



**Axene Health Partners, LLC**  
Health Actuaries & Consultants  
[www.axenehp.com](http://www.axenehp.com)

**California Department of Insurance**

**Review Of Anthem Blue Cross 2010 Rate Increases**

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Presented by:**

**Axene Health Partners, LLC**

**David V. Axene, FSA, CERA, FCA, MAAA**  
**President and Consulting Actuary**  
*Email: david.axene@axenehp.com*

**John F. Fritz, FSA, MAAA**  
**Consulting Actuary**  
*Email: john.fritz@axenehp.com*

**David J. Bohmfalk, FSA, MAAA**  
**Consulting Actuary**  
*Email: david.bohmfalk@axenehp.com*

**Joshua W. Axene**  
**Assistant Actuary**  
*Email: josh.axene@axenehp.com*

**April 28, 2010**

---

**Axene Health Partners, LLC**  
**35067 Mahogany Glen Drive, Winchester, CA 92596**  
**951.294.0841 619.839.3980 fax**

# Review of Anthem Blue Cross 2010 Rate Increases

April 28, 2010

## Section I Executive Summary

At the request of Adam M. Cole, General Counsel of the California State Department of Insurance, we have been retained to review multiple Anthem Blue Cross (i.e., ABC) individual health insurance rate filings and determine whether or not these filings meet the requirements of the State's 70% lifetime loss ratio.

The scope of our review was defined as:

- Review current and recent Anthem rate filings to become familiar with them, the benefit plans, rating structure and methodologies used to develop rates and rate increases
- Review correspondence between the Department and Anthem regarding rates and rate filings
- Familiarize ourselves with extensive data provided to the Department by Anthem regarding these rates, rate filings, and rate increases
- Develop list of additional information needed from Anthem, communicate that to the Department, and request from Anthem
- Identify all key actuarial assumptions used by Anthem to prepare information for rate filing
- Evaluate all key actuarial assumptions
- Independently develop sample rates for validation and comparison to Anthem rates
- Validate Anthem calculations to determine appropriateness and accuracy
- Test rates to determine whether they meet loss ratio requirements of the Department (i.e., the 70% lifetime loss ratio rule)
- Clarify our understanding of Department's position on loss ratio testing and what elements can be included to satisfy the loss ratio requirements.
- Provide oral report as soon as information is available
- Communicate with the department on a regular basis as to progress on project and any interim findings
- Prepare written report for Department
- Present findings of report as directed by department (i.e., hearing, etc.)

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

We have accessed a significant number of materials for this review including multiple additional data requests from Anthem Blue Cross. This information was collected by the California Department of Insurance and provided by them to us for our analysis. We independently reviewed this information without direct communication with or explanation by Anthem Blue Cross staff. We developed multiple data requests and lists of questions that Anthem responded to. We do not have any concern about our understanding of the information. If any of the information we reviewed was incomplete or inaccurate, our findings and conclusions may be affected. We have assumed that the responses provided by Anthem Blue Cross are complete and accurate. We are not expressing an opinion about the accuracy of the information provided Anthem Blue Cross. We are not aware of any effort by Anthem Blue Cross to misrepresent any of the information we reviewed.

Our most significant findings are as follows:

- Anthem Blue Cross projection methodologies
  - Based upon a thorough review of Anthem's calculations we found several errors in Anthem's methodology used to project total lifetime loss ratios. Correcting these errors resulted in lower lifetime loss ratios than initially calculated by Anthem. Some of the errors created material differences, while others created more minor differences in total lifetime loss ratios.

The following errors were identified:

- Error #1(material): Double counting of aging in the calculation of underlying medical trend<sup>1</sup> for the projection of total lifetime loss ratio. Anthem developed product specific trend factors

---

<sup>1</sup> Underlying medical trend is an estimate of the rate of inflation health care costs will be subject to under these policies. This is a combination of both a utilization component and a unit cost component. Utilization refers to the rate at which individual insureds use the health care system. Unit cost refers to the increase in costs of specific items. The underlying medical trend is subject to a variety of adjustments to be appropriate for a specific health insurance product. Correcting for the errors described earlier, Anthem's underlying medical trend for this rate filing was 14% per year.

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

from its assumed underlying medical trend assumption of 19.8%.

