STATE OF CALIFORNIA

Dave Jones, *Insurance Commissioner*

DEPARTMENT OF INSURANCE

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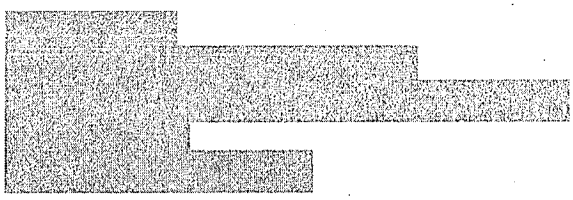

Re: Including 2014 Federal Affordable Care Act Fees in 2013 Health Insurance Premium Rates

Dear [redacted]:

This letter responds to your inquiry to the Department's Health Actuarial Office. You ask whether health insurers may include in their 2013 premium rates fees due to the federal government in 2014 under the Patient Protection and Affordable Care Act ("PPACA"). For two reasons, the answer is no. This letter is written pursuant to California Insurance Code section 12921.9.[1]

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[1] Insurance Code section 12921.9 provides:

> (a) A letter or legal opinion signed by the Commissioner or the Chief Counsel of the Department of Insurance that was prepared in response to an inquiry from an insured or other person or entity and that discusses either generally or in connection with a specific fact situation the application of the Insurance Code or regulations promulgated by the commissioner shall be made public. The department may redact the name, address, policy number, and other identifying information regarding a particular insured or other person or entity from the letter or legal opinion when it is made public.
>
> (b) A letter or legal opinion made public pursuant to this section shall not be construed as establishing an agency guideline, criterion, bulletin, manual, instruction, order, standard of general application, rule, or regulation, as those terms are described in Sections 11340.5 and 11342.600 of the Government Code.

I. Federal Fees Due in 2014

PPACA provides that health insurers must pay a number of taxes and fees to the federal government. Among them are two fees due in 2014.

A. Annual Fee on Health Insurance Providers

Section 9010 of PPACA provides that starting in 2014 and annually after that every health insurer must pay a "fee" to the United States Treasury (hereafter, "Annual Fee"). PPACA § 9010(a)(1). The total fee to be collected in 2014 is $8 billion. *Id.* § 9010(e)(1). The total fee increases every subsequent year. *Id.* § 9010(e)(2). Each health insurer will pay a portion of the total fee calculated as the ratio of its annual net premium to annual net premium of the entire health insurance industry times the total $8 billion fee, subject to certain adjustments. *Id.* § 9010(b)(1) & (2). The first payment is due to the Treasury in 2014. *Id.* § 9010(a)(1) & (j). The Secretary of the Treasury ("Secretary") will determine the amount each insurer owes. *Id.* § 9010(b)(3). For 2014, the determination is based on premium data for calendar year 2013. *Id.* § 9010(a)(1) & (b)(1). The Secretary will provide a deadline for insurers to pay the fee. *Id.* § 9010(a)(2). The Secretary may set the deadline up to September 30. *Id.* This process then repeats every year.

B. Transitional Reinsurance Fee

PPACA provides that every health insurer must pay an annual "contribution" to a federal transitional reinsurance program (hereafter, "Transitional Reinsurance Fee"). 42 U.S.C. § 18061(b)(3)(A). The Secretary is directed to develop a "method" for calculating each insurer's obligation "for each plan year beginning in the 36-month period beginning January 1, 2014." *Id.* PPACA sets forth contours for the calculation methodology. *Id.* § 18061(b)(3)(A) & (B).

II. Health Insurers May Not Collect 2014 Federal Fees in 2013 Rates

For two reasons, health insurers may not collect 2014 federal fees in 2013 rates.

A. 2014 Federal Fees Bear No Relationship to Insurance Sold to Customers in 2013 and Cannot Be Imposed on Those Customers

Imposing 2014 federal fees on customers in 2013 forces them to pay a charge that bears no relationship to the insurance they are being sold. Such an assessment would be impermissible.

