REPORT OF MEDICAL LOSS RATIO EXAMINATION
OF THE
HEALTH NET LIFE INSURANCE COMPANY
AS OF
DECEMBER 31, 2015

Filed on July 12, 2017
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Los Angeles, California  
April 28, 2017

Honorable Dave Jones  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, a Medical Loss Ratio examination was made of the

HEALTH NET LIFE INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at  
21281 Burbank Boulevard, Woodland Hills, California 91367.

SCOPE OF EXAMINATION

We have performed a Medical Loss Ratio (MLR) examination of the Company to  
determine compliance with California Insurance Code (CIC) Section 10112.25 related to  
minimum medical loss ratio requirements. CIC Section 10112.25 grants the Insurance  
Commissioner authority to adopt regulations to implement the medical loss ratio as  
described under Section 2718 of the federal Public Health Service Act. Section 2718 of  
the federal Public Health Service Act authorizes the U.S. Code of Federal Regulation  
(CFR) Title 45 – Public Welfare Part 158 to be implemented. This examination covers  
the reporting period from January 1, 2013 through December 31, 2015.

We performed procedures established by the U.S. Department of Health & Human  
Services (HHS) to examine the MLR Annual Reporting Form as completed by the  
Company and submitted to HHS for the 2015 MLR reporting year, to ensure the validity  
of the underlying data, accuracy of the calculation, and accuracy and timeliness of the  
rebate payments made and reported in compliance with Title 45 CFR Part 158. Title 45
CFR §158.403(a)(2) permits HHS to accept the State’s audit provided it, amongst other things, reports on the validity of the data regarding expenses and premiums that the issuer reported to the Secretary of HHS, including the appropriateness of the allocations of expenses used in such reporting and whether the activities associated with the issuer's reported expenditures for quality improving activities meet the definition of such activities. Title 45 CFR §158.403(a)(3) further permits HHS to accept the State's audit provided it also, amongst other things, reports on the accuracy of rebate calculations and the timeliness and accuracy of rebate payments.

**OWNERSHIP**

The Company is a wholly-owned subsidiary of Health Net of California, Inc. (HNCA), which is a wholly-owned subsidiary of Health Net Inc., (HNI).

On July 2, 2015, the Company’s ultimate parent, Health Net Inc., and Centene Corporation (“Centene”), a Delaware corporation entered into an Agreement and Plan of Merger, pursuant to which Centene will acquire all outstanding shares of Health Net, Inc.

On March 22, 2016 the California Department of Insurance approved the acquisition of Health Net Inc. by Centene.

**TERRITORY AND PLAN OF OPERATION**

The Company offers preferred provider organization health plans, exclusive provider organization health plans, point of service health plans (not after 2014), indemnity health, dental, vision, Medicare supplemental, Medicare Advantage PPO behavioral health, and life insurance products. The Company also offers life insurance products, which include group term life, individual term life, accidental death and dismemberment, supplemental term life, and dependent term life.
The Company was licensed to sell life and accident and health products in all states except New York during the exam period. The Company is also licensed in the District of Columbia. The principal line of business written is health insurance. The Company concentrates on the small group and individual market. The Company’s total direct written premium for the year ending 2015 was $1.70 billion of which 99.90% was Accident and Health and the remaining 0.10% was life insurance. Of the direct premiums written, $997 million (58.4%) was written in California, $362 million (21.2%) in Arizona, $318 million (18.6%) in Oregon, and $30.9 million (1.81%) in the remaining states.

MEDICAL LOSS RATIO REPORTING FORM

Title 45 of the U.S. Code of Federal Regulations (CFR) §158.110(b) requires that a report for each Medical Loss Ratio (MLR) reporting year be submitted to the Secretary of the U.S. Department of Health and Human Services by July 31st of the year following the end of an MLR reporting year, on a form and in the manner prescribed by the Secretary. Based on our review of the filings, the Company filed acceptable forms by July 31st, 2016 for the 2015 reporting year and is in compliance with Title 45 CFR §158.110(b).