This underlying trend assumption was to exclude:

- the effects of the aging of the insured population;
- the time elapsed since policy effective date (i.e. policy duration);
- any changes in the proportions of healthy vs. unhealthy lives remaining in the insured population due to the tendency that healthy lives lapse their policies sooner than unhealthy lives;
- the leveraging effect of fixed deductibles and copayment amounts on net benefit costs; and,
- changes in the distribution of the population by benefit mix.

It turns out that Anthem failed to remove the impact of aging which in essence resulted in an overstatement of the underlying medical trend. Additionally, there were several other errors in the trend calculation including not annualizing the measured trend. The combination of these errors including the aging, resulted in a reduction of the 19.8% underlying trend assumption to 16.7%. The 16.7% is the overall product weighted trend including deductible leveraging. Without deductible leverage, this corresponds to an underlying trend of 14.0%.

- Error #2(material): Anthem overstated the initial medical trend used to project claims for September 2009 for known risk factors. The approach Anthem used to calculate the trend factor to apply at the very beginning of their projection (i.e. to September 2009 from the base period June 2008 through May 2009) was incorrect and results in a material overstatement of trend, especially for newer plans such as Smart Sense and CDHP Non-Maternity. The correction results in a 7.6% reduction of the starting claims cost for SmartSense at Sept. 2009 and 4.0% reduction for CDHP Non-Maternity.

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

- Error #3(minor): Adjustment to weighted average number of months between successive periods used to obtain annual historical trend (i.e., used to project September 2009 – December 2009 claims). For SmartSense a specific formula error made this more significant.
- Error #4 (minor): Adjustment to weighted average number of months from base period to starting month (i.e., September 2009), rather than the assumed 9.5 months to project January 2009 and later claims.
- Error #5 (moderate): Combination of adjustments to reflect multiple changes in methodology to project more accurate results
  - Seasonality adjustment (e.g., CY deductible) based upon experience by plan
  - Re-estimation of September 2009 – December 2009 experience based upon seasonality-adjusted base period, rather than single month estimates
  - Alternative premium projection calculations based upon existing and new sales cohorts and modified premium trend approach
  - Alternative claims to premium relativity factors by duration based upon Anthem experience, including removing the re-widening of the claim to premium ratio for policy years 11+.
  - Discounting of incurred claims by an additional 0.5 months relative to premium
  - Other variations applicable to alternate scenarios
- We have no concerns in how Anthem structures their rates
- We have no concerns in how Anthem makes area rating adjustments
- We have no concerns regarding Anthem's use of underwriting rating tiers.
- We have no concerns regarding Anthem's age/gender slope for making rates

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

## Review of Anthem Blue Cross 2010 Rate Increases

April 28, 2010

- We have no concerns with Anthem's use of or selection of deductible leveraging factors
  - We have no concerns with Anthem's selection of lapse rate assumptions. We question whether the currently proposed and requested rate increases would result in comparable lapses. We confirmed that these lapse assumptions were consistent with Anthem's recent lapse study.
  - We have no concerns about the claims data used by Anthem in projections, and were able to reconcile claims data to that shown in their General Ledger.
  - We do have concerns about how initial Anthem Blue Cross rating structures are changed to new structures in subsequent years and the rate consequences that might occur on some policyholders (e.g., unisex rates changed to gender specific rates, rating structure changes, area factor changes, etc.). Some policyholders, as a result of the structure change, will experience significant rate increases above and beyond what might normally be expected. We have recommended incorporating a maximum rate increase that would apply whenever a rating structure changes, thus protecting policyholders from unusual rate increases.
- Total Lifetime Loss Ratio Projections
    - All products as filed by Anthem showed a projected total lifetime loss ratio greater than 70%
    - After correcting for Anthem Blue Cross methodological errors, the projected total lifetime loss ratios for all Anthem products is reduced from those levels presented by Anthem. As a result SmartSense total lifetime loss ratios are less than 70% putting this product out of compliance. All of the other products have reduced lifetime loss ratios but continue to be greater than 70%.
    - Assuming that the filed total lifetime loss ratio was a measure of an acceptable product performance level for Anthem, we have recalculated plan-specific rate increases for each plan that match the filed total lifetime loss ratio for each product. Each of these increases is smaller than requested as part of the initial filing as a result of the methodological corrections we have recommended.

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

The following table presents the reduced rate increases that match the filed total lifetime loss ratios included in the original rate filings by Anthem Blue Cross.

