

STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
OFFICE OF FINANCIAL AND INSURANCE REGULATION

Before the Commissioner of Insurance

In the matter of Blue Cross and Blue Shield
of Michigan's application for approval of a
formula for the calculation of rates of area
rated groups _____/

Order No. 12-022-BC

Issued and entered
this 8th day of May 2012
by Rhonda Fossitt

Special Deputy Commissioner of Insurance

**ORDER APPROVING A FORMULA FOR THE CALCULATION OF RATES FOR
COVERAGE PURCHASED BY AREA RATED GROUPS**

BACKGROUND

MCLA 550.1608(2) requires BCBSM to refile for approval, every 3 years, the methodology and definitions of each rating system, formula, component, and factor used to calculate rates for group subscribers. On December 21, 2011, Blue Cross and Blue Shield of Michigan (BCBSM) filed with the Commissioner of Insurance (Commissioner) the formula, factors, and definitions for coverages offered to area rated groups, as required by MCLA 550.1608(2) and MCLA 550.1610(1).

On January 20, 2012, the Office of Financial and Insurance Regulation (OFIR) Staff (Staff) determined that the filing was in substantial and material compliance with the requirements of MCLA 550.1610(6) and (8). BCBSM was notified by letter dated January 20, 2012 that the filing had been determined to be complete and was instructed to publish notices of its filing for approval of a formula and factors in newspapers having general circulation throughout the state, to comply with the requirements of MCLA 550.1612(1). On February 17, 2012, BCBSM placed advertisements in newspapers notifying subscribers of its filing and of their right to intervene in the process. On March 8, 2012, the Commissioner sent by certified mail a Notice to Interested Parties as required by MCLA 550.1612. Therefore, the final Order on this filing must be issued within 60 days of the latest of these three notices.

On May 7, 2012, the 60-day intervention period expired. At the expiration of the intervention period, no requests to intervene had been received by the Commissioner.

DISCUSSION

BCBSM uses its area rating system (ARS) to price benefits for groups with 50 or fewer subscribers. As of 4th quarter 2011, BCBSM had average monthly contracts of 143,019 in this category. The ARS groups employers together on the basis of either their geographical location or their type of business, and the ARS formula is applied to the claims experience of these groupings to determine the rate change for each group for the coming year. Most elements of the formula are calculated on a coverage-by-coverage basis. This includes incurring factors, trend factors, and administrative expense factors. These factors are entered into the formula, which is then applied, at the beginning of each calendar quarter, to a twelve-month experience period that ends 6 months prior to the rating period.

BCBSM's proposed modifications to its current ARS formulas are described in Section 1 of the filing and shown algebraically in Section 2 of the filing. A brief recap of some of the current factors will be discussed, followed by a recommendation on each proposed modification.

CURRENT METHODOLOGY ELEMENTS

As a matter of background, current ARS methodology elements are as follows:

Reform Groups (represents 94% of total ARS groups in force)

Reform groups consist of those with 50 or fewer eligible employees (as defined by Chapter 37 of the Michigan Insurance Code, P.A. 88 of 2003).

- Community Rated by Area (9 Geographic Rating Areas)
- Complies with P.A. 88 of 2003 with adjustments for age and industry but not more than +/- 35% from index rate for any group
- A sole proprietor size adjustment is applied

Nonreform Groups (represents 6% of total ARS groups in force)

Nonreform groups consist of those with more than 50 eligible employees *but* with 50 or fewer enrolled contracts.

- Community Rated by Area (9 Geographic Rating Areas)
- Adjustments for industry, size and participation (**Not Age**)
- A sole proprietor size adjustment is applied

PROPOSED CHANGES TO METHODOLOGY

Age Factors for Nonreform Groups

BCBSM proposes to use the same age factors and methodology used in the Reform segment to determine a Nonreform group's age factor. Age rating will be introduced to the Nonreform segment in a revenue neutral process by adjusting the Relative Rate Level (RRL).

The stated reasons for this modification include creating more accurate pricing and improving the demographic composition of the Nonreform segment. The costs for the

Nonreform segment demographic composition consistently exceed the Reform segment, and the disparity in costs has increased since December 2008. BCBSM attributes this widening gap between the Nonreform and Reform segments to the lack of age rating in the Nonreform segment, which causes groups with a younger blend of employees to obtain insurance coverage elsewhere.

