

**Report to the  
Massachusetts Division of Insurance:  
The Projected Impact  
on Health Insurance Premiums in  
the Merged Individual/Small Group Market  
with the Implementation of Federal Rating Rules that  
Restrict the Use of Massachusetts Rating Factors**

## **Report qualifications/assumptions and limiting conditions**

This report is for the exclusive use of the Massachusetts Division of Insurance (“Division”). Oliver Wyman Actuarial Consulting, Inc.’s (“Oliver Wyman”) consent to any distribution of this report (whether herein or in the written agreement pursuant to which this report has been issued) to parties other than Division does not constitute advice by Oliver Wyman to any such third parties and shall be solely for informational purposes and not for purposes of reliance by any such third parties. Oliver Wyman assumes no liability related to third party use of this report or any actions taken or decisions made as a consequence of the results, advice or recommendations set forth herein. This report should not replace the due diligence on behalf of any such third party.

For our analysis, Oliver Wyman relied on data and information described in this report without independent audit. Though Oliver Wyman has reviewed the data for reasonableness and consistency, Oliver Wyman has not audited or otherwise verified this data. It also should be noted that our review of data may not always reveal imperfections. Oliver Wyman has assumed that the data and information are both accurate and complete. The results of our analysis are dependent on this assumption. If this data or information is inaccurate or incomplete, our findings and conclusions may need to be revised.

Our conclusions are based on an analysis of the data and information described herein and on the estimation of the outcome of many contingent events. The sources of uncertainty affecting our estimates are numerous and include the implementation of the rating rules of the federal Patient Protection and Affordable Care Act (“ACA”) through recently released regulations, carriers’ reactions to those regulations, and changes in coverage by the individuals and small groups in the market.

There are many additional changes that will occur for non-grandfathered policies beginning on and after January 1, 2014, at the same time that the new ACA rating requirements become effective. The scope of the premium rate changes presented in this paper is limited only to the impact of changes to ACA rating requirements.

While this analysis complies with applicable Actuarial Standards of Practice, users of this analysis should recognize that our projections involve estimates of future events, and are subject to variations from expected values. Oliver Wyman has not anticipated any extraordinary changes to the legal, social, or economic environment that might affect our estimates. For these reasons, no assurance can be given that the emergence of actual experience will correspond to the projections in this analysis.

The opinions expressed in this report are valid only for the purpose stated herein and as of the date of this report. No obligation is assumed to revise this report to reflect changes, events or conditions, which occur subsequent to the date hereof.

This report was prepared by Dianna Welch, FSA, MAAA and Kurt Giesa, FSA, MAAA from Oliver Wyman.

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## **Executive Summary**

The ACA will require changes in how carriers establish rates for individuals and small groups with between 1 and 50 employees for all health coverage issued or renewed on or after January 1, 2014. In Massachusetts, the ACA rating restrictions appear to make the following changes to the rules that have applied to Massachusetts small group rates since 2007:

- Implement restrictions on age rating;
- Remove use of industry as a rating factor;
- Remove use of participation-rate as a rating factor;
- Remove use of group size as a rating factor;
- Remove use of intermediary discounts as a rating factor, and
- Remove use of group purchasing cooperative discounts as a rating factor.

Oliver Wyman analyzed the impact of implementing the final ACA market rules, as formally promulgated on February 27, 2013, and our analysis does not reflect any deviation from these rules, as issued on that date.

## **2-to-1 Rating Bands**

Massachusetts currently requires premiums to vary within 2-to-1 rating bands for a number of factors combined. Assuming that Massachusetts keeps 2-to-1 rating bands, but applies the bands for age alone and only to adults, it is projected that the ACA rating rules will have the following impact on premiums:

### **Individual Market:**

Many of the 85,000 individual market members will see premium reductions, but some will see premium increases. Some of these premium increases may be reduced through low-income subsidies, but the impact of subsidies were not part of this analysis.

- **Large Decreases:** 23,000 individual plan members will see 2014 premiums decrease by more than 10%; over 1,000 of those 23,000 members will see premiums decrease by over 30%.
- **Smaller Changes:** 55,000 individual plan members will see 2014 premiums increase or decrease between 0% and 10%.
- **Large Increases:** 7,000 individual plan members will see 2014 premiums increase by more than 10%; over 1,000 of those 7,000 members will see their premiums increase by over 30%.

### **Small Group Market:**

Many of the 634,000 small employer members will see reductions, but many will see premium increase shocks.

- **Large Decreases:** 83,000 small employer plan members will see 2014 premiums decrease by more than 10%; over 1,000 of those 83,000 members will see premiums decrease by over 30%.

- Smaller Changes: 370,000 small employer members will see 2014 premiums increase or decrease between 0% and 10%.
- Large Increases: 181,000 small employer members will see 2014 premiums increase by more than 10%; over 6,000 of those 180,000 members will see their premiums increase by over 30%.

### **3-to-1 Rating Bands**

The ACA permits states to implement rules that allow rates to vary within 3-to-1 rating bands. If Massachusetts amends its laws and regulation to permit adult rates to vary within a 3-to-1 rating band for age, Oliver Wyman has modeled the market and found the following:

#### **Individual Market:**

Moving to 3-to-1 rating bands will adversely impact older persons who will be charged significantly more solely based on their age than they would under a 2-to-1 band. Some of these premium increases may be reduced through low-income subsidies.