**Impact on Rate Increase of Matching Filed Total Lifetime Loss Ratio**

<b>Product</b>	<b>Initial LLR</b>	<b>Corrected LLR</b>	<b>Initial Rate Increase</b>	<b>Corrected Rate Increase</b>	<b>Difference</b>
SmartSense	75.19%	67.90%	22.7%	6.5%	-16.2%
Share	72.85%	70.60%	32.0%	22.7%	-9.3%
Right	73.80%	72.40%	29.1%	23.9%	-5.2%
Tonik	71.96%	70.50%	29.5%	24.5%	-5.0%
Saver	76.13%	73.20%	16.3%	4.7%	-11.6%
CDHP - with maternity	144.75%	138.00%	32.7%	23.5%	-9.2%
CDHP - without Maternity	78.94%	73.30%	12.3%	2.8%	-9.5%
3500	79.83%	75.50%	16.6%	7.4%	-9.2%
<b>Overall</b>	<b>76.39%</b>	<b>76.4%</b>	<b>25.4%</b>	<b>15.2%</b>	<b>-10.2%</b>

This table shows that Anthem Blue Cross could reduce their average rate increase by 10.2% and still achieve the Lifetime Loss Ratio they forecasted in their rate filing, once their methodology was corrected. The average rate increase was reduced from 25.4% to 15.2%.

- We independently developed key assumptions (i.e., referred to as Best Estimate assumptions later in this report) and used the corrected Anthem Methodology to project Total Lifetime Loss ratios based upon Anthem’s filed rate increases.
  - All products as filed show total lifetime loss ratios greater than 70%.
  - Assuming that the filed total lifetime loss ratio was a measure of an acceptable performance level for each plan for Anthem, we recalculated plan-specific rate increases for each plan that matched the filed total lifetime loss ratio. All of the products had a total lifetime loss ratio greater than 70% with the exception of SmartSense which puts it out of compliance. Each of these increases was smaller than requested as part of the filing.

**AHP Best Estimate Assumptions**

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled “confidential/trade secret” information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

**Impact on Rate Increase of Matching Filed Total Lifetime Loss Ratio**

<b>Product</b>	<b>Initial LLR</b>	<b>Corrected LLR</b>	<b>Initial Rate Increase</b>	<b>Corrected Rate Increase</b>	<b>Difference</b>
SmartSense	75.19%	67.6%	22.7%	5.8%	-16.9%
Share	72.85%	70.4%	32.0%	21.9%	-10.1%
Right	73.80%	72.2%	29.1%	23.2%	-5.9%
Tonik	71.96%	70.3%	29.5%	23.8%	-5.7%
Saver	76.13%	73.0%	16.3%	4.0%	-12.3%
CDHP - with maternity	144.75%	137.4%	32.7%	22.6%	-10.1%
CDHP - without Maternity	78.94%	72.9%	12.3%	2.1%	-10.2%
3500	79.83%	75.1%	16.6%	6.6%	-10.0%
<b>Overall</b>	<b>76.39%</b>	<b>72.3%</b>	<b>25.4%</b>	<b>14.5%</b>	<b>-10.9%</b>

Applying our recommended inflationary trend value of 13.5%, the other best estimate assumptions and correcting all of the methodological changes this suggests that Anthem Blue Cross could reduce their composite rate increase by 10.9% and still achieve the filed Lifetime Loss Ratio.

- The lower rate increases shown in the preceding table result in the same total lifetime loss ratios as were filed with the original Anthem rate filings. As mentioned elsewhere in this report, beginning with the 2010 rate filing, Anthem Blue Cross no longer presented their expense assumptions in the rate filing but presented the total Lifetime Loss Ratio. The complement of this loss ratio (i.e., 76.4% as filed) is 23.6%. This suggests that Anthem Blue Cross has agreed that they are willing and able to keep their expense and margins to 23.6%.
- We have analyzed the above assumptions and have characterized them in terms of a range of reasonable assumptions for each product. We have developed a “best estimate” assumption that was used in the AHP assumptions shown above. We have also developed “low” and “high” assumptions which define the range of reasonable assumptions from which Anthem could have selected its assumptions. The impact on calculations by using the “low” assumption is as follows:

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled “confidential/trade secret” information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*



