of specific policy forms. In contrast, the federal 80% minimum loss ratio involves different factors, is retrospective in nature, and is determined based on an aggregation of the loss ratios for all of the insurer's individual health insurance forms. Further, the federal 80% minimum loss ratio includes factors, such as premium tax and HIPAA Guaranteed Issue business costs, which are not included in the California 70% loss ratio calculation. This amendment to the regulation conforms the California regulation to the requirements of federal health reform, while preserving the consumer protections of the existing loss ratio standard.

2) Purchasers of individual hospital, medical, or surgical policies lack expertise and market power

One of the most significant factors facing purchasers of individual hospital, medical, or surgical insurance is the disparity in expertise and market power between the purchaser and the insurer. While large purchasers of group health insurance have expertise in judging the level of benefit, and market power in negotiating benefits, small groups and individuals lack such expertise and market power. In part as a result of this disparity, the market for individual insurance does not function at full efficiency. In addition, in part because of this disparity, loss ratios for individual health insurance policies are lower compared to the ratios seen in group health insurance.[4]

3) Purchasers of individual hospital, medical, or surgical policies bear an increasing economic burden

Consumers who purchase individual hospital, medical, or surgical insurance policies face a growing economic burden, as both premium costs and out-of-pocket expenses have significantly increased. This economic burden is consistent with larger trends in health care costs. In the past decades, health care spending in the United States has outpaced the general rate of inflation.[5] Nationally, the amount spent per person on health care increased 74 percent between 1994 and 2004.[6] In addition to the increase in health care costs, the nature of the expenses has changed over the past 20 years, shifting to areas for which the individual hospital, medical, or surgical insurance policyholder often must pay a significant portion of the expense. For example, between 1984 and 2004, the amounts paid for prescription drugs, as a percentage of national health expenditures, increased from 4.9% to 10.0%.[7] From 2001 through 2004, the average annual growth rate in national health care expenditures was 8.4 percent.[8] In the California individual hospital, medical, or surgical insurance market, premiums rose almost 40 percent between 1997 and 2002, in contrast to an approximately 12 percent rise in the prices of other goods and services, as measured by the Consumer Price Index, over the same period.[9] Since section 2222.12 was last amended in 2006, the disparity between the rate of increase of health insurance premiums and the overall rate of inflation has become even more dramatic: while cumulative overall inflation between 2006 and 2010 was 12%, the cumulative rate of premium increases for individual and group insurance over the same five years was 48%, four times the rate of overall inflation.[10] Moreover, in the individual market recent increases have been more extreme. In 2010, the Kaiser Family Foundation reported that the most recent premium increases imposed by insurers in the individual market averaged 20%.[11]

4) Purchasers of individual hospital, medical, or surgical policies are a vulnerable population

While this environment of rising costs poses challenges for purchasers of individual hospital, medical, or surgical insurance, additional factors make these purchasers particularly vulnerable.[12] First, the individual hospital, medical, or surgical insurance market is the last resort for many; California has a higher rate of persons without insurance and lower rates of employer-sponsored coverage than does the nation as a whole.[13] In addition, the need for individual hospital, medical, or surgical insurance has been increasing due to corporate downsizing.[14] Those who are not fortunate enough to receive insurance through their workplace and are not eligible for public programs must attempt to obtain coverage in the individual market. Once covered by individual insurance, many consumers rely on maintaining that coverage for years. In California, the individual insurance market is an important source of long-term hospital, medical, or surgical insurance coverage for a sizable fraction of those who purchase it.[15]

A second factor that confronts purchasers of individual hospital, medical, or surgical insurance policies is the fact that products in the individual market are difficult to qualify for because they are carefully underwritten to manage risk. A third factor is the rapidly increasing cost of individual insurance. High premiums and the low incomes of many of the potential purchasers of individual

insurance make affordability a particular concern.[16] The increasing expense of individual hospital, medical, or surgical insurance reduces affordability, which in turn reduces availability for consumers who might otherwise be forced to go without vital hospital, medical, or surgical insurance coverage. Also, inadequate benefits in individual insurance coverage can be a major source of underinsurance, which affects 13-20 percent of the privately insured.[17] On average, coverage in the individual hospital, medical, or surgical insurance market is less complete than coverage in the group market.[18] Thus, purchasers of individual hospital, medical, or surgical insurance are faced with rapidly increasing health care costs in general, as well as even more rapidly increasing premiums for individual coverage. Because they have no realistic alternative to individual coverage, such persons are at risk of being priced out of the individual insurance market, and joining the large number of uninsured Californians.

