



**Report of the
Commissioner of Insurance**

**To
The Colorado General Assembly**

**On
Rating Flexibility**

Pursuant to CRS 10-16-105(8.7)

January 15, 2007

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Introduction and Statutory Authority

To evaluate the affect of the rating flexibility enacted in 2003, the Legislature requested the Colorado Division of Insurance to conduct a study and report to the General Assembly on the impact of:

- Rating flexibility based on claims experience and application of rating flexibility on small business groups of one to small employers with no more than fifteen employees, as compared to the impact of small employers with sixteen or more employees.
- Rating flexibility on the size and stability of the small group market.
- Rating flexibility on the aggregate health status of the small group market, including, but not limited to, whether the risk profile of the small group market improved because of the implementation of §10-16-105(8.5), Colorado Revised Statutes, rating flexibility.
- The number of small employer groups whose premiums are at or below the index rate and the number of small employer groups whose premiums are above the index rate.

See 10-16-105(8.7), Colorado Revised Statutes.

To perform this analysis, the Colorado Division of Insurance surveyed the carriers offering small group products in Colorado and prepared this report. A copy of the survey instrument is attached in the Appendix.

In addition, for comparison purposes, the Division also utilized the annual Small Group Activity Reports which are available for 2000 through present on the Division's website at www.dora.state.co.us/insurance under the "Publications" button. The Small Group Activity Reports include information on aspects of the small group marketplace including small group premiums, numbers of individuals in various classes or covered by specific products, etc.

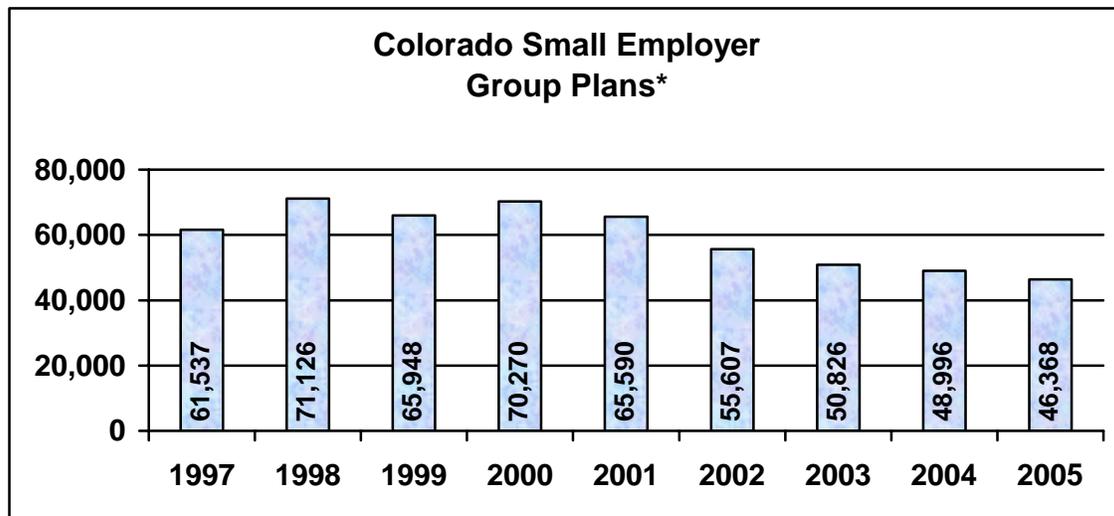
History and Background

In 1993, the Colorado General Assembly enacted a health insurance program focused on improving access to health insurance for small employers and to remediate problems occurring in the small group market (HB94-1210). Among the hallmarks of this legislation was the phased-in establishment of the small group market as applying to employers from sole proprietors through those with 50 employees, and requiring both guaranteed access to certain benefit packages offered by carriers (the original Standard and Basic benefit designs) and imposing modified community rating on small group policies by 1998. Under the HB94-1210 modified community rating schema beginning January 1, 1998, premiums for benefit packages could vary from a standardized rate (the index rate), only by age, family composition, geographic area and the specific plan design selected.