- Large Decreases: 39,000 individual plan members will see 2014 premiums decrease by more than 10%; over 2,000 of those 39,000 members will see premiums decrease by over 30%.
- Smaller Changes: 34,000 individual plan members will see 2014 premiums increase or decrease between 0% and 10%.
- Large Increases: 12,000 individual plan members will see 2014 premiums increase by more than 10%; about 1,000 of those 12,000 members will see their premiums increase by over 30%.

#### **Small Group Market:**

Moving to 3-to-1 rating bands will adversely impact those small employers who have older employees because they will be charged more solely due to their employees' older age than they would under a 2-to-1 band. However, moving to a 3-to-1 rating band would greatly reduce the number of small employer members that see large rate changes. Specifically, 48,000 fewer merged market members would see increases greater than 10% using a 3-to-1 band as compared to a 2-to-1 band.

- Large Decreases: 81,000 small employer members will see 2014 premiums decrease by more than 10%; 2,000 of those 81,000 members will see premiums decrease by over 30%.
- Smaller Changes: 420,000 small employer members will see 2014 premiums increase or decrease between 0% and 10%.
- Large Increases: 133,000 small employer members will see 2014 premiums increase by more than 10%; about 5,000 of those 133,000 members will see their premiums increase by over 30%.

Regardless of whether the age band remains at the 2-to-1 level or is changed to be at a 3-to-1 level, there will be significant rate changes for many individual and small group members in 2014.

## **1. Introduction**

Health insurance carriers<sup>1</sup> generally calculate the premiums charged to an individual policyholder or employer by multiplying the base rate - applicable to all individual policyholders and small businesses – by the rating factors that are specific to an individual policyholder’s or employer group’s relative risk. The base rate is developed so that it is sufficient to meet a carrier’s projected claim costs and administrative expenses, as well as its planned contributions to surplus. The rating factors are developed based on the carrier’s analysis of the relative risk of coverage based on allowable variations and actuarially supported data.

The Division reviews carriers’ merged market rate filings to ensure that proposed base rates are not excessive, inadequate or unreasonable in relation to the benefits provided, and that rating factors are in compliance with all laws and regulations, are not discriminatory and are based on sound actuarial principles.<sup>2</sup> The Division has the authority to disapprove any rate filing if it finds that the filing does not meet the statutory standards.<sup>3</sup>

Different rules and levels of review currently apply to health insurance rates offered to individuals and small employers (with up to 50 eligible employees) when compared to those that apply to large employers (with more than 50 eligible employees). For example, while large employer rates may be based on the historic claims experience of the employer, Massachusetts law applicable to individual and small employer health insurance, M.G.L. c. 176J, prohibits carriers from basing rates on any individual’s or employer’s past or projected health claim experience and limits the type and range of rating factors that may be applied when calculating premiums.

### **Massachusetts’ Small Group Health Coverage**

Under M.G.L. c. 176J and 211 CMR 66.00, which originally became effective in 1992, health insurance carriers that offer coverage to eligible small employers are required to offer coverage on a guarantee issue basis<sup>4</sup> to all eligible small employers. Carriers also are required to charge premiums according to specific rate calculation rules that limit the range of premiums charged to be within a mandatory rating band.

When originally enacted, M.G.L. c. 176J applied to small employers with between one (self-employed individuals) and 25 eligible employees. In 1996, the statute was amended to require that carriers apply the same guarantee issue and rating rules to employers with between 26 and 50 eligible employees at the end of a three-year transition period and to remove the use of gender as a permissible rating factor.

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<sup>1</sup> In Massachusetts, carriers that offer insured health benefit plans are licensed as commercial health insurance companies under M.G.L. c. 175, authorized to operate as hospital/medical service plans under M.G.L. c. 176A/176B or licensed as Health Maintenance Organizations under M.G.L. c. 176G.

<sup>2</sup> See M.G.L. c. 176J and 211 CMR 66.00.

<sup>3</sup> *Id.*

<sup>4</sup> Without any medical underwriting.

With the market reforms instituted by Chapter 58 of the Acts of 2006, Chapter 176J was further modified to cause the merger of the guaranteed issue market for individuals, previously referred to as the nongroup market subject to M.G.L. c. 176M, into a merged market for individual/small employers (“merged market”). Beginning with coverage effective July 1, 2007, all carriers operating in the merged market have been required to make coverage available on a guarantee issue basis to all eligible individuals and eligible small employers.

According to the rating rules set forth in M.G.L. c. 176J and 211 CMR 66.00, carriers are permitted to develop and use the following rating factors when calculating the premiums of any individual or small employer policy’s coverage:

Factors which, in combination, may not exceed a 2-to-1 rating band:

- Ages of the covered members;
- Industry of the employer;
- Participation rate of employees in the employer’s health coverage;
- Participation in approved wellness programs; and
- Tobacco usage of the covered members.

