

REPORT OF MEDICAL LOSS RATIO EXAMINATION  
OF THE  
HEALTH NET LIFE INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2011

Filed October 8, 2013

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Los Angeles, California  
August 9, 2013

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 the primary location of its books and records, 21650 Oxnard Street, Woodland Hills, California 91367. The Company's statutory home office and main administrative office is located at 21281 Burbank Boulevard, Woodland Hills, California 91367.

#### SCOPE OF EXAMINATION

We have performed a Medical Loss Ratio (MLR) examination of Health Net Life Insurance Company to determine compliance with California Insurance Code (CIC) Section 10112.25 related to minimum MLR requirements. CIC Section 10112.25 grants the Insurance Commissioner authority to adopt regulations to implement the MLR as described under Section 2718 of the federal Public Health Service Act (PHSA). Section 2718 of the federal PHSA authorizes the U.S. Code of Federal Regulation (CFR), Title 45 – Public Welfare, Part 158 (45 CFR §158) to be implemented. This examination covers the twelve months ending December 31, 2011.

We examined the MLR Annual Reporting Form as completed by the Company and submitted to the U.S. Department of Health & Human Services (HHS) for the 2011 MLR reporting year, to ensure the validity of the underlying data, accuracy of the calculations, and accuracy and timeliness of the rebate payments made and reported in compliance

with 45 CFR Part 158. 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. 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.

The MLR examination of the Company covers the states which the Company is required to submit a MLR Annual Reporting Form to HHS. The examination covers the filings in the states of Arizona, California, Connecticut, Florida, New Jersey, and Washington.

#### OWNERSHIP

The Company, domiciled in the state of California, is a wholly-owned subsidiary of Health Net of California, Inc., and is ultimately owned by Health Net, Inc., a Delaware corporation.

#### TERRITORY AND PLAN OF OPERATION

The Company writes preferred provider organization (PPO), point of service, indemnity, Medicare supplement, Medicare Advantage PPO, California Healthy Family coverage, dental, vision, behavioral health and life insurance products. The Company is licensed to operate in all states except New York. For the year ended December 31, 2011, the Company had direct written premiums of \$1.12 billion in the state of California, or 56.6% of total written premiums.

MEDICAL LOSS RATIO REPORTING FORM

Title 45 of the U.S. Code of Federal Regulations (45 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 June 1<sup>st</sup> 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 filing, the Company filed an acceptable form by June 1, 2012 for the 2011 reporting year and is in compliance with 45 CFR §158.110(b).

45 CFR §158.210(a) requires that an issuer must provide a rebate to enrollees if the issuer has a MLR of less than 85% for the large group market. 45 CFR §158.210(b) and (c) requires that an issuer must provide a rebate to enrollees if the issuer has a MLR of less than 80% for the small group market and the individual market. The Company's MLR and rebate calculations for the states of Arizona, California, Connecticut, Florida, New Jersey, and Washington from the MLR Annual Reporting Form, Part 5 are as follows:

MLR Components (Arizona)	Individual	Small Group	Large Group	Notes
Adjusted Incurred Claims	\$26,344,944	\$96,612,053	\$102,060,212	
plus: Quality Improvement Expenses	\$212,328	\$533,980	\$511,810	
MLR Numerator	\$26,557,272	\$97,146,033	\$102,572,022	(1)
Premium Earned	\$29,216,561	\$109,992,036	\$111,320,604	
less: Federal & State Taxes and Licensing or Regulatory Fees	\$(804,587)	\$(1,755,927)	\$(536,024)	
MLR Denominator	\$30,021,148	\$111,747,963	\$111,856,628	(2)
Preliminary MLR Before Credibility Adjustment	88.5%	86.9%	91.7%	
Credibility Adjustment	2.4%	1.4%	1.5%	(3)
Credibility Adjusted MLR	90.8%	88.4%	93.2%	(4)
MLR Standard	80.0%	80.0%	85.0%	
Rebate Amount	\$0	\$0	\$0	(5)

MLR Components (California)	Individual	Small Group	Large Group	Notes
Adjusted Incurred Claims	\$128,112,481	\$267,025,865	\$277,198,054	
plus: Quality Improvement Expenses	\$15,410	\$36,955	\$37,930	
MLR Numerator	\$128,127,891	\$267,062,820	\$277,235,984	(1)

<b>MLR Components (California)</b>	<b>Individual</b>	<b>Small Group</b>	<b>Large Group</b>	<b>Notes</b>
Premium Earned	\$153,002,063	\$326,281,597	\$327,543,543	
less: Federal & State Taxes and Licensing or Regulatory Fees	\$5,896,074	\$11,264,939	\$14,573,375	
MLR Denominator	\$147,105,989	\$315,016,658	\$312,970,168	(2)
Preliminary MLR Before Credibility Adjustment	87.1%	84.8%	88.6%	
Credibility Adjustment	1.1%	0.4%	0.8%	(3)
Credibility Adjusted MLR	88.2%	85.2%	89.4%	(4)
MLR Standard	80.0%	80.0%	85.0%	
Rebate Amount	\$0	\$0	\$0	(5)

<b>MLR Components (Connecticut)</b>	<b>Individual</b>	<b>Small Group</b>	<b>Large Group</b>	<b>Notes</b>
Adjusted Incurred Claims	-	\$652,041	\$902,521	
plus: Quality Improvement Expenses	-	\$133	\$103	
MLR Numerator	-	\$652,174	\$902,624	(1)
Premium Earned	-	\$1,079,485	\$698,621	
less: Federal & State Taxes and Licensing or Regulatory Fees	-	\$251,068	\$212,183	
MLR Denominator	-	\$828,417	\$486,438	(2)
Preliminary MLR Before Credibility Adjustment	-	80.0%	85.0%	
Credibility Adjustment	-	-	-	(3)
Credibility Adjusted MLR	-	80.0%	85.0%	(4)
MLR Standard	80.0%	80.0%	85.0%	
Rebate Amount	-	\$0	\$0	(5)