A tenet of California insurance law is that premium must bear a relationship to the insurance sold to a particular customer. "[I]t is commonly understood that a premium is the amount paid *for certain insurance for a certain period of coverage*." *Troyk v. Farmers Group, Inc.*, 171 Cal. App. 4th 1305, 1324 (2009) (quoting *Interinsurance Exchange of the Automobile Club v.*

Superior Court, 148 Cal. App. 4th 1218, 1230 (2007)) (addressing the issue in the context of automobile insurance) (emphasis added).

Federal fees due in 2014 are not "for . . . insurance" for the "*period of coverage*" of 2013 customers. Such fees would be invalid premium for a 2013 customer. Even if 2014 federal fees are treated as a charge outside premium, the same principle applies: There must be a nexus between the fee and the insurance sold to the customer. Such a nexus is absent between 2013 customers and 2014 federal fees.

The lack of nexus between 2014 federal fees and insurance sold to customers in 2013 is amplified by the fact that the amount of those fees is unknown at this time. Under PPACA, the Secretary will determine both the Annual Fee and the Transitional Reinsurance Fee. The Annual Fee will not, and cannot, be calculated until well into 2014, after premium data for all of 2013 are available and the Secretary makes a determination. Further, the Annual Fee is based on a given insurer's premium in 2013 and industry-wide premium in 2013. Even if, for argument's sake, an insurer could project the former, there is no way an insurer could precisely project the latter.

B. Including 2014 Fees in 2013 Rates Would Render Those Rates "Unreasonable" Under Departmental Guidance 1163:2

Under SB 1163 (Stats. 2010, Chapter 661), the Department is authorized to determine whether health insurance rate increases for individual and small group insurance are "unreasonable." Ins. Code § 10181.11(a). The Department issued "guidance" to spell out when a rate increase is "unreasonable." *See id.* § 10181.9(a) (authorizing the Department to issue guidance); Guidance 1163:2 (issued April 5, 2011).

Including 2014 federal fees in 2013 rates would run afoul of three factors in Guidance 1163:2.

1. Factor 3

This factor evaluates:

> Whether the choice of assumptions or combination of assumptions on which the rate increase is based is reasonable.

Forcing 2013 customers to pay federal fees not due until 2014 involves at least two unreasonable assumptions. First, as discussed above, it is impossible to estimate with reasonable accuracy the amount of fees at this time. Second, 2013 customers may not even be covered by the insurer in 2014, when the fees are due. To impose a fee on a person who is not a customer when the fee is due is unreasonable.

2. Factor 12

This factor evaluates:

> Whether the rating factors applied and any change in rating factors are reasonable and result in a distribution of the proposed rate increase across risk categories that is reasonable and not overly burdensome on any particular individual or group, including consideration of the minimum and maximum rate increases a policyholder could receive, and how many policyholders will be subject to increases lower and higher than the average.

Including 2014 federal fees in 2013 rates would be inequitable to individual customers whose policies lapse in 2013 and to small group customers who discontinue coverage in 2013. As with Factor 3, to impose a fee on people who are not customers when the fee is due is unreasonable. In addition, including 2014 fees in 2013 rates would be inequitable to customers that do not buy health insurance in 2014 or that self-insure and buy "stop loss" insurance. The inequitable outcome would violate the prohibition against rates being "overly burdensome on any particular individual or group."

3. Factor 17

This factor evaluates:

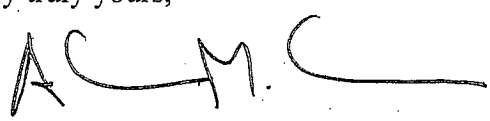
> Whether the filed rates appropriately reflect the effects of reinsurance, risk adjustment, and risk corridor programs that are expected to be in place during the time the filed rates are anticipated to be in effect.

Including 2014 fees in 2013 rates would mean customers are charged transitional reinsurance fees that would *not* "be in place at the time the rates are anticipated to be in effect."

III. Conclusion

Health insurers may not include in their 2013 premium rates fees due to the federal government in 2014.

Very truly yours,



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