5) Conclusion

The current 70% lifetime anticipated loss ratio standard, evaluated on a policy-form basis, protects California consumers by assuring that each policy form will return at least 70 cents of benefit for each premium dollar. The amendment reflected in this notice extends further protection to California consumers by conforming the California regulation to the requirements of federal health care reform while providing consumers with immediate access to the additional benefit of the federal 80% standard, on a market segment basis. This regulation applies the 80% standard to consumers' premium dollars from the outset, without the insured having to wait for up to twenty months for a premium refund. Under federal law, a consumer who pays a premium in excess of that justified under the federal loss ratio requirement would have to wait until August of the following year for a refund. This presents the consumer with an inflated premium for the entire year of coverage; for individuals and families in difficult economic circumstances, such a front-end excess premium can create a barrier to access to health coverage, making the coverage effectively unavailable. Applying both the California and Federal standards in a complementary fashion through this amendment achieves the mandate of Insurance Code section 10293, that benefits under a policy be reasonable in relation to the premium charged, while also removing a barrier to access to coverage, therefore making this vital coverage more available to Californians.

Effect of Proposed Action

As a result of the proposed action, insurers will demonstrate both (1) compliance with the existing 70% lifetime anticipated loss ratio standard, so that consumers are assured of receiving reasonable benefit value for their premium dollars on a policy-form basis, as well as (2) compliance with the 80% federal standard on a market-segment basis at the time of the Department's rate review, so that consumers can have the benefit of the federal medical loss ratio from the outset of the rate, rather than having to wait from eight to twenty months for a premium refund.

Comparable Federal Law

As discussed above, there are existing federal statutes and a regulation that are comparable to the proposed regulation, specifically 42 USCS §300gg-18 and 45 C.F.R. §§ 158.220-158.232, 75 Fed. Reg. 74927-74928, (December 1, 2010).

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The proposed regulations do not impose any mandates on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with section 17500) of Division 4 of the Government Code would require reimbursement.

COST OR SAVINGS TO ANY STATE OR LOCAL AGENCY OR SCHOOL DISTRICT OR IN FEDERAL FUNDING

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency and no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of the Government Code. There are no nondiscretionary costs or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESSES AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Commissioner has made an initial determination that the adoption of the proposed regulations will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR ENTITIES/BUSINESSES

The Commissioner is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

The Commissioner is required to assess any impact the proposed regulations may have on the creation or elimination of jobs within the State of California; to assess the creation of new businesses or the elimination of existing businesses within the State of California; to assess the expansion of businesses currently doing business within the State of California. The Commissioner finds that this proposed regulation will not affect the creation or elimination of jobs within California, nor will it affect the creation of new businesses, nor the elimination or expansion of existing businesses within California.

The Commissioner also invites interested parties to comment on these issues.

FINDING OF NECESSITY

The Commissioner finds that it is necessary for the welfare of the people of the State that the proposed regulations apply to businesses.

IMPACT ON SMALL BUSINESS

The Commissioner has determined the proposed action will not affect small business. This proposed regulation only affects insurance companies. Per Government Code section 11342.610(b)(2), insurance companies are, by definition, not small businesses.

IMPACT ON HOUSING COSTS

The matters proposed herein will have no significant effect on housing costs.

ALTERNATIVES

The Commissioner has determined that no reasonable alternative considered by the Commissioner or that has been otherwise identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which the regulations are proposed or would be as effective as and less burdensome to affected private persons than the proposed regulations.

The Commissioner invites public comment on alternatives to the regulations.

DEADLINE FOR WRITTEN COMMENTS

All written comments, whether submitted at the hearing or by U.S. Postal Service or any other delivery service, or by e-mail or facsimile, must be received by the Commissioner, c/o the contact person at the address listed above, **no later than 5:00 P.M. on September 13, 2011.**

All persons are invited to submit statements, arguments, or contentions relating to the proposed regulations by submitting them in writing to the contact person **no later than 5:00 P.M. on September 13, 2011.** In the alternative, statements, arguments, or contentions may be presented orally at the public hearing.

ACCESS TO HEARING ROOMS

The facilities to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the contact person in order to make special arrangements, if necessary.

ADVOCACY OR WITNESS FEES

Persons or groups representing the interests of consumers may be entitled to reasonable advocacy fees, witness fees, and other reasonable expenses, in accordance with the provisions of Title 10 of the CCR in connection with their participation in this matter. Interested persons should contact the Office of the Public Advisor at the following address to inquire about the appropriate procedures.

Office of the Public Advisor
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105

A copy of any written materials submitted to the Public Advisor regarding this rulemaking must also be submitted to the contact person for this hearing. Please contact the Office of the Public Advisor for additional information.

TEXT OF REGULATIONS AND INITITAL STATEMENT OF REASONS

The Commissioner has prepared an Initial Statement of Reasons ("ISOR") that sets forth the reasons for the proposed regulations. Upon request, the ISOR and the text of the proposed regulations will be made available for inspection and copying. Requests for the ISOR and the text of the proposed regulations should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the proposed regulations, the ISOR, and any supplemental information, is contained in the Rulemaking File: REG-2011-00005 and is available for inspection and copying by prior appointment at 45 Fremont Street, 23rd Floor, San Francisco, California 94105, between the hours of 9:00 A.M. and 4:30 P.M., Monday through Friday.

