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MEDIGAP INSURANCE:
Expected 1990 Premiums After Repeal of the Medicare Catastrophic Coverage Act and 1988 Loss Ratio Data

Statement of
Janet Shikles, Director
Health Financing and Policy Issues
Human Resources Division

Before the
Subcommittee on Medicare and Long-Term Care
Committee on Finance
United States Senate

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SUMMARY

Almost from the beginning of Medicare in 1966 private insurance companies have offered Medigap policies designed to pay some or all beneficiaries' deductibles and coinsurance. In 1980, the Congress established federal requirements that must be met before insurers can market Medigap policies.

In 1988, the Congress passed the Medicare Catastrophic Coverage Act, one of the most significant expansions of the program since its beginning. In November 1989, the Congress repealed the Act and restored Medicare benefits to what they were before the Catastrophic Coverage Act.

GAO recently surveyed 29 commercial Medigap insurers concerning their 1990 premiums for Medigap insurance. Twenty insurers responded and told GAO that they expect to increase their 1990 premiums for Medigap insurance by an average of 19.5 percent over their 1989 premiums. The companies attributed about half of this increase to increased benefits and administrative costs necessitated by repeal of the Catastrophic Act. The companies said that the other half of the increase was due to factors such as inflation, increased use of health services, and prior years' claims experience. For 19 companies, the increases will range from a low of 5.0 percent to a high of 51.6 percent, and one company said it expects its 1990 premium to remain unchanged.

The Blue Cross and Blue Shield Association also surveyed its member organizations. The Association said that 38 organizations responded, and the median increase in 1990 non-group Medigap insurance premiums would be about 29 percent.

The 1988 loss ratios of 34 percent of the commercial companies with over $250,000 in earned premiums from individual policies in force for more than 3 years were below the minimum standard of 60 percent. For Blue Cross/Blue Shield plan individual policies, about 98 percent met or exceeded the minimum standard. For group plans, about 66 percent of commercial companies and 24 percent of Blue Cross and/or Blue Shield plans had loss ratios that were below the minimum standard of 75 percent.

After repeal of the Catastrophic Coverage Act, the National Association of Insurance Commissioners revised its model regulation and minimum benefit standards for Medigap policies. These revisions include several new consumer protection provisions designed to eliminate certain abusive sale and marketing practices. Also, policies must now cover some expenses of policyholders that were not required before, such as all part B coinsurance after the beneficiary pays the annual part B deductible of $75.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the work we have done on Medigap insurance and recent developments related to Medigap. As you requested, we will be discussing 1990 Medigap premium increases, the percentage of premiums paid out as benefits (the loss ratios) in 1988, and recent changes in federal and state regulatory requirements for Medigap policies.

MCCA AND ITS REPEAL

The Medicare Catastrophic Coverage Act (MCCA), which became law in July 1988, provided for the most significant expansion of Medicare benefits since the program's beginning. Beneficiary out-of-pocket costs for covered services were to be capped, and additional services would have been covered when the law was fully implemented.

In June and April 1989, we testified before committees of both houses of the Congress on the effects of MCCA on benefits provided by the Medicare program and Medigap insurance[1]. In both instances, we noted that MCCA expanded Medicare benefits and thus reduced the coverages required of Medigap policies. We pointed out that a number of major benefits provided under MCCA would become effective in 1990, and we expected that Medigap premiums for 1990

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[1]See "MEDIGAP INSURANCE: Effects of the Catastrophic Coverage Act of 1988 on Future Benefits", Statement of Mr. Michael Zimmerman before the Senate Committee on Finance (GAO/T-HRD-89-22, June 1, 1989) and "MEDIGAP INSURANCE: Effects of the Catastrophic Coverage Act of 1988 on Benefits and Premiums", Statement of Mr. Michael Zimmerman before the Subcommittee on Commerce, Consumer Protection, and Competitiveness, House Committee on Energy and Commerce (GAO/T-HRD-89-13, Apr. 6, 1989).

would be substantially lower than they would have been without MCCA.