Factors outside the permissible 2-to-1 rating band:

- Value of benefits in a health product compared to other health products;
- Family composition (also known as rate basis type of the family<sup>5</sup>);
- Geographic location of business or individual policyholder’s residence;
- Size of the employer group;
- Use of an intermediary when obtaining coverage; and
- Use of a group purchasing cooperative when obtaining coverage.

### **Changes Based on Federal Law**

The ACA, as it is implemented between 2014 and 2016, will require that all state insurance markets comply with certain laws, regulations and other regulatory guidance. Although certain ACA rating rules – such as those requiring that employers with between 51 and 100 eligible employees be subject to small group rules – are not effective until January 1, 2016, other ACA rating rules, including those impacting existing individual and small employer markets are effective on January 1, 2014.

The ACA sets forth specific rating factors that may be used in developing individual and small group premiums for most coverage<sup>6</sup> issued or renewed on and after January 1, 2014. When fully implemented, the ACA requires that premiums may differ from one eligible individual to another or from one eligible employer to another only based on the following permissible rating factors:

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<sup>5</sup> Premiums are usually offered as individual, dual, family, and parent and child rate basis types.

<sup>6</sup> Certain plans have been designated as grandfathered plans under ACA rules and are not subject to ACA rating restrictions; there are very few plans that have been designated as “grandfathered plans” in Massachusetts.

- Family composition;
- Ages of the covered members (which may only vary within a 3-to-1 band for adults);
- Tobacco usage of the covered members (must provide wellness program to offset tobacco load for small employers); and
- Geographic location of the business or the individual policyholder's residence.

These requirements, when applied in 2014, will require that carriers eliminate the use of the following Massachusetts rating factors:

Factors part of Massachusetts' 2-to-1 rating band:

- Industry of the employer;
- Participation of employees in the employer's health coverage; and
- Participation in approved wellness programs.

Factors outside the permissible 2-to-1 rating band:

- Size of the employer group;
- Use of an intermediary when obtaining coverage; and
- Use of a group purchasing cooperative when obtaining coverage.

With the elimination of these state rating factors, many individuals' and small employers' premiums will change in material ways as their coverage renews in 2014. In order to understand the impact of the changes, the Division retained Oliver Wyman to study restrictions on the use of rating factors in the merged market imposed by the ACA. This report describes Oliver Wyman's work to understand the current rating practices of carriers in the Commonwealth's merged market, to evaluate changes in rating practices to comply with the ACA, to analyze the premium impact of those changes on individuals and small groups in the merged market, and to understand the characteristics of individuals and small groups that will experience changes in premium.

## **2. Data and Methodology**

The Division initiated market conduct examinations pursuant to M.G.L. c. 175, § 4 (for commercial insurance carriers), M.G.L. c. 176B, § 9 (for Blue Cross and Blue Shield of Massachusetts, Inc.) and M.G.L. c. 176G, § 10 (for Health Maintenance Organizations) for the purpose of examining the rating factors and small group experience of the largest carriers in the Massachusetts health insurance market.

Oliver Wyman was asked to study the current rating practices of carriers in the merged market, as well as the composition of each carrier's individual and small employer business. We were then asked to anticipate changes in rating practices necessary to comply with the ACA, as well as estimate the premium impact of those changes on individuals and small groups in the merged market.

### **Sources of Data**

Oliver Wyman obtained data to support its study from the following carrier groups which are the largest carriers participating in the Massachusetts merged market:

- Blue Cross and Blue Shield of Massachusetts, including both:  
Blue Cross and Blue Shield of Massachusetts, Inc. and  
Blue Cross and Blue Shield of Massachusetts HMO Blue, Inc.
- Fallon Community Health Plan, including both:  
Fallon Community Health Plan, Inc. and  
Fallon Life & Health Assurance Company
- Harvard Pilgrim Health Plan, including both:  
Harvard Pilgrim Health Care, Inc. and  
HPHC Insurance Company, Inc.
- Health New England, Inc.
- Neighborhood Health Plan, Inc.
- Tufts Associated Health Plan, including both:  
Tufts Associated Health Maintenance Organization, Inc. and  
Tufts Insurance Company.

Oliver Wyman obtained access to detailed membership and premium information from the former Division of Health Care Finance and Policy, now called the Center for Health Information and Analysis (“CHIA”)<sup>7</sup>, through an Interdepartmental Service Agreement between the Division and CHIA. Oliver Wyman, acting as an agent of the Division, obtained member eligibility data from the Massachusetts All Payer Claim Database (“APCD”), as well as other rating factor data provided to CHIA to support 2011/2012 Health Care Cost Trends studies.

In addition, Oliver Wyman had access to the Division's 2011 membership reports which identified that there were 719,084 members enrolled in insured merged market products as of

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<sup>7</sup> The Division of Health Care Finance and Policy was reconstituted as the Center for Health Information and Analysis by Chapter 224 of the Acts of 2012 in the summer of 2012.

December 31, 2011.<sup>8</sup> Of that total, 634,085 members were covered through 83,235 small group employers and 84,999 members were covered through 55,016 individual policies.

Oliver Wyman obtained information related to current rating practices in the merged market, as well as financial and demographic information related to each individual or small group policy that was in force during any portion of calendar year 2011. The data was not audited, but was reviewed for reasonableness. Where necessary, Oliver Wyman contacted the carriers directly to inquire about the data and to collect supplemental information where necessary to provide additional detailed data that was not available from the CHIA data sources.