Between the 1994 small group reforms through the initiation of modified community rating in 1998, Colorado's small group market increased from 25,381 groups and 413,643 individuals to 71,126 groups and 536,367 individuals. In 1999, the General Assembly enacted SB99-124 commissioning the University of Northern Colorado to examine the impact of HB94-1210. This report found that the reforms initiated under HB94-1210 had increased both the access to and coverage under small group plans significantly – 16.82% growth in groups covered and 1.31% in lives covered between 1996 and 1998.¹

In 1999, both the numbers of small groups and covered lives took a small dip before reaching their peak in 2000. Since 2000, there has been steady erosion of the number of groups and covered lives in the small group market.

Exhibit 1

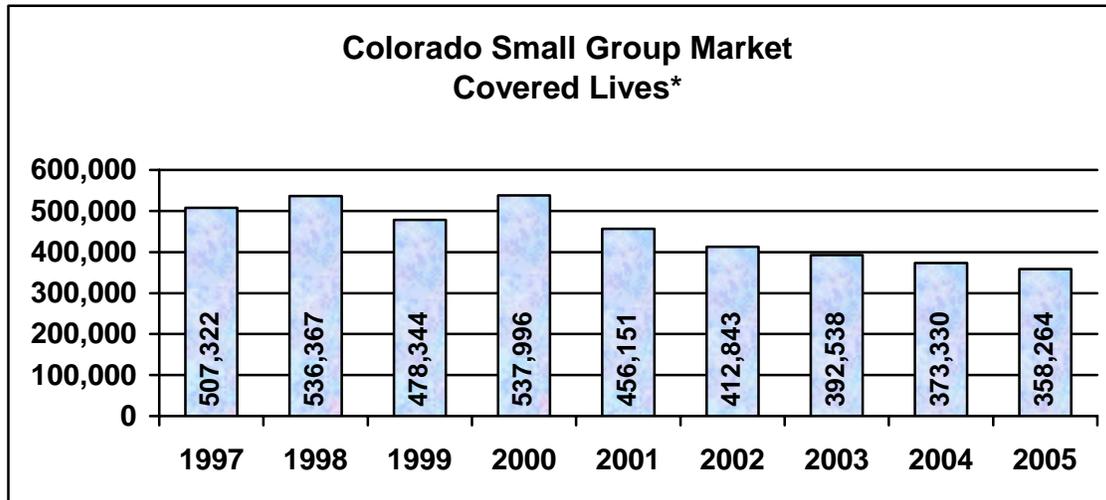


Source: Colorado Division of Insurance (4/12/06)

*As of December 31, 2005

¹ Report to the Colorado Legislature, Senate Bill 99-124, "Small Group Health Insurance Reform," Kenneth W. Monfort College of Business, University of Northern Colorado, at iii.

Exhibit 2



Source: Colorado Division of Insurance (4/12/06)

*As of December 31, 2005

In part to stem the deterioration of the small group market, in 2003, the General Assembly enacted a bill providing some rating flexibility in the small group market. Under HB03-1164, the “case characteristics” that a carrier can use to establish a group’s premium rate added smoking status, claims experience, standard industrial classification, and health status, *see* §10-16-102(10(b)(IV – VII), Colorado Revised Statutes. Using these case characteristics, carriers are permitted to vary group premiums from the modified community rate by:

- For plans between September 1, 2003 until September 29, 2004, a decrease of up to 15% from the filed rate; and
- After September 30, 2004, between an increase of up to 10% above the filed rate and 25% below the filed rate, except that the annual increase from year to year due to claims experience, health status, standard industrial classification or tobacco use for the group cannot exceed 15%.

See 10-16-105(8.5), Colorado Revised Statutes.

Analysis

A. Impact of the Application of Rating Flexibility on Small Groups

How Small Group Premiums Were Set Prior to Rating Flexibility

Insurance premiums for small employers and their employees are established through a carrier's "base premium rate" defined as, for a rating period, "the lowest premium rate charged or that could have been charged by the small employer carrier to small employers with similar case characteristics for health benefit plans subject to state regulation." §10-16-102(3), Colorado Revised Statutes. The arithmetic average of the applicable base premium rate and the corresponding highest premium rate for small employers with similar case characteristics is the "index rate." §10-16-102(25), Colorado Revised Statutes. This is the rate all small group carriers are to charge to small employers, adjusted for case characteristics of age, geographic area and family composition, §10-16-105(8)(e), Colorado Revised Statutes, and for plan design, §10-16-105(8)(f)(I), Colorado Revised Statutes.