In November 1989, the Congress passed legislation to repeal MCCA and to restore Medicare benefits to what they were before the Act became effective. The repeal legislation reversed the reduction in coverage required of Medigap policies, and we expected this would result in significantly higher Medigap premiums than if MCCA had remained in effect.

PREMIUMS FOR MEDIGAP INSURANCE AFTER REPEAL OF MCCA

During the debate surrounding the repeal of MCCA, concerns were raised in the Congress about the effect repeal would have on Medigap premiums and how the additional premium increases would affect low-income elderly persons. We recently contacted 29 commercial Medigap insurers to obtain (1) their estimate of their 1990 premiums and (2) their reasons for premium changes.[2]

Twenty companies responded to our request and are listed in appendix I to this statement. The policies sold by these 20 companies covered about 2.6 million policyholders, and they estimate their 1990 premiums will, on average, be 19.5 percent higher than premiums in 1989. The average increase is $11.44 per month. The increases range from 5.0 percent to 51.6 percent, and one company reported that it expected its 1990 premium to be the

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[2]See "MEDIGAP INSURANCE: Expected 1990 Premiums after Repeal of the Medicare Catastrophic Coverage Act", Statement of Ms. Janet Shikles before the Senate Special Committee on Aging (GAO/T-HRD-90-9, Jan. 8, 1990).

same as its 1989 premium. Appendix II to this statement shows the estimates from the twenty companies.

The companies attributed about half of the expected premium increases to general inflation within the medical sector of the economy, increased use of health services by senior citizens, and higher than expected claims experience in prior years. The companies attributed the other half of the increase to repeal of MCCA. The companies said that changes required by repeal of MCCA included: (1) additions to benefits, such as coverage of the part A deductible or reducing the policy deductible for part B coinsurance coverage from $200 to $75, and (2) administrative costs associated with repeal of the MCCA, such as modifications to policies and notices to policyholders.

The Blue Cross and Blue Shield Association also surveyed its member organizations. Thirty-eight organizations responded, representing two-thirds of the total Blue Cross and Blue Shield Medigap enrollment. After summarizing the responses, the Association found that the median increase in 1990 non-group Medigap insurance premiums would be about 29 percent. The Association said that a 9 percent increase was projected prior to repeal of the MCCA. The Association said that plan rate increases reflect numerous factors, including growth in costs and utilization, benefit changes, and adjustments for prior rate inadequacies.

MEDIGAP LOSS RATIOS FOR 1988

In addition to concerns about increasing premiums for Medigap insurance, another area of congressional concern has been the percentage of Medigap premiums returned to policyholders in the form of benefits, or the policies' loss ratios. A loss ratio is computed by dividing the total incurred claims[3] for a period of time by earned premiums for the same period. The result of this computation is usually expressed as a percentage.

The Baucus amendment, which amended the Medicare law to establish federal Medigap standards, set federal targets for loss ratios for Medigap policies. The Baucus amendment required as a condition of approval that Medigap policies be expected to have loss ratios of at least 75 percent in the case of group policies and at least 60 percent in the case of individual policies. MCCA revised the Baucus amendment to require states to collect data on actual Medigap loss ratios.

In an earlier report[4] and other congressional hearings[5], we reported on the loss ratios of Medigap policies. Generally, we have reported that pre-1988 loss ratios of most commercial policies were below the minimum standards. In contrast, the pre-1988 loss ratios of Blue Cross and Blue Shield plans were generally

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[3]Incurred claims include actual payments for claims plus reserves for claims incurred but not yet received or processed by the insurer.

[4]Medigap Insurance: Law Has Increased Protection Against Substandard and Overpriced Policies (GAO/HRD-87-8, Oct. 17, 1986).