Title 45 CFR §158.210(a) requires that an issuer must provide a rebate to enrollees if the issuer has a Medical Loss Ratio (MLR) of less than 85% for the large group market. Title 45 CFR §158.210(b) and (c) require that an issuer must provide a rebate to enrollees if the issuer has an MLR of less than 80% for the small group market, the individual market and the student business market. The Company’s MLR and rebate calculations from the 2015 MLR Annual Reporting Forms, Part 4, for Arizona and California are as follows:
<table>
<thead>
<tr>
<th>MLR Components (Arizona)</th>
<th>Individual</th>
<th>Small Group</th>
<th>Large Group</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Incurred Claims</td>
<td>$502,903,739</td>
<td>$306,095,842</td>
<td>$142,646,633</td>
<td></td>
</tr>
<tr>
<td>Plus: Quality Improvement Expenses</td>
<td>$5,343,353</td>
<td>$5,676,526</td>
<td>$2,938,557</td>
<td></td>
</tr>
<tr>
<td>Minus: Reconciled payments of cost-sharing reductions</td>
<td>$22,861,444</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus: Federal Transitional Reinsurance Program payments</td>
<td></td>
<td>$86,069,637</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program payments expected from HHS (as indicated by HHS as of 6/30)</td>
<td></td>
<td>$9,086,683</td>
<td>$7,300,053</td>
<td></td>
</tr>
<tr>
<td>Minus: Federal Risk Adjustment Program net payments</td>
<td>$4,697,071</td>
<td>$504,558</td>
<td></td>
<td></td>
</tr>
<tr>
<td>payments expected from HHS / (charges payable to HHS) (as indicated by HHS as of 6/30)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MLR Numerator</td>
<td>$385,532,439</td>
<td>$303,967,757</td>
<td>$145,585,190</td>
<td>(1)</td>
</tr>
<tr>
<td>Premium Earned</td>
<td>$227,653,669</td>
<td>$332,803,815</td>
<td>$165,509,447</td>
<td></td>
</tr>
<tr>
<td>Less: Federal &amp; State Taxes and Licensing or Regulatory Fees</td>
<td>$9,743,175</td>
<td>$10,525,611</td>
<td>$3,752,169</td>
<td></td>
</tr>
<tr>
<td>MLR Denominator</td>
<td>$267,910,494</td>
<td>$322,278,204</td>
<td>$161,757,278</td>
<td>(2)</td>
</tr>
<tr>
<td>Preliminary MLR Before Credibility Adjustment</td>
<td>143.9%</td>
<td>94.3%</td>
<td>90.0%</td>
<td></td>
</tr>
<tr>
<td>Credibility Adjustment</td>
<td>0</td>
<td>0</td>
<td>.02</td>
<td>(3)</td>
</tr>
<tr>
<td>Credibility-Adjusted MLR</td>
<td>143.9%</td>
<td>94.3%</td>
<td>90.2%</td>
<td>(4)</td>
</tr>
<tr>
<td>MLR Standard</td>
<td>80%</td>
<td>80%</td>
<td>85%</td>
<td></td>
</tr>
<tr>
<td>Rebate Amount</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>(5)</td>
</tr>
<tr>
<td>MLR Components (California)</td>
<td>Individual</td>
<td>Small Group</td>
<td>Large Group</td>
<td>Student Business</td>
</tr>
<tr>
<td>------------------------------------------------------------------</td>
<td>--------------</td>
<td>--------------</td>
<td>-------------</td>
<td>------------------</td>
</tr>
<tr>
<td>Adjusted Incurred Claims</td>
<td>$1,002,106,224</td>
<td>$951,046,850</td>
<td>$526,975,077</td>
<td>$88,839,952</td>
</tr>
<tr>
<td>Plus: Quality Improvement Expenses</td>
<td>$3,841,874</td>
<td>$3,172,779</td>
<td>$2,322,967</td>
<td>$451,475</td>
</tr>
<tr>
<td>Minus: Reconciled payments of cost-sharing reductions</td>
<td>$2,877,694</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus: Federal Transitional Reinsurance Program payments expected from HHS (as indicated by HHS as of 6/30)</td>
<td>$190,603,989</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus: Federal Risk Adjustment Program net payments expected from HHS / (charges payable to HHS) (as indicated by HHS as of 6/30)</td>
<td>$107,243,521</td>
<td>$10,355,300</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus: Federal Risk Corridors Program net payments / (charges)</td>
<td>$0</td>
<td>$620,254</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MLR Numerator</td>
<td>$705,222,893</td>
<td>$943,244,075</td>
<td>$529,298,044</td>
<td>$89,291,427</td>
</tr>
<tr>
<td>Premium Earned</td>
<td>$618,600,662</td>
<td>$1,119,882,939</td>
<td>$650,048,402</td>
<td>$102,618,934</td>
</tr>
<tr>
<td>MLR Denominator</td>
<td>$592,318,001</td>
<td>$1,065,576,309</td>
<td>$612,256,631</td>
<td>$96,621,175</td>
</tr>
<tr>
<td>Preliminary MLR Before Credibility Adjustment</td>
<td>119.1%</td>
<td>88.5%</td>
<td>86.5%</td>
<td>92.4%</td>
</tr>
<tr>
<td>Credibility Adjustment</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1.5%</td>
</tr>
<tr>
<td>Credibility-Adjusted MLR</td>
<td>119.1%</td>
<td>88.5%</td>
<td>86.5%</td>
<td>94.0%</td>
</tr>
<tr>
<td>MLR Standard</td>
<td>80%</td>
<td>80%</td>
<td>85%</td>
<td>85%</td>
</tr>
<tr>
<td>Rebate Amount</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
</tbody>
</table>
Based on our review, it was noted that the Company’s policies and procedures for determining group size and market classification were inconsistent with the requirements of §158.220, which stipulate that an insurer’s MLR must be calculated separately for the large group market, small group market, and individual market within each state.