Rates for each insured employee in a small group are based on the carrier's index rate. This rate can be thought of as a base rate for employers and the index rate varies by the particular plan design selected by the employer and the geographic area in which the employer's business is located. The premium for each particular employee will vary by the employee's age and family size. The final rate charged an employee is the product of the Index Rate times the plan factor for the plan selected (plan design), times the factor based on the employee's age and the family size, times the geographic factor for the area of the state in which the employer's business is located. Section 4(A) of Regulation 4-6-7 defines this rate to be the "filed rate." The final rate charged a small group is the sum of the filed rates for each of the small group's employees.

Additional Factors under Rating Flexibility

Beginning on September 1, 2003, the rating flexibility provisions allowed small employer carriers to make an adjustment in the final rate charged a small group based on the following additional criteria: claims experience, health status and standard industrial classification (SIC). §10-16-105(8.5)(a)(I)(A), Colorado Revised Statutes. The rating factor based on these criteria is called the rate adjustment factor or RAF. This section also allows carriers to adjust a group's rates based on the tobacco use of the group. §10-16-105(8.5)(a)(I)(B), Colorado Revised Statutes.

As noted, we surveyed the 21 carriers with covered lives in the small group market as of September 30, 2006. None of the carriers are adjusting rates based on the tobacco use of the group. For the other factors, more companies (11) use claims experience and health status than use all three factors (5), claims experience only (2), or who don't utilize these additional RAFs at all (3).

Figure 1 – Number of Carriers Utilizing RAFs



Range of Variance Utilizing RAFs

The statute providing rating flexibility by use of the additional factors imposed constraints on the amount of variance to which a small employer could be subject. The amount of permissible deviation from a carrier’s final rate is as follows:

For the period September 1, 2003 until September 29, 2004 - small employer carriers were allowed to decrease the final rate charged a small group by a maximum of 15% by use of these criteria. The final rate charged was 85% to 100% of the rate without these permissible adjustments, i.e., the allowable range for the RAF was (.85 – 1.00).

Beginning September 30, 2004 - small employer carriers could increase the final rate charged a small group up to 10% and decrease the final rate charged by no more than twenty-five percent by use of these criteria. The final rate charged had to be 75% to 110% of the rate without these permissible adjustments, i.e., the allowable range for the RAF was (.75 – 1.10)

On and after September 1, 2004 - small employer carriers could adjust the small group’s renewal rate by a maximum of 15% over the prior rate based on these criteria.

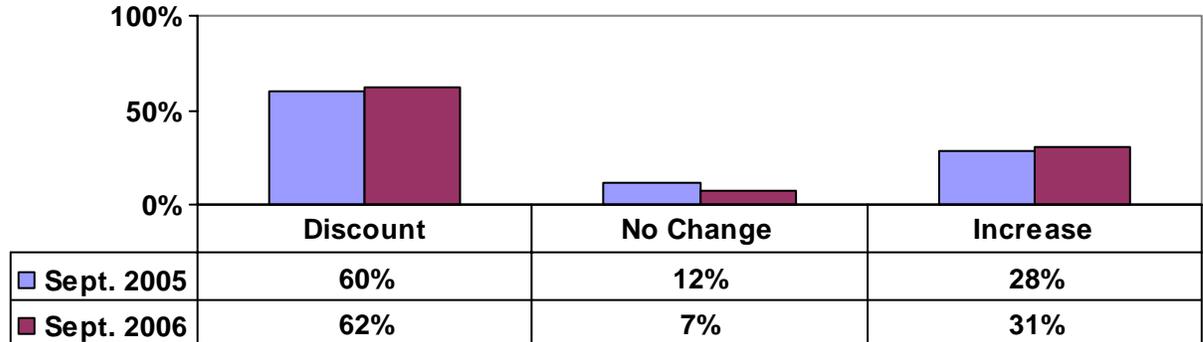
Carriers are not allowed to adjust the final rate charged based on the size of the small employer group. The RAF must be independent of the size of the small group.

Of the 18 carriers utilizing RAFs in setting their rates for small employers, 17 used the entire permissible range (.75 – 1.10) to establish the final rate charged a small group. One carrier utilized the range .85 – 1.10, but has subsequent to the survey begun using the entire permissible range. Seven of the eighteen carriers began using the RAF methodology at the first permitted opportunity of September 1, 2003.