**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

Applying the “low” assumptions for each product has the following impact on the AHP lifetime loss ratio:

**AHP “Low” Assumptions**  
**Impact on Rate Increase of Matching Filed Total Lifetime Loss Ratio**  
**(correcting double counting of aging, computational errors)**

<b>Product</b>	<b>Initial LLR</b>	<b>Corrected LLR</b>	<b>Initial Rate Increase</b>	<b>Corrected Rate Increase</b>	<b>Difference</b>
<b>SmartSense</b>	75.19%	64.9%	22.7%	2.7%	-20.0%
<b>Share</b>	72.85%	69.4%	32.0%	17.0%	-15.0%
<b>Right</b>	73.80%	70.8%	29.1%	17.7%	-11.4%
<b>Tonik</b>	71.96%	68.4%	29.5%	18.1%	-11.4%
<b>Saver</b>	76.13%	71.6%	16.3%	-2.6%	-18.9%
<b>CDHP - with maternity</b>	144.75%	131.7%	32.7%	15.5%	-17.2%
<b>CDHP - without Maternity</b>	78.94%	68.5%	12.3%	-4.9%	-17.2%
<b>3500</b>	79.83%	71.8%	16.6%	-0.2%	-16.8%
<b>Overall</b>	76.39%	70.0%	25.4%	8.9%	-16.5%

Four products fall below the 70% threshold putting them out of compliance. However, the composite overall lifetime loss ratio for these products is 70.0%. The file rate increase drops by 16.5% to a composite of 8.9% compared to the 14.5% value for our best estimate.

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled “confidential/trade secret” information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

Applying the “high” assumptions for each product has the following impact on the AHP lifetime loss ratio:

**AHP “High” Assumptions**  
**Impact on Rate Increase of Matching Filed Total Lifetime Loss Ratio**  
**(correcting double counting of aging, computational errors)**

<b>Product</b>	<b>Initial LLR</b>	<b>Corrected LLR</b>	<b>Initial Rate Increase</b>	<b>Corrected Rate Increase</b>	<b>Difference</b>
SmartSense	75.19%	72.0%	22.7%	14.9%	-7.8%
Share	72.85%	71.1%	32.0%	25.0%	-7.0%
Right	73.80%	74.4%	29.1%	31.3%	+2.2%
Tonik	71.96%	72.9%	29.5%	33.2%	+3.7%
Saver	76.13%	74.7%	16.3%	10.9%	-5.4%
CDHP - with maternity	144.75%	144.1%	32.7%	31.8%	-0.9%
CDHP - without Maternity	78.94%	72.9%	12.3%	33.2%	19.9%
3500	79.83%	77.9%	16.6%	12.4%	-4.2%
<b>Overall</b>	<b>76.39%</b>	<b>74.7%</b>	<b>25.4%</b>	<b>21.1%</b>	<b>-4.3%</b>

None of the products fall below the 70% threshold. The composite overall lifetime loss ratio for these products is 74.7%. Even though this is a “high” scenario, the filed rate increase still drops by 4.3%. The filed rate increase of 25.4% drops to 21.1%.

- We have developed year by year projections of the total lifetime loss ratio showing the transition of loss ratios from today through the end of the policy lifetime included in the projections of each product. This is included in Appendix M. This can be used to show the emergence of overall loss ratio levels over the policy’s anticipated lifetime.

Following this Executive Summary, Section II provides critical background information regarding the pricing of individual health insurance products. Section III provides information about the key issues affecting all of the policy forms. Section IV presents our assessment of each of the products and whether it met the 70% lifetime loss ratio. Section V presents important information on related questions and considerations.

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled “confidential/trade secret” information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

**Review of Anthem Blue Cross 2010 Rate Increases**  
**April 28, 2010**

Multiple Appendices have been included which will elaborate on discussions presented elsewhere in this report.

We would like to recognize the valuable assistance provided by the Department of Insurance Staff and the thorough responses by Anthem Blue Cross actuarial staff to our multiple requests for additional information. Without this help we would not have been able to complete this review within the required timeframe.

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*

*This report has been prepared for the exclusive use of the California Department of Insurance and we have provided it only to them. This report includes material and references to material that has been labeled "confidential/trade secret" information by Anthem when initially submitted to the California Department of Insurance. It is critical that this report be reviewed in its entirety to assure that no conclusion or assessment is taken out of context.*