Although the Company employed standards that were inconsistent with the requirements in §158.220, based on the unique circumstances for each policy, and alternative documentation provided, the examination team was able to substantiate the market classification assigned to the policies tested during the examination. The information provided by the Company indicated that for policies with effective dates during 2013 - 2015, the Company incorrectly determined the group size and based the market classification on the total number of employees of the policyholder at the time of initial application or policy renewal. §158.103 employs the definition Large Employer, Large Group Market, Small Employer and Small Group Market from section 2791(e) of the Public Health Services Act (PHS Act). Section 2791(e) of the PHS Act requires that the small and large group market classifications be based on the average number of employees on the business days of the calendar year preceding the coverage effective date. The Company did not obtain information regarding the average number of total employees for the calendar year preceding the effective date of the coverage and therefore was not able to accurately determine group size and market classification.

It is recommended that the Company adopt and implement procedures to ensure that all market classification determinations are in compliance with Title 45 CFR §158.220 and comply with the definitions contained in section 2791 of the PHS Act and the applicable requirements of Title 45 CFR §158 and associated technical guidance. It is also recommended that the Company implement procedures for determining group size. The Company is currently in the process of revising its new business Group Application Forms to require the group size based on the federal MLR definition, and revising their annual renewal process, including the renewal offer and follow-up outreach to include an additional request for the confirmation of the MLR group size based on the deferral
definitions. Additionally, the Company will issued a one-time survey requesting MLR group size for all groups that were active in 2016, which was targeted for release in February 2017. Based on the survey responses, groups will be classified as large or small group for MLR reporting purposes. Manual adjustment will be made to the Annual MLR Reporting Form based on the data collected.

COMMENTS ON MEDICAL LOSS RATIO CALCULATION:

(1) Medical Loss Ratio Numerator

According to the U.S. Code of Federal Regulations (CFR) Title 45 §158.221(b), the numerator of the Medical Loss Ratio (MLR) calculation is comprised of incurred claims, as defined in Title 45 CFR §158.140, plus expenditures for activities that improve health care quality, as defined in Title 45 CFR §158.150, and Title 45 CFR §158.151. We verified the data used to calculate the adjusted incurred claims. Based on our review, the Company included appropriate adjusted incurred claims in the MLR numerator.

We reviewed the reasonableness of the health care quality improvement expenses including confirming that the methodology complies with the narrative provided within the Part 6 - Expense Allocation portion of the MLR Reporting Form and that it conforms to the definition of Healthcare Quality Improvement Expenses as defined by Title 45 CFR §158.150, and Title 45 CFR §158.151. Based on our review, the Company’s allocation methodology and health care quality improvement expenses reported in the MLR numerator are reasonable and conforms to the regulations.

(2) Medical Loss Ratio Denominator

According to Title 45 CFR §158.221(c), the denominator of the MLR calculation is comprised of premium revenue, as defined in Title 45 CFR §158.130, minus federal and state taxes and licensing and regulatory fees, described in Title 45 CFR §158.161(a), and Title 45 CFR §158.162(a) (1) and (b) (1). We verified the data used to calculate the
premium revenue. Based on our review, the Company included appropriate premiums earned in the MLR denominator.

We reviewed the reasonableness and appropriateness of the federal and state taxes and regulatory fees including the appropriateness of allocations and the definition of such activities. Based on our review, the Company’s allocation methodology and federal and state taxes and regulatory fees reported in the MLR denominator is reasonable and conforms to the regulations.

(3) Credibility Adjustment

According to Title 45 CFR §158.232, the credibility adjustment is the product of the base credibility factor multiplied by the deductible factor. The experience for the California individual, small group and large group, as well as the Arizona individual and small group market segments, were fully credible, therefore, no base credibility factors were calculated for these segments. The experience for the Arizona large group market segments was partially-credible and a credibility factor of 0.2% was calculated in accordance with Title 45 CFR §158.232.

The Company did not report an average deductible factor for all California and Arizona market segments. Therefore, a deductible factor of 1.0 was assigned in accordance with Title 45 CFR §158.232(c). Based on our review, the Company appropriately calculated the credibility adjustments.

(4) Credibility Adjusted Medical Loss Ratio

According to Title 45 CFR §158.221(a), the calculation of MLR is the ratio of the numerator to the denominator, subject to the applicable credibility adjustment, if any. Based on our review, it appears that the Company appropriately calculated the MLRs for each market segment.
(5) Rebate Amount, Calculation and Distribution

According to Title 45 CFR §158.240, a rebate is required if an issuer's MLR is less than the minimum MLR standard. Based on our review, the Company’s 2013, 2014 and 2015 MLRs exceeded the minimum percentage for the all market segments.

REBATE NOTICE

According to Title 45 of the U.S. Code of Federal Regulations §158.250(a) and (b), a notice of rebate is required when the medical loss ratios do not exceed the minimum percentage. Based on our review, the Company’s medical loss ratios exceeded the minimum percentage for all market segments and no rebates were issued.

REBATE PAYMENTS ON SOLVENCY

According to Title 45 of the U.S. Code of Federal Regulations §158.270(a), rebate payments having any adverse impact to the Company’s Risk Based Capital (RBC) level requires notification by the California Department of Insurance to the Secretary of the U.S. Department of Health & Human Services (HHS). Based on our review, the Company’s MLRs exceeded the minimum percentage for all market segments, and no rebates were issued, therefore there was no impact on the RBC level that would warrant notification to the Secretary of HHS.

SUMMARY OF COMMENTS, FINDINGS AND RECOMMENDATIONS

Current Report of Examination

Medical Loss Ratio Reporting Form (Page 6) - It is recommended that the Company adopt and implement procedures to ensure that all market classification determinations are in compliance with Title 45 CFR §158.220 and comply with the definitions contained in section 2791 of the PHS Act and the applicable requirements of Title 45 CFR §158
and associated technical guidance. It is also recommended that the Company implement procedures for determining group size.

The Company is currently in the process of revising its new business Group Application Forms to require the group size based on the federal MLR definition, and revising their annual renewal process, including the renewal offer and follow-up outreach to include an additional request for the confirmation of the MLR group size based on the deferral definitions.

Previous Report of Examination

None
ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company’s officers and employees during the course of this examination.

Respectfully submitted,

/S/ _______________________
Cuauhtémoc Beltran, CFE
Examiner-In-Charge
Department of Insurance
State of California