Effect of RAFs

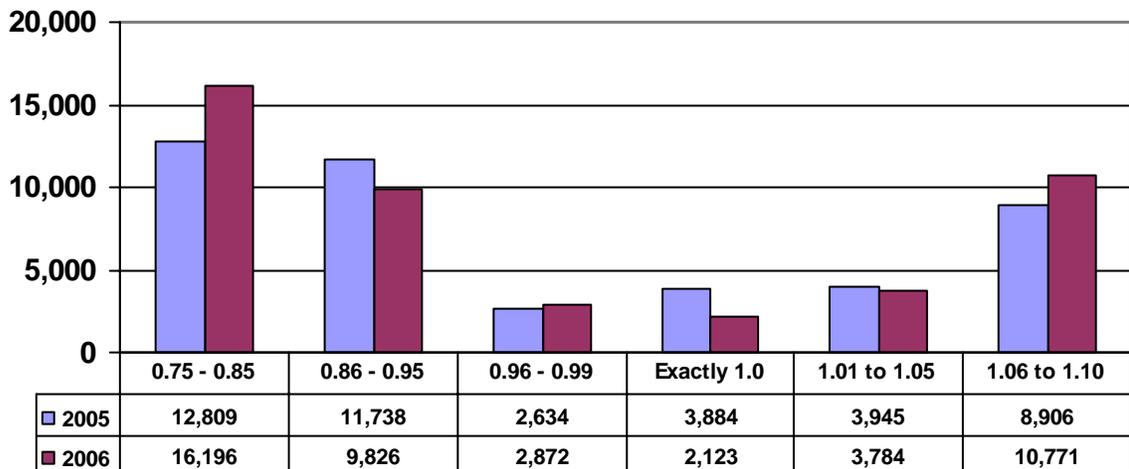
In practice, by a margin of two to one, small employers in aggregate received a rating discount under the RAF methodology and application.

Figure 2 – Overall Application of RAFs



In 2006, 35.64% of small groups received a discount of between 15% and 25% utilizing the RAFs, while another 21.56% received a discount of between 5% and 15%. In contrast, 23.64% received an increase of between 6% and 10%, and 8.66% received a 1% to 5% increase. Generally, we have seen movement away from the center or index point and to the end points comparing 2005 to 2006.

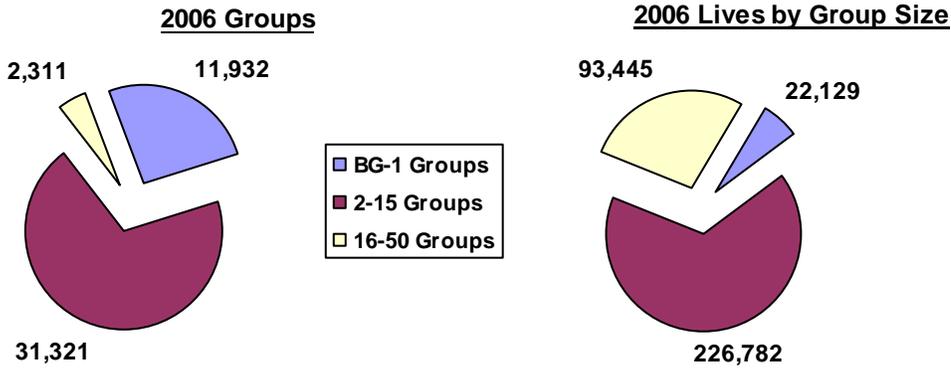
Figure 3 – Small Groups Arrayed by Application of Rating Flexibility



The small group market is made up of 3 size groupings of employers – Business Groups of One (BG-1s), two to fifteen employees (2-15), and sixteen to fifty employees (16-50). The greatest part of this market is groups from 2 to 15 which represent approximately