FINAL STATEMENT OF REASONS

After it has been prepared, and upon request, the Final Statement of Reasons ("FSOR") will be made available for inspection and copying. Requests for the FSOR should be directed to the contact person listed above.

AUTOMATIC MAILING

A copy of the proposed regulations and this Notice (including the Informative Digest, which contains the general substance of the proposed regulations) will be sent to all persons who have previously filed a request to receive notice of proposed rulemaking with the Commissioner.

WEBSITE POSTINGS

Documents concerning these proposed regulations are available on the CDI's website. To access them, go to http://www.insurance.ca.gov. Find at the right-hand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'REGULATIONS.' When the 'INSURERS: REGULATIONS AND GUIDANCE' screen appears, click the fourth item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'PROPOSED REGULATIONS ' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To browse, click on the 'Currently Proposed Regulations' link. A list of the names of regulations for which documents are posted will appear. Find in the list the link to 'Loss Ratio Regulation For Individual Health Insurance Policies' and click it. Links to the documents associated with these regulations will then be displayed.

To search, enter "REG-2011-00005" (the CDI's regulation file number for these regulations) in the search field. Alternatively, search by keyword ("loss ratio," for example) Then, click on the 'Submit' button to display links to the various filing documents.

MODIFIED LANGUAGE

If the Commissioner adopts regulations which differ from those which have originally been made available but are sufficiently related to the original proposed regulations, the amended regulations will be made available to the public for at least 15 days prior to the date of adoption of the amended regulations. Interested persons should request a copy of the amended regulations from the contact person listed above.

July 21, 2011

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[1]Insurance Code section 10293(a)

[2] Insurance Code section 10293(a)

[3] California Department of Insurance Ruling 127, file number RH-89, November 30, 1962, "In the Matter of the Proposed Adoption of Rules and Regulations of the Insurance Commissioner relating to Standards by which the Insurance Commissioner shall withdraw Approval of any Individual Medical, Hospital, or Surgical Policy the Benefits of which are Unreasonable in Relation to the Premium Charge.".

[4] see, "Health Insurance in California: Where Do Your Premium Dollars Go?" PowerPoint presentation by Department of Insurance staff at June 1, 2006 Investigatory Hearing Regarding Profitability of Health Insurance Products (file number IH05049314) and Prenotice Public Discussion on Proposed Regulation [Individual Disability Policy Loss Ratio Regulations] (file number RH06092236).

[5] As of 2004, the growth rate in national health expenditures was 7.9%, compared with an annual growth rate in the Consumer Price Index of 2.7 percent. Per-capita national health care expenditure in 2004 was 17.6 times the level in 1970, while consumer prices, as measured by the CPI were 4.9 times 1970 levels. *Snapshot: Health Care Costs 101, 2006 edition*,pp.1, 15, 16, California Health Care Foundation, www.chcf.org.

[6] *Snapshot: Health Care Costs 101, 2006 edition*,p.4, California Health Care Foundation, www.chcf.org.

[7] *Snapshot: Health Care Costs 101, 2006 edition*,p.6, California Health Care Foundation, www.chcf.org.

[8] *Snapshot: Health Care Costs 101, 2006 edition*,p.14, California Health Care Foundation, www.chcf.org.

[9] Buntin, *supra* at W3-456.

[10] *California Health Care Almanac: California Health Plans and Insurers*, October 2010, California HealthCare Foundation, www.chcf.org

[11] *Recent Premium Increases Imposed by Insurers Averaged 20% for People Who Buy Their Own Health Insurance, Kaiser Survey Finds Facing Such Increases, Some Enrollees Switched To Lower-Cost Coverage People With Pre-*

Existing Conditions Much More Likely To Report Problems, Kaiser Family Foundation, http://www.kff.org/kaiserpolls/posr062110nr.cfm?RenderForPrint=1.

[12] *Snapshot: Health Care Costs 101, 2006 edition*,p.1, California Health Care Foundation, www.chcf.org.

[13] Marquis, et al., *Consumer Decision Making in the Individual Health Insurance Market*, Health Affairs, W226, 227, May 2, 2006, www.healthaffairs.org.

[14] Testimony of Mr. Roupen Berberian, Health Net Life Ins. Co., December 1, 2005 California Department of Insurance Investigatory Heating Regarding Profitability of Health Insurance Companies, (file number IH05049314) RT 64:16-18.

[15] Marquis, et al., *Consumer Decision Making in the Individual Health Insurance Market*, Health Affairs, W226, 228, May 2, 2006, www.healthaffairs.org.

[16] Marquis, et al., *Consumer Decision Making in the Individual Health Insurance Market*, Health Affairs, W226, May 2, 2006, www.healthaffairs.org.

[17] Buntin, et. al., *Trends and Variability in Individual Insurance Products in California*, Health Affairs,W3-449, Sept. 23, 2003, www.healthaffairs.org.

[18] Buntin, *supra* at W3-457