<b>MLR Components (Florida)</b>	<b>Individual</b>	<b>Small Group</b>	<b>Large Group</b>	<b>Notes</b>
Adjusted Incurred Claims	-	-	\$14,249	
plus: Quality Improvement Expenses	-	-	-	
MLR Numerator	-	-	\$14,249	(1)
Premium Earned	-	-	\$34,960	
less: Federal & State Taxes and Licensing or Regulatory Fees	-	-	\$15,323	
MLR Denominator	-	-	\$19,637	(2)
Preliminary MLR Before Credibility Adjustment	-	-	85.0%	
Credibility Adjustment	-	-	-	(3)
Credibility Adjusted MLR	-	-	85.0%	(4)
MLR Standard	80.0%	80.0%	85.0%	
Rebate Amount	-	-	\$0	(5)

<b>MLR Components (New Jersey)</b>	<b>Individual</b>	<b>Small Group</b>	<b>Large Group</b>	<b>Notes</b>
Adjusted Incurred Claims	-	\$881,985	\$388,323	
plus: Quality Improvement Expenses	-	\$43	\$28	
MLR Numerator	-	\$882,028	\$388,351	(1)
Premium Earned	-	\$468,506	\$159,958	
less: Federal & State Taxes and Licensing or Regulatory Fees	-	\$(249,027)	\$(125,664)	
MLR Denominator	-	\$717,533	\$285,622	(2)
Preliminary MLR Before Credibility Adjustment	-	80.0%	85.0%	
Credibility Adjustment	-	-	-	(3)
Credibility Adjusted MLR	-	80.0%	85.0%	(4)
MLR Standard	80.0%	80.0%	85.0%	
Rebate Amount	-	\$0	\$0	(5)

<b>MLR Components (Washington)</b>	<b>Individual</b>	<b>Small Group</b>	<b>Large Group</b>	<b>Notes</b>
Adjusted Incurred Claims	-	\$16,950,193	-	
plus: Quality Improvement Expenses	-	\$102,902	-	
MLR Numerator	-	\$17,053,095	-	(1)
Premium Earned	-	\$24,423,248	-	
less: Federal & State Taxes and Licensing or Regulatory Fees	-	\$2,447,365	-	
MLR Denominator	-	\$21,975,883	-	(2)
Preliminary MLR Before Credibility Adjustment	-	77.6%	-	
Credibility Adjustment	-	3.5%	-	(3)
Credibility Adjusted MLR	-	81.1%	-	(4)
MLR Standard	80.0%	80.0%	85.0%	
Rebate Amount	-	\$0	-	(5)

## COMMENTS ON MEDICAL LOSS RATIO CALCULATION

### (1) Medical Loss Ratio Numerator

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

the Company 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 confirmation that the methodology complies with the narrative provided within Part 4 - Expense Allocation portion of the MLR Reporting Form and that it conforms to the definition of Healthcare Quality Improvement Expenses as defined by 45 CFR §158.150 and 45 CFR §158.151. Based on our review, the Company's allocation methodology and health care quality improvement expenses reported in the MLR numerator is reasonable and conforms to the regulations.

## (2) Medical Loss Ratio Denominator

According to 45 CFR §158.221(c), the denominator of the MLR calculation is comprised of premium revenue, as defined in 45 CFR §158.130, minus federal and state taxes and licensing and regulatory fees, as defined in 45 CFR §158.161(a) and 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 premium 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 the federal and state taxes and regulatory fees reported in the MLR denominator is reasonable and conforms to the regulations.

## (3) Credibility Adjustment

According to 45 CFR §158.232(a), an issuer's credibility adjustment is the product of the base credibility factor, as defined in 45 CFR §158.232(b), multiplied by the deductible factor, as defined in 45 CFR §158.232(c). The experience for the individual, small

group, and large group market segments was partially credible in the states of Arizona and California. In the state of Washington, which only offered the small group market segment, the experience was also partially credible. Therefore, a credibility adjustment was calculated for these market segments. In the states of Connecticut and New Jersey, which only offered small group and large group market segments, the experience was not credible. In the state of Florida, which only offered the large group market segment, the experience was also not credible. Therefore, no credibility adjustment was applicable for these market segments. Based on our review, the Company appropriately calculated the base credibility factor and the deductible factor, and conforms to the regulations.

#### (4) Credibility Adjusted Medical Loss Ratio

According to 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, the Company appropriately calculated the MLR for all market segments.

#### (5) Rebate Amount Calculation and Distribution

According to 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 MLR exceeded the minimum MLR standard for all market segments, and therefore, was not required to issue any rebates.

### 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 therefore, the Company was not required to issue rebate notices.

## MEDICAL LOSS RATIO INFORMATION NOTICE

According to Title 45 of the U.S. Code of Federal Regulations §158.251(a), a notice of Medical Loss Ratio (MLR) information is required when the MLR meets or exceeds the minimum percentage. Based on our review, the Company's MLR exceeded the minimum percentage for all market segments. The Company has appropriately issued the MLR information notices.

## 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). There were no rebates issued therefore, there was no impact on the RBC level.

## SUMMARY OF COMMENTS, FINDINGS, AND RECOMMENDATIONS

### Current 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/\_\_\_\_\_  
Jack Ho, CFE, CISA  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California