In order to perform the study, Oliver Wyman first examined the current rating factors for policies active on December 31, 2011.<sup>9</sup> Oliver Wyman limited the analysis to policies effective on this date in order to avoid counting the same individual or small group more than once in the event they changed policies during the year. The carriers provided us with each policyholder's zip code and Standard Industrial Classification ("SIC") code, which we used to determine the area rate adjustment and industry rate adjustment factors, respectively. Oliver Wyman obtained counts of covered subscribers by dependent coverage tier, counts of members, and the ages of the covered subscribers and members from the APCD for many policies. For policies where subscriber and member information was not available from the APCD or from the 2011/2012 Health Care Cost Trends studies, additional data was obtained directly from the carriers.

In the course of reviewing the rating factors, Oliver Wyman observed that conversion factors commonly have been used to convert base rates that are expressed on a per-member basis to per-subscriber rates, but that there has been significant variation from carrier to carrier in how conversion factors are calculated. In order to conduct the analysis, Oliver Wyman used each carrier's conversion factor methodology as provided by the carrier. Using these factors, and the carrier-provided rating formulas including the application of the 2-to-1 rate band, Oliver Wyman estimated how rating factors would change for each carrier under the ACA rules and multiplied these factors by the base rates for specific benefit plans to project premium impacts.

#### **Assumptions Based on ACA Requirements**

The federal Department of Health and Human Services ("HHS") is responsible to develop the regulations and guidelines for the implementation of the ACA. This report is based on the final regulation for "Health Insurance Market Rules; Rate Review" as published in the Federal Register on February 27, 2013. Our understanding of these rules and our reading of the ACA rating requirements comes from Section 2701 of the Public Health Service Act, added by Section 1201 of the ACA of the ACA. Based upon these documents, it was necessary to make the following assumptions regarding the implementation of the ACA and final regulations:

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<sup>8</sup> See <http://www.mass.gov/ocabr/business/insurance/insurance-companies/group-products-and-plans/small-group-membership/2011-annual-massachusetts-individual-small.html>.

<sup>9</sup> The rating factors are those permitted pursuant to 211 CMR 66.08, available at: <http://www.mass.gov/ocabr/docs/doi/legal-hearings/211-66.pdf>

- The ACA small group rating rules become effective for all coverage issued, renewed or becoming effective on and after January 1, 2014 for non-grandfathered plans; based on a review of Massachusetts' merged market, it is assumed that all the currently offered plans are not grandfathered plans as defined under the ACA and the rating rules apply on January 1, 2014.
- Age rate adjustments are referenced within the ACA and carriers may vary within a 3-to-1 rating band<sup>10</sup> for adults aged 21 or older. The ACA age rating factor must be standard from one carrier to another and our analysis assumes the use of the standard 3-to-1 age rating band used in the February 27, 2013 final rules.
  - Age rate adjustments will be calculated at the member level up to a limit of three children under age 21 on a policy.
  - The ACA requires that carriers not exceed at 3-to-1 rating band and it is assumed that Massachusetts could implement more restrictive age factor requirements than those in the ACA, if desired. Because Massachusetts currently imposes a 2-to-1 rating band across a range of factors, an analysis should be done to examine the impact of assuming a 2-to-1 standard age rating curve developed from the federal 3-to-1 standard age rating curve.
- Area rate adjustments are referenced in the ACA and will be permitted for rating areas to be established by each state. Because Massachusetts already has established rating areas – defined as regions for area rate adjustments in 211 CMR 66.08(2)(b)2. - it is assumed that there will not be changes to the rating areas or the area rate adjustment factors currently in place in the market.
- Rate adjustment factors based on industry, employee participation in an employer's health plan, group size and enrollment through an intermediary or group purchasing cooperative will not be allowable case characteristics by which premium rates may vary beginning in 2014.
- Massachusetts currently has a 2-to-1 rating band that applies at the policy level to the product of the age, participation-rate, industry rate, wellness and tobacco usage rate adjustment factors. The 2-to-1 rate band limit is applied after all the applicable rating factors are multiplied. In some cases, the product of the rate bands may produce a result outside the 2-to-1 limit, but the carrier is required to truncate the results of the product so that the result is within a 2-to-1 rating band. Starting in 2014, instead of the product of the factors being limited that the age factor itself must be limited.
- Finally, it was assumed that because tobacco use and wellness factors currently are allowed but is not used in the market, that carriers will continue to not use the factor. While, it is possible that carriers may choose to implement tobacco use as a rating factor

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<sup>10</sup> The rate factor applied for the age with the highest risk cannot be more than 3 times as high as the age with the lowest level of risk.

when other rating factors are eliminated, the carriers do not have data that would allow us to estimate the potential effect on premiums.

Once the new age rating factors were estimated, Oliver Wyman determined the new factors that would apply to each policy using a process similar to the one employed for determining the current factors. The preliminary aggregate factor for the group was calculated as the product of the age, area, and conversion factor. It was assumed there would not be a rate band applicable to the aggregate factor analogous to the current 2-to-1 rate band.

Once the preliminary aggregate factors were determined, Oliver Wyman calculated the total premium collected under the current rating formula for each carrier and compared it to the premium that would be generated by the application of the ACA-compliant preliminary aggregate factors.

An adjustment factor was applied uniformly to each policy within a carrier to ensure that the total premium collected using the ACA-compliant aggregate factors was equal to the premium collected with the current factors. Oliver Wyman then was able to calculate a percentage change in each policy's premium resulting from the application of the ACA-compliant factors.

Appendix A contains an example of the ACA compliant premium rate calculation for a hypothetical policy.

### 3. Analysis of the Rating Factors

The analysis is dependent upon the characteristics of the current market rules and the nature of the policies and members currently covered. In Section 2, the current market rules were discussed in the context of the methodology for modeling the current rating factors. In this section, Oliver Wyman discusses the demographics of the currently covered policies and their enrollees.

The table below shows some of the characteristics of the policies for four of the carriers whose data was included in the study.

	Average Group Size		Average Group Size Factor <sup>1</sup>			Average Family Size		Average Age Factor <sup>2</sup>		
	Individual	Small Group	Individual	Small Group	% Difference	Individual	Small Group	Individual	Small Group	% Difference
Carrier A	1.00	4.13	1.10	1.01	9%	1.56	2.10	1.31	1.13	15%
Carrier B	1.00	4.29	1.10	1.00	10%	1.42	1.85	1.25	1.17	6%
Carrier C	1.00	2.99	1.10	1.03	7%	1.63	2.12	1.31	1.22	7%
Carrier D	1.00	4.54	1.10	1.01	9%	1.80	2.23	1.05	0.95	11%

	% of policies being capped at high end of 2:1 rate band		% of members being capped at high end of 2:1 rate band	
	Individual	Small Group	Individual	Small Group
Carrier A	30%	18%	23%	4%
Carrier B	9%	4%	7%	1%
Carrier C	27%	18%	18%	1%
Carrier D	33%	20%	23%	4%

<sup>1</sup> Normalized to maximum allowable factor of 1.10.

<sup>2</sup> Not normalized to a common factor for all carriers; therefore, factors should not be compared across carriers.

This analysis was needed to understand the relative differences in factors and their impact on the development of premiums in the market. The table above shows some important differences:

- Individuals currently have an average group size factor that is 7% to 10% higher than the average small group factor. Group size will be eliminated as a rating factor under the ACA. Therefore, all else equal, individuals would see lower rate changes than small groups due to the elimination of group size as a rating characteristic.
- There are more members on average covered under small employer coverage per subscriber with about 0.5 more persons on an employment-based plan than on an individual policy.
- Persons with individual coverage are on average older and have age factors that are 6% to 15% higher than those for persons with small group plans.

- The product of the policy's age, industry, and participation factors currently is limited to a 2:1 band, whereby the highest combined impact of these factors may not exceed the lowest impact by more than two times. One percent to 4% of members in small group policies have rating factors that are being capped by the 2-to-1 rate band. By comparison, up to 23% of members in individual policies have their rating factors capped on the high end due to the age of the members in the individual policies.<sup>11</sup> The removal of the 2:1 rate band, along with the change in the application of the age factors, will impact individuals differently than small groups.

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<sup>11</sup> Industry and participation factors do not apply to individual policies. Therefore, the 2-to-1 rate band flooring and capping is determined by the policy's age factor. Wellness and tobacco factors were not in use in the merged market at the time of the study.

## 4. Results

In conducting the analysis, Oliver Wyman recognizes that the Division will need to understand the projected impact according to the scenarios that are permitted under the ACA. As such, we projected the impact based on a 2-to-1 age rating band applying to adults age 21 and older, and then again with a change to a 3-to-1 age rating band for adults. Also, recognizing the nature of the merged market, Oliver Wyman did an analysis that examined the relative impact on individual policyholders and then on small employer policyholders.

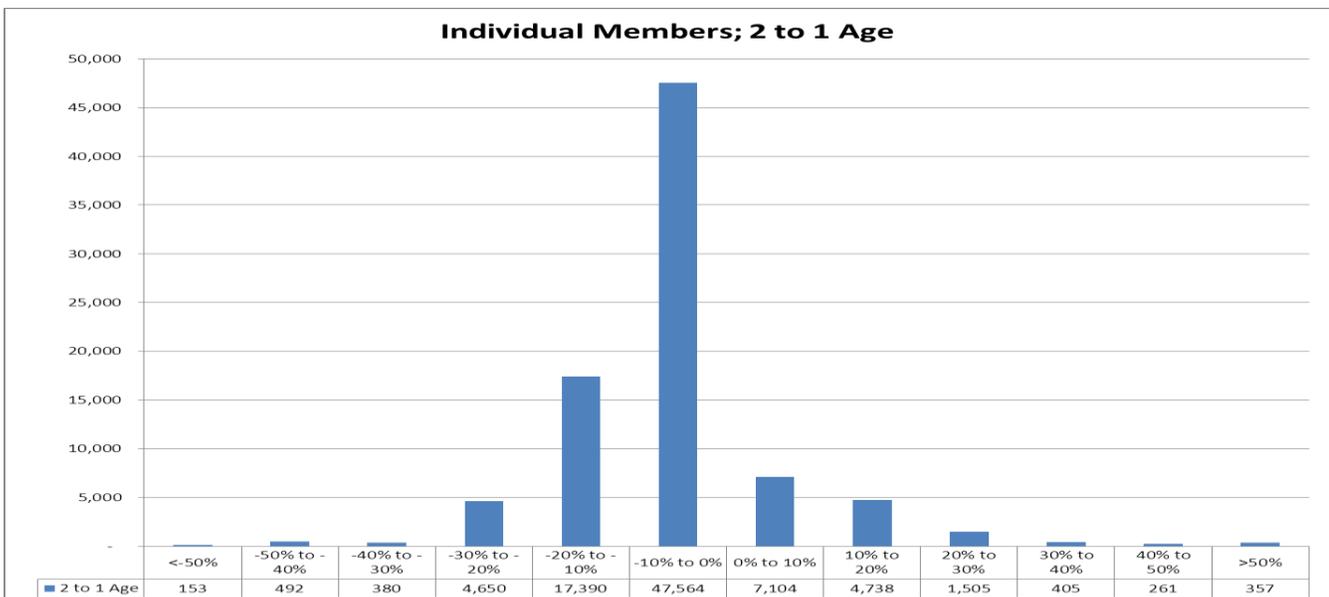
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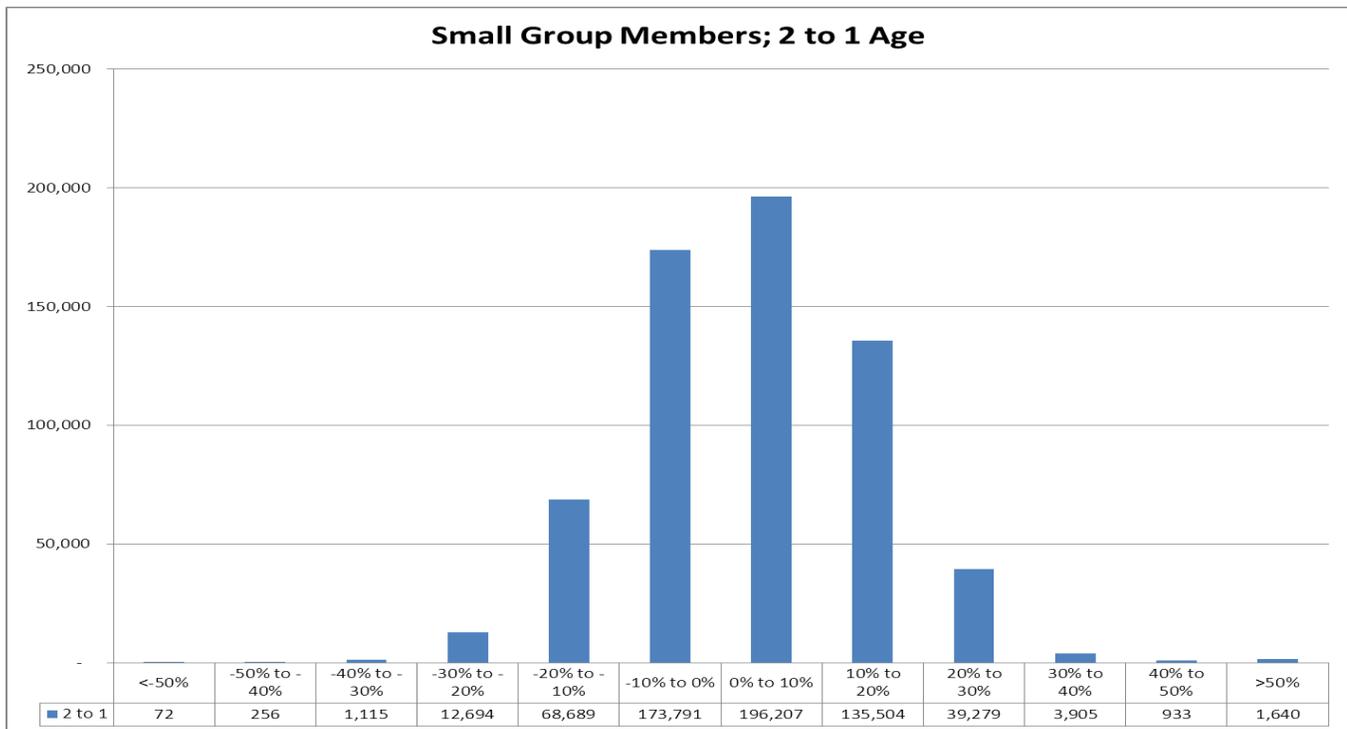
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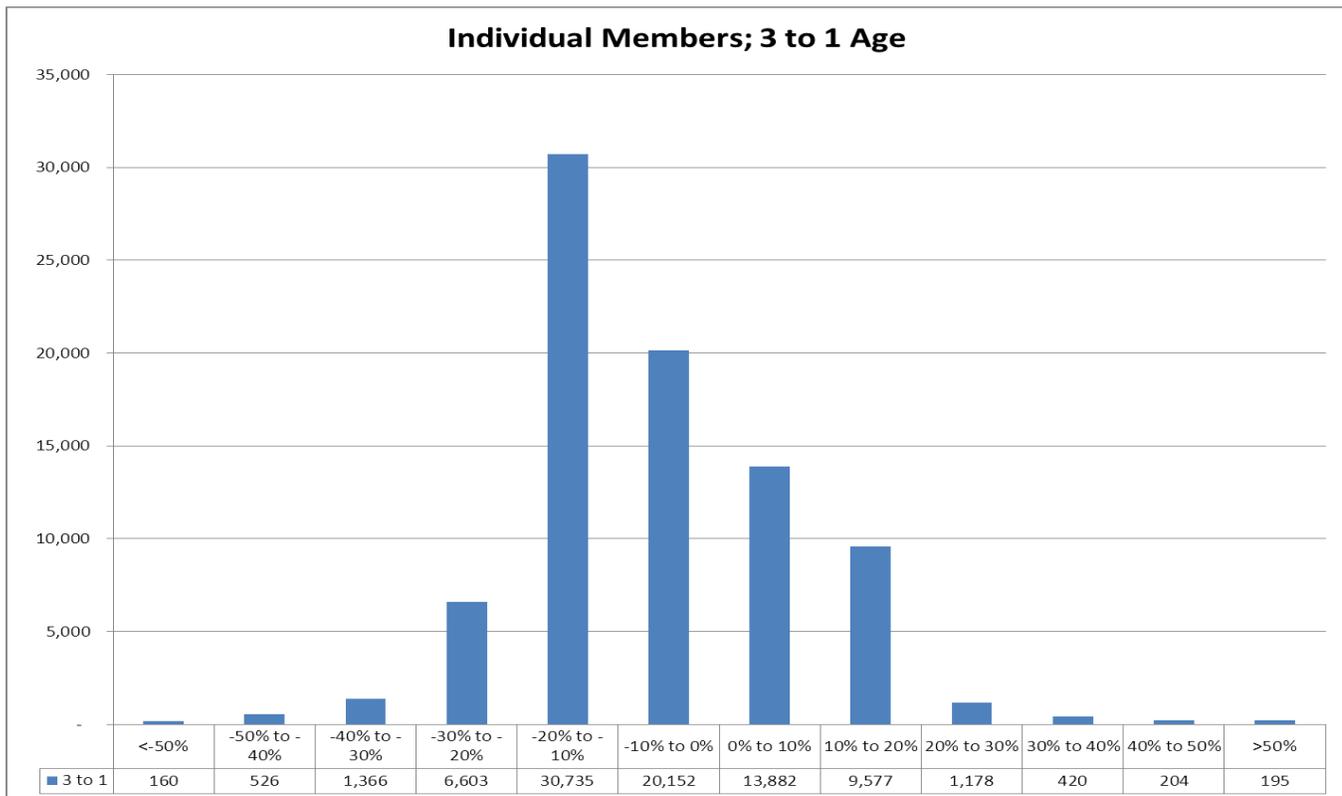
### **3-to-1 Rating Bands**

The ACA and final rules permit states to allow rates to vary within 3-to-1 rating bands. If Massachusetts changes its laws and regulations to allow adult rates to vary within 3-to-1 rating bands for age, Oliver Wyman has modeled the market and found the following:

#### **Individual Market:**

Moving to 3-to-1 rating bands will adversely impact older persons who will be charged significantly more solely based on their age than they would under a 2-to-1 band. Some of these premium increases may be reduced through low-income subsidies which are not considered in this analysis.

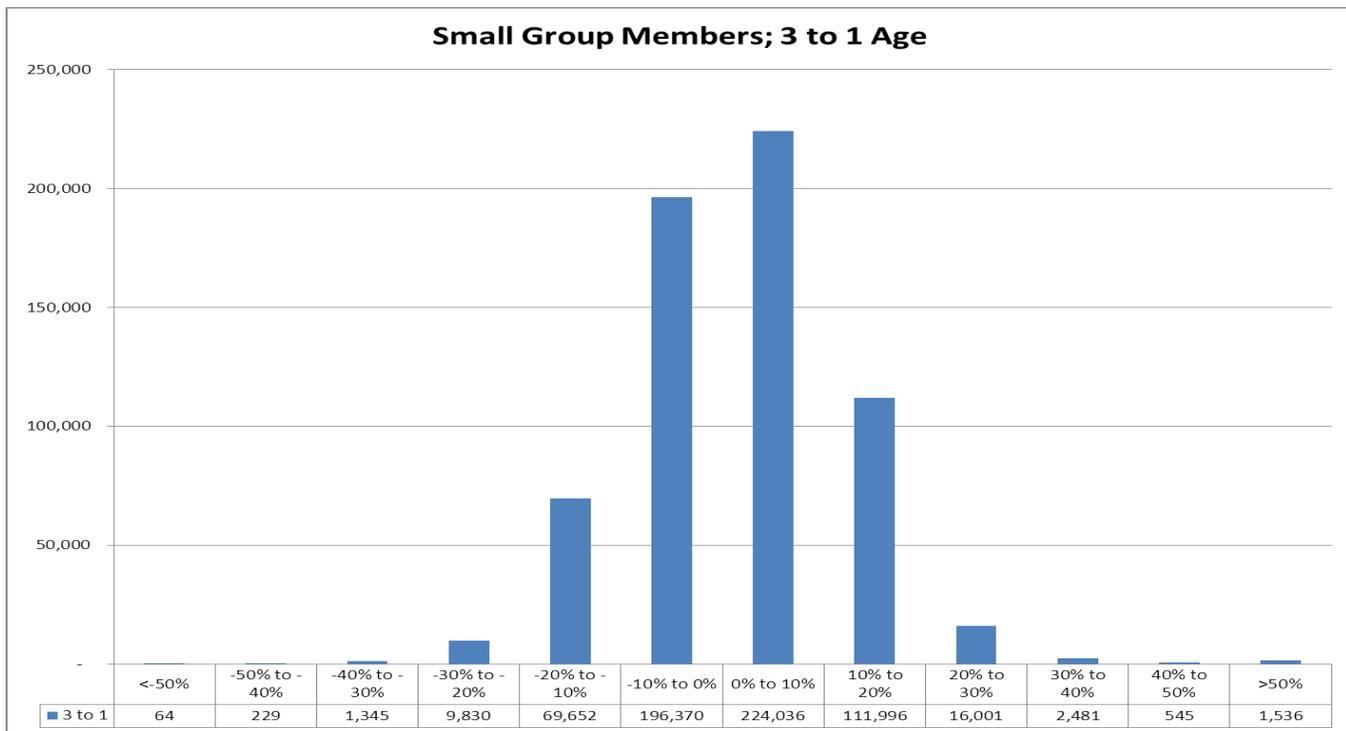
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Moving to 3-to-1 rating bands will adversely impact those small employers who have older employees because they will be charged more solely due to their employees’ older age than they would under a 2-to-1 band. However, moving to a 3-to-1 rating band would greatly reduce the number of small employer members that see large rate changes. Specifically, 48,000 fewer merged market members would see increases greater than 10% using a 3-to-1 band as compared to a 2-to-1 band.

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### **Causes of Premium Changes**

Small groups that receive significant premium reductions (those on the left side of the curve) have higher average age, industry, and group size rating factors than the merged market average. Because of their higher average age and industry factors, they are more likely to currently be capped at the high end of the 2:1 rate band.

In both the 2-to-1 and 3-to-1 scenarios, the industry and group size loads are removed, which results in the significant premium decreases. In the 2-to-1 rate band scenario, small groups receive lower average age factors than in the 3-to-1 rate band scenario due to the narrower age bands, resulting in greater overall rate decreases for these groups.

Those groups who have the highest premium increases are those who have lower age, industry and group size factors than average. These groups lose their favorable industry and group size factors, which results in significant premium increases.

In the 2-to-1 rate band scenario these groups receive higher age factors than the 3-to-1 rate band scenarios, because the 2-to-1 scenarios require the younger groups to pay more to subsidize older groups. Therefore, the small group policies also see greater variation under the 2-to-1 scenarios than 3-to-1 scenarios.

Regardless of whether the age band is applied at the 2-to-1 level or at a 3-to-1 level, there will be significant premium changes for many individual and small group members' premiums in 2014.

### **Recommendation**

Because ACA rating rules are projected to have a significant impact on certain groups when implemented in 2014, Massachusetts will want to investigate all available options – including transition periods allowing for a gradual elimination of the Massachusetts rating factors - in order to mitigate premium increase shocks that will occur when the ACA rating factors are implemented.

## APPENDIX A

### Sample ACA-Compliant Premium Calculation

Note: The rating factors shown are illustrative and do not represent the factors of any given carrier in the study.

#### Small Group Enrollee Information

Employee 1: 25 years old, single coverage

Employee 2: 40 years old, 38 year old spouse, 2 children

Employee 3: 60 years old, 62 year old spouse, no children

#### Age Factor Calculation

<i>Member</i>	<i>Age</i>	<i>Age Factor</i>
1	25	1.004
2	40	1.278
3	38	1.246
4	0-20	0.635
5	0-20	0.635
6	60	2.714
7	62	2.873
Average		1.484

#### Assumed Area Rate Adjustment Factor

Boston: 1.100

#### Preliminary Aggregate Adjustment Factor Calculation

<i>Adjustment Type</i>	<i>Factor</i>
Age	1.484
Area	1.100

Tobacco Factor	n/a
Preliminary Aggregate(=product)	1.6324
<u>Revenue Neutrality Adjustment Factor</u>	
Assume equals 1.10	
<u>Final Factor Calculation</u>	
<i>Adjustment Type</i>	<i>Factor</i>
Preliminary Aggregate	1.6324
Revenue Neutrality	1.10
Final Aggregate	1.7956
<u>Premium Rate Calculation</u>	
Monthly Base Rate for Product	\$400.00
Final Aggregate	1.7956
Monthly ACA Compliant Premium (for Single Coverage)	\$718.24
<u>Rate Change Calculation</u>	
Monthly ACA Compliant Premium	\$718.24
Current Premium	\$600.00
Rate Change (=ACA/Current – 1)	19.7%



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