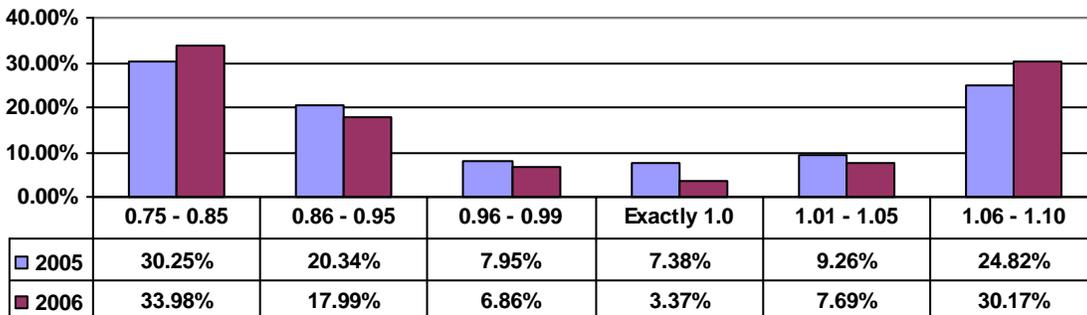
70% of the groups and 65% of the lives. BG-1s are about 25% of the groups but only about 6.5% of the small group lives. Groups with between 16 and 50 employees make up only about 5% of the groups, but 28% of the lives.

Figure 4 – Component Categories of Small Group Market



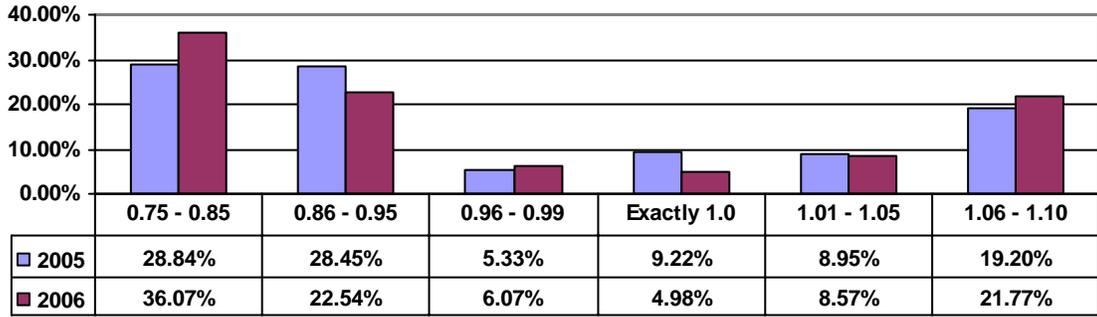
Looking at the component groups of the small group market, Business Groups of One (BG-1), two to fifteen employees (2-15), and sixteen to fifty employees (16-50), we see the trend remains the same across the various size groups.

Figure 5 – RAFs Applied to BG-1s



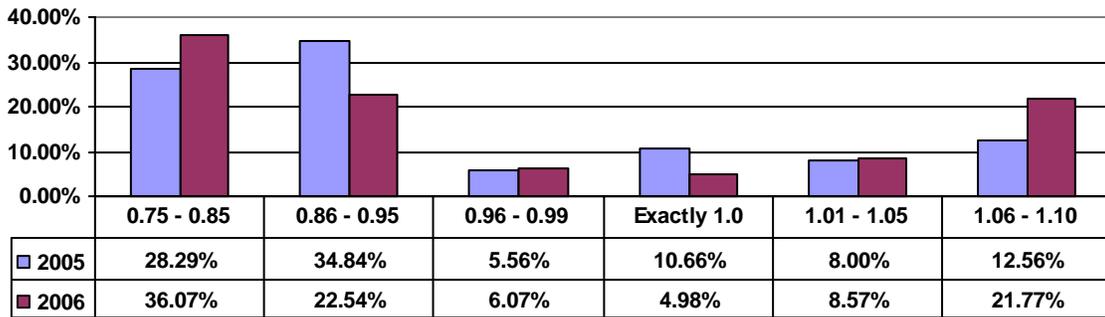
* Totals may not add to 100% due to rounding.

