In the Literature

Highlights from Commonwealth Fund-Supported Studies in Professional Journals

Impact of Medical Loss Regulation on the Financial Performance of Health Insurers

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Synopsis

For-profit insurers operating in the individual health insurance market increased their spending on medical claims and quality improvement, reduced premiums, or both, resulting in a significant rise in the median "medical loss ratio"—a measure of spending on care and quality improvement relative to premiums earned—from 2010 to 2011. Other changes in the financial performance of both for-profit and nonprofit insurers in the individual, small-, and large-group markets were less notable.

The Issue

Under a provision of the Affordable Care Act, health insurers are required to devote at least 80 percent of the premiums collected for individual and small-group plans, and at least 85 percent of those for large-group plans, to health care and quality improvement—rather than to overhead or profits. Insurers failing to meet this minimum level must provide rebates to their customers; nonprofit insurers also may risk losing their favored tax status. A Commonwealth Fund–supported study tracked the early effects of the new "medical loss ratio" regulation on the nation's insurers by examining changes in their financial performance from 2010—the year before the rule went into effect—to 2011.

> "For-profit insurers offering individual insurance increased their medical claims and quality improvement expenses, reduced their premiums, or both."

Key Findings

The researchers examined three indicators: the net adjusted *medical loss ratio*, defined as total claims plus expenses for quality improvement as a percentage of premiums earned; the *administrative cost ratio*, or total administrative expenses and claims adjustment expenses as a percentage of net

adjusted premiums earned; and the *operating margin*, or the percentage of pretax operating income earned from net adjusted premiums. Here's what they found:

- Changes in financial performance were most apparent in the individual market, where the median medical loss ratio increased by 5.5 percentage points from 2010 to 2011. The median administrative cost ratio declined by 2.6 percentage points, and the median operating margin declined by 1.3 percentage points.
- Within the individual market, such changes were most notable among for-profit insurers. These insurers increased spending on medical claims and quality improvement, reduced premiums, or both, raising their median medical loss ratio from 71.8 percent in 2010 to 79.0 percent in 2011—much closer to the required minimum level.
- Changes in profitability were also noteworthy. In the individual market, operating margins declined from 1.2 percent in 2010 to near the break-even point in 2011. But in the small- and large-group markets, median operating margins in 2011 were 3.6 percent and 1.8 percent, respectively—similar to those in 2010.

Addressing the Problem

The findings, while based on just one year's worth of data, suggest that the Affordable Care Act's medical loss ratio regulation has had some effect on insurers' actions in the individual market. Further analysis would help ascertain whether changes in insurers' financial performance are related to the new rule or to other regulatory factors and market conditions.

About the Study

The researchers examined standardized data reported by health insurers on premiums, medical claims, quality improvement expenses, administrative costs, and underwriting gains and losses. The analysis examined changes across market sectors for both for-profit and nonprofit insurers; in all, it included 1,219 insurers in the individual market, 804 in the small-group market, and 750 in the large-group market.

The Bottom Line

Although insurers overall reduced their administrative costs in the individual, small-group, and large-group markets from 2010 to 2011, this reduction appears to be linked to the new minimum medical loss ratio only among for-profit insurers in the individual market. In the other cases, insurers' medical loss ratios were closer to the regulatory minimum in 2010, and their reduced administrative costs appear to have been absorbed, at least partially, by small increases in profits.

Citation

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