[5]See statements cited in footnote 2.

above the standards. For example, in our 1986 report, we reported that the 1984 average loss ratio for individual policies sold by 92 commercial firms was 60 percent; for policies sold by 13 Blue Cross and Blue Shield plans, the average was 81 percent. Loss ratio data for 92 commercial policies showed the average 1987 loss ratio was 74 percent; however, that average was heavily influenced by the relatively large block of business represented by the Prudential Insurance Company, whose loss ratio was 83 percent. Excluding Prudential, the other commercial policies had an average loss ratio of 59 percent. For 75 Blue Cross and Blue Shield plans, the 1987 average loss ratio on individual plans was 93 percent. Because of changes in loss ratio reporting requirements discussed below, these pre-1988 loss ratios cannot be directly compared with more current loss ratio data.

State insurance regulators caution on the interpretation and use of loss ratio data because a number of factors may affect the computations. For example, early policy experience may result in a relatively low loss ratio because policies do not cover costs related to pre-existing conditions during the policy's waiting period. Also, new policyholders may be relatively healthy and file few claims, so a policy with substantial amounts of new business may experience a relatively low loss ratio. Thus, loss ratios should be viewed over the time that represents "mature" experience. For reporting prior to 1988, the National Association of Insurance Commissioners' (NAIC) reporting form included the reporting year's experience for all policies in force and a cumulative report of the 3 most current years' experience. Beginning with reports covering 1988 and later, the NAIC provides a two-tiered set of criteria for determining if loss ratios comply with loss ratio standards:[6]

-- For policies that have been in force 3 years or more, the most recent year's loss ratio must equal or exceed the 60 or 75 percent standard (whichever is applicable).

-- For policies that have been in force less than 3 years, the policies must have a third-year expected loss ratio equal to or greater than the 60 or 75 percent standard.

In connection with work we have been doing for two Committees of the House of Representatives, we have obtained 1988 loss ratio data (the latest available) for Medigap insurance from NAIC[7] and the Blue Cross and Blue Shield Association. The data are reported in aggregate for all policies sold by a company. These aggregate data measure a company's overall performance because they average experience across all policies. This means that a company whose aggregate loss ratio is below the standards has one or more policies which fail to meet the minimum standards but may have other policies that meet or exceed the standards. Conversely, a

[6]In addition, the NAIC has revised the formula for determining the incurred claims portion of the loss ratio. Prior to 1988, incurred claims included actual payments for claims plus reserves for claims incurred but not yet reported to or processed by the company plus a life-time reserve for future claims. For loss ratios covering 1988 and later years, incurred claims no longer include the life-time reserves in the computation.

[7]The NAIC labeled its data "preliminary results only," and these data are subject to change.

company can have an aggregate loss ratio above the standards but offer some policies that fall below them.

The aggregate loss ratios by companies for policies in force more than 3 years that had more than $250,000 in earned premiums are summarized in appendix III. Similar data for policies that have been in force for 3 years or less are in appendix IV.

As in our earlier report and testimonies, many company loss ratios are still not meeting the minimum standards. In 1988, the loss ratios for companies with policies in force more than 3 years were based on total earned premiums of approximately $3.7 billion. For policies sold to individuals:

-- By commercial insurers, 34 percent of the company loss ratios were below the 60 percent minimum standard. The average loss ratios for companies exceeding the standard was 68.5 percent while the average for companies below the standard was 50 percent.

-- Among the Blue Cross and Blue Shield plans, 98 percent met or exceeded the target loss ratio percentage. The average loss ratio for these plans was 93.4 percent; the loss ratio of the single plan that fell below the standard was 53.9 percent.

For group coverage:

-- About 66 percent of the commercial company loss ratios were below the 75 percent minimum standard. The average loss ratio for companies that were at or above the target was

101.5 percent, and the average for those below the target was 62.6 percent.

-- Among the Blue Cross and Blue Shield plans, 24 percent had loss ratios that fell below the minimum target. The average loss for plans that met or exceeded the target was 94.1 percent, and the average for those below the target was 71.5 percent.

Earned premiums for policies in force 3 years or less totaled approximately $3.5 billion for 1988. For policies sold to individuals:

-- By commercial insurers, 60 percent of the company loss ratios were below the 60 percent minimum standard.

-- Among the Blue Cross and Blue Shield plans, all met or exceeded the standard.

For group coverage, about 71 percent of the commercial companies and 16 percent of the Blue Cross and Blue Shield plans did not meet the 75 percent target. Additional details are in appendix IV.

Under the Baucus amendment, states are responsible for monitoring whether Medigap policies meet the loss ratio standards and for taking action when they do not. In the past, states did little to assure that the loss ratio targets were actually met. This was because the loss ratio standards were expressed as targets and the manner in which loss ratio data were reported by insurers did not facilitate monitoring. Under the revised federal and NAIC loss ratio standards, loss ratios <u>must</u> meet the standards after 3 years and the form in which loss ratios are reported will make such determinations easier than in the past. When states adopt the new standards, they should be better able to enforce the standards than was the case previously.

REGULATORY REQUIREMENTS FOR MEDIGAP POLICIES AFTER REPEAL OF MCCA

Over the years, another congressional concern related to Medigap has been marketing abuses and consumer protections against those abuses. NAIC's most recent revision to its model regulations, adopted in early December 1989, included several new consumer protection provisions along with changes to the minimum standards which were needed because of MCCA's repeal. These new standards will be the criteria for approval of state regulatory programs under the Baucus amendment and are now before the states for their consideration and adoption. The new NAIC standards continue efforts, which began with the passage of the Baucus amendment, to eliminate abuses in the sale and marketing of Medigap insurance. We believe that if adopted and enforced by the states, they will help prevent abuses in the sale of Medigap policies.

One problem in the sale of Medigap insurance that has been identified over the years is that some Medicare beneficiaries purchase multiple policies that duplicate coverage. Revised consumer protection provisions in the NAIC model should help alleviate this problem. Application forms will include questions asking whether the applicant has another Medigap policy in force and, if so, is the policy being applied for intended to replace any medical or health insurance already in force. Agents must also list on the application any health insurance policies they have sold to the applicant. The sale of more than one Medigap policy to an individual is prohibited, unless the combined policies' coverages do not exceed 100% of the individual's actual medical expenses. In addition, if the sale involves replacement of a Medigap policy, an insurer or its agent must provide the applicant with a notice before the replacement policy goes into effect that the coverage applied for replaces health insurance in force. This notice will give purchasers an additional opportunity to review their coverage and to cancel the new policy without penalty if they decide not to replace a policy already in force.

Another problem with Medigap marketing has been frequent replacement of policies which results in new waiting periods for pre-existing conditions. New provisions should decrease the incentives to sell new policies by placing restrictions on the way commissions are paid and prohibiting waiting periods when replacement policies are sold. The compensation provision limits the first-year commission and other compensation[8] that may be paid to an agent selling a Medigap policy and also requires companies to spread the total compensation for selling a policy over a reasonable number of years. These requirements will prevent companies from loading agent compensation into the first years a policy is in effect, thus decreasing the incentive to sell replacement policies. Also, when issuing a replacement Medigap policy insurers must waive waiting periods applicable to pre-

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[8]Compensation includes bonuses, gifts, prizes, awards, finders fees, and other similar forms of remuneration.

existing conditions or other similar restrictions to the extent such time was spent under the original policy.

In addition to the consumer protection provisions, the new NAIC model regulation modified some minimum benefit standards for Medigap policies from those required before MCCA was enacted. For example:

-- For services covered under part A of Medicare. Current NAIC standards require Medigap policies to cover either all or none of the part A deductible ($592 per benefit period in 1990). The NAIC standard in effect before MCCA did not contain a minimum requirement for coverage of the part A deductible, and thus a policy could have covered just a portion of that deductible.

-- For services covered under part B of Medicare. NAIC's current standards require Medigap policies to cover all policyholders' coinsurance for services covered by part B of Medicare, after the policyholder has paid the part B deductible of $75 per year. This coinsurance is 20 percent of the Medicare-approved charge for services. Prior to the MCCA, the NAIC standards required Medigap policies to pay part B coinsurance after the policyholder paid $200 (the $75 annual part B deductible plus $125 in part B coinsurance), and Medigap policies could limit coverage to $5,000 in benefits in any calendar year.

Mr. Chairman, this concludes my prepared remarks. I will be happy to answer any questions you have.

INSURANCE COMPANIES THAT RESPONDED TO OUR REQUEST FOR DATA

Prudential Insurance Company of America
United American Insurance
Bankers Life
Mutual of Omaha
Union Fidelity Life Insurance Company
National Home Life Assurance Company
Union Bankers Insurance Company
Standard Life and Accident Insurance Company
The Principal Mutual Life Insurance Company
Pioneer Life Insurance Company of Illinois
Pyramid Life Insurance Company
Associated Doctors Health and Life Insurance Company
Colonial Penn Franklin
State Farm Mutual Auto Insurance Company
Continental Casualty Company
American Integrity Insurance Company
New York Life Insurance Company
Provident Companies
American Republic
Atlantic American Life Insurance Company

EXPECTED INCREASES IN 1990 MONTHLY MEDIGAP INSURANCE PREMIUMS AFTER REPEAL OF THE MEDICARE CATASTROPHIC COVERAGE ACT

Company	1989 monthly premium	1990 expected monthly premium	Increase (percentage)
Company AA	$50.00	$50.00	0.0
Company AB	83.09	87.26	5.0
Company AC	59.93	65.32	9.0
Company AD	73.96	81.29	9.9
Company AE	73.46	80.79	10.0
Company AF	61.65	70.15	13.8
Company AG	68.00	78.00	14.7
Company AH	81.00	94.00	16.0
Company AI	39.25	45.95	17.1
Company AJ	58.75	70.39	19.8
Company AK	68.00	81.52	19.9
Company AL	33.90	41.00	20.9
Company AM	57.65	70.33	22.0
Company AN	38.00	46.36	22.0
Company AO	43.29	53.68	24.0
Company AP	90.00	115.00	27.8
Company AQ	50.82	67.59	33.0
Company AR	43.84	59.67	36.1
Company AS	62.82	90.93	44.7
Company AT	32.95	49.95	51.6
Average	$58.52	$69.96	19.5

DISTRIBUTION OF 1988 MEDIGAP LOSS RATIOS
FOR POLICIES THAT HAVE BEEN IN FORCE FOR MORE THAN 3 YEARS

	Commercial			Blue Cross/Blue Shield		
Individual	Above 60% Target	Below 60% Target	Total	Above 60% Target	Below 60% Target	Total
Companies	87	44	131	50	1	51
Earned premiums (millions)	$690	$101	$791	$1,887	$.53	$1,888
Avg. Loss Ratio	68.5	50.0	66.1	93.4	53.9	93.4

	Commercial			Blue Cross/Blue Shield		
Group	Above 75% Target	Below 75% Target	Total	Above 75% Target	Below 75% Target	Total
Companies	10	19	29	26	8	34
Earned Premiums (millions)	$600	$49	$649	$361	$48	$409
Avg. Loss Ratio	101.5	62.6	98.5	94.1	71.5	91.4

DISTRIBUTION OF 1988 MEDIGAP LOSS RATIOS FOR POLICIES THAT HAVE BEEN IN FORCE FOR LESS THAN 3 YEARS

	Commercial			Blue Cross/Blue Shield		
Individual	Above 60% Target	Below 60% Target	Total	Above 60% Target	Below 60% Target	Total
Companies	55	83	138	36	0	36
Earned Premiums (millions)	$650	$616	$1,266	$1,215	—	$1,215
Avg. Loss Ratio	66.7	51.4	59.3	87.5	—	87.5

	Commercial			Blue Cross/Blue Shield		
Group	Above 75% Target	Below 75% Target	Total	Above 75% Target	Below 75% Target	Total
Companies	6	15	21	16	3	19
Earned Premiums (millions)	$616	$48	$664	$364	$13	$377
Avg. Loss Ratio	99.9	55.8	96.7	92.6	67.3	91.7