BCBSM has proposed the introduction of age factors and the associated age rating methodology for the Nonreform segment of its business beginning 4th quarter 2012. Although the Nonreform segment is not subject to the Small Employer Group Health Act, Chapter 37 of the Michigan Insurance Code, P.A. 88 of 2003, BCBSM has confirmed that it will utilize the rating restrictions contained in Chapter 37. Accordingly, the +/- 35% constraint on a group's Case Characteristic Factor (CCF), the combination of age and industry, and the annual increase limit of 15% of the CCF contained in Chapter 37 and utilized for the Reform segment will also be utilized for the Nonreform segment as the age factors are introduced.

Staff recommends this proposed change in methodology be approved.

Area Factors vs Area Rating by Quarter

BCBSM currently utilizes nine (9) geographical areas for its Reform and Nonreform segments that are rated each quarter as independent pools. Because the rates in each area and business segment are developed independently, the area relativities between the Reform and Nonreform rates are not consistent. Further, the decline in membership in many area pools has caused the experience in these pools to become less credible.

Therefore, BCBSM has proposed that area factors be utilized. These factors would still allow the rates in each area and business segment to be independently developed, but would provide for consistent relativities between areas in developing Reform and Nonreform rates. Additionally, credibility would be based on 25,000 contract months.

The effect of this proposed change will be seen in BCBSM's ARS Quarterly filings. Those quarterly changes will no longer be made by area. Instead, the quarterly filings will continue to reflect changes due to factors such as industry, group size, age, and sole proprietor status. The area relativity will be a change made annually, based on experience studies. The result will be a more consistent area relativity over time.

BCBSM has proposed the introduction of area factors beginning 4th quarter 2012.

Staff recommends this proposed change in methodology be approved.

Administrative Expense Load

BCBSM has proposed a new methodology for allocating the administrative expense load for area rated groups. Rather than allocate administrative expenses to all groups as a percentage of premium as has been done previously, BCBSM has proposed a combination of both fixed and percentage of premium allocation of expenses. Some of these allocations will be done by group and number of contracts. However, all allocations will be charged on a basis that reflects activities that generate the expense. Consequently, this methodology change is anticipated to be more equitable among groups of all sizes.

In the ARS filing, BCBSM has provided sample calculations. There are three components: two variable and one fixed. Because BCBSM's systems are not yet able to accommodate its proposed allocation, initially, BCBSM will use a composite expense factor.

BCBSM's ARS Quarterly filings, as required by PA 350 of 1980, will continue to provide current factors and administrative expense loads in order to remain compliant.

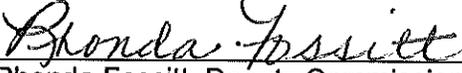
Staff recommends this proposed change in methodology be approved.

ORDER

Based on the foregoing it is ORDERED:

1. BCBSM may introduce and utilize age factors for the Nonreform segment of its ARS business in a revenue neutral process by adjusting the RRL. BCBSM will further comply with the rating limitations of +/- 35% on a group's CCF, the combination of age and industry, and the annual increase limit of 15% of the CCF contained in Chapter 37 of the Michigan Insurance Code, P.A. 88 of 2003, when utilizing age factors for the Nonreform segment.
2. BCBSM must notify OFIR of any changes in age factors from those included with this ARS filing by including new age factors in either its ARS Quarterly Factor Filing or a separate and distinct ARS Age Factor filing.
3. BCBSM may introduce and utilize area factors for its ARS business to replace area rating by quarter, in a manner consistent with the detailed explanation contained in this ARS filing. ARS rates in each area and business segment will continue to be independently developed on a quarterly basis, but the use of area factors will provide for consistent relativities between areas in developing Reform and Nonreform rates. Additionally, credibility will be based on 25,000 contract months.
4. Prior to implementing ARS area factors, BCBSM must file with OFIR its first set of area factors, together with the experience study and any additional information evidencing how those factors were developed. Thereafter, BCBSM will review and, if necessary, modify its ARS area factors not less than annually based on additional experience studies, and will file with OFIR any changes to its area factors.
5. BCBSM may introduce and utilize a new administrative expense load allocation method for its ARS business, in a manner consistent with the detailed explanation contained in this ARS filing. This method will be a combination of both fixed and percentage of premium allocation of expenses. Some of these allocations will be done by group and number of contracts.
6. BCBSM must provide OFIR its actual new administrative expense load allocations in its ARS Quarterly Factor filing. Due to systems modification requirements, BCBSM intends to implement these changes as soon as practicable, but no sooner than 4th quarter 2012.

Jurisdiction over the matters contained herein is specifically retained by the Commissioner along with the authority to enter such further order or orders as he shall deem just, necessary and appropriate.


Rhonda Fossitt, Deputy Commissioner
Office of Financial & Insurance Regulation
Product & Provider Class Plan Review Unit
Insurance Rates & Forms Division