Figure 6 – RAFs Applied to 2-15 Employee Groups



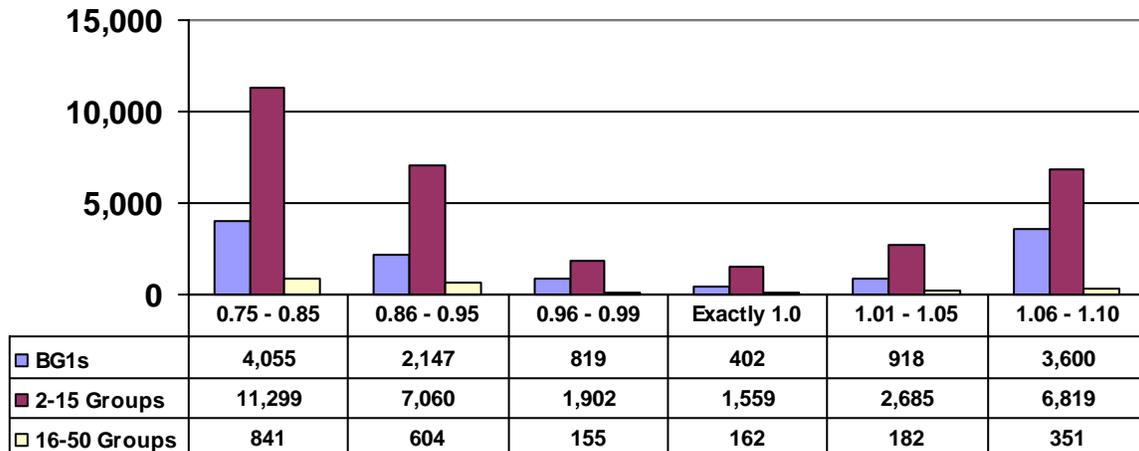
*Totals may not add to 100% due to rounding.

Figure 7 – RAFs Applied to 16-50 Employee Groups



*Totals may not add to 100% due to rounding.

Figure 8 – 2006 RAFs by Group Size



B. Impact of Rating Flexibility on the Size and Stability of the Small Group Market

As noted in the Section on History and Background, there has been steady erosion in the small group market in Colorado from 2000 through 2005. From the survey conducted for this report, it appears that there may be a slight “uptick” in the number of groups and covered lives in the small group market in 2006.

Prior to the institution of rating flexibility in 2003, the rate of decline in the small group market was substantial. After rating flexibility was put in place, the rate of decline moderated, and between year-end 2005 and September 2006 the rate of change went to positive from negative. Between September 30, 2005 and September 30, 2006, there was an increase of 1,289 groups and 11,047 lives in the small group market, further evidencing that the small group market may have stabilized and show an increase at year end 2006.

Figure 9 – Number of Small Groups 1996 to Sept. 2006

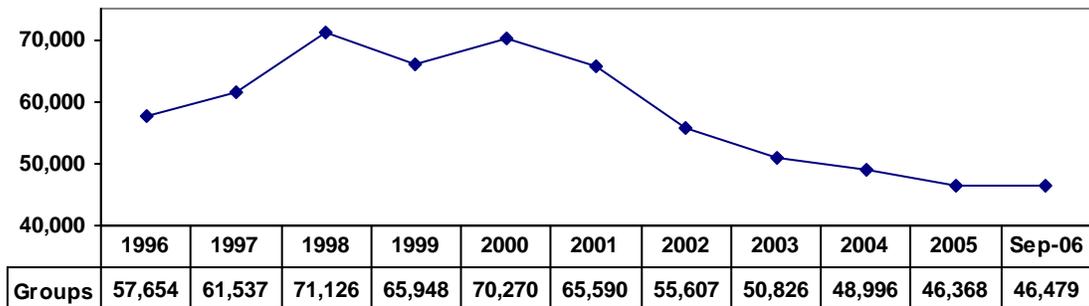


Figure 10 – Number of Covered lives in Small Group Market 1996 to Sept. 2006

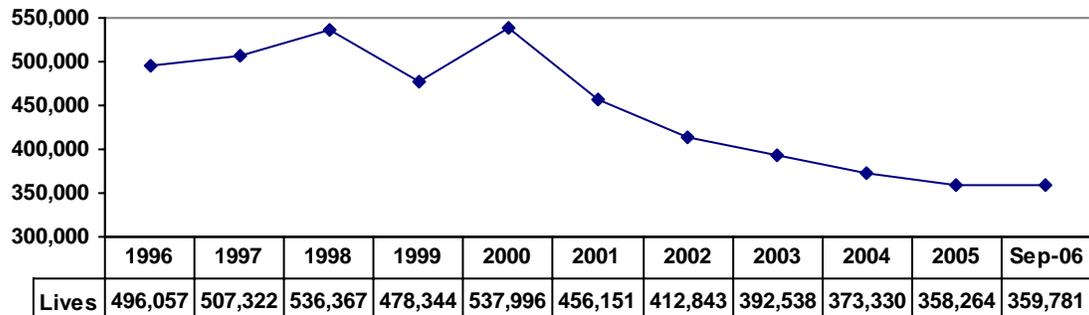
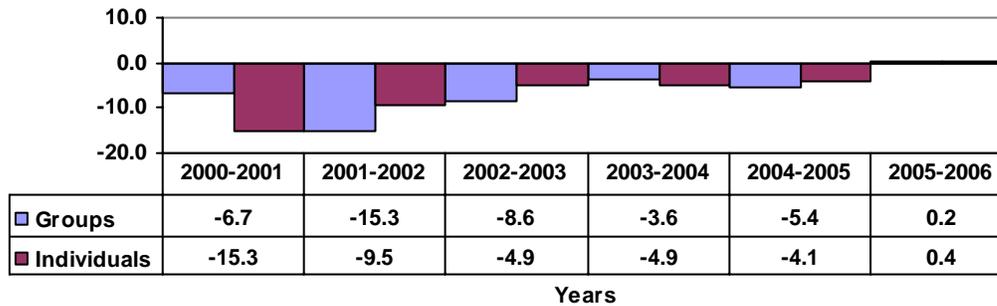


Figure 11 – Annual Rate of Change in Number of Small Groups in Market 2000 to 2006



C. Effect of Rating Flexibility on Aggregate Health Status of the Small Group Market and Number of Groups with a Discount, at the Index Rate, and with an Increase Under Rating Flexibility

To evaluate the change in the aggregate health status of the small group market, we evaluated the number of small groups which received a discount based on the RAFs compared to the number of groups which received an increase. By this measure, the aggregate health status of the market has declined. Between 2005 and 2006, 1,713 groups received a RAF discount while 1,704 received an increase. This represents a 6% increase in the number receiving a discount, but a 12% increase in those receiving an increase. In addition, the ratio of groups receiving a discount to those receiving an increase dropped from 2.12 to 1.99.

Figure 12 – Chart of Groups Receiving Discount, At Index, or Receiving Increase Under Rating Flexibility 2005 and 2006

	Groups Receiving RAF Discount	Groups at RAF of 1.0	Groups Receiving RAF Increase	Ratio of Groups With Discount to Increase
2005	27,181	3,884	12,851	2.12: 1
2006	28,894	2,123	14,555	1.99: 1
Difference 2006 to 2005	1,713	(1,761)	1,704	
Percent Change between 2005 to 2006	6%	(54%)	12%	

D. Carrier Perception of Rating Flexibility

To ascertain how small group carriers perceive the effect of rating flexibility on their business and the small group market, we queried the carriers as follows:

Please answer yes or no. In your opinion, has the rating flexibility allowed under §10-16-105(8.5)

- 1) attracted more new small groups to your Company?
- 2) improved the overall risk profile of your small group cohort, compared to the profile prior to the implementation of this section?
- 3) created more stability in the small group market:
- 4) increased your willingness to either remain in the small group market, or to expand your writings?

See Appendix A, Questions 13 to 17.

- The responses from 17 of the 21 carriers responding to the survey were used in this analysis. The responses from three carriers were not used because they do not use RAFs and the responses from one carrier were omitted because that carrier is not actively involved in the small group market.
- Thirteen out of seventeen carriers (13/17) reported that the rating flexibility allowed under §10-16-105(8.5) has “attracted more new small groups to your Company.”
- Eleven out of seventeen carriers (11/17) reported that the rating flexibility allowed under §10-16-105(8.5) has “improved the overall risk profile of your small group cohort, compared to the profile prior to the implementation of this section.”
- Thirteen out of seventeen carriers (13/17) reported that the rating flexibility allowed under §10-16-105(8.5) has “created more stability in the small group market.”
- Sixteen out of seventeen carriers (16/17) reported that the rating flexibility allowed under §10-16-105(8.5) has “increased your willingness to either remain in the small group market, or to expand your writings.”

Conclusions

Rating flexibility utilizing the additional rating factors of claims experience, health status, and standard industrial code have been available in the Colorado small group marketplace on a phased-in basis since September 2003. The Colorado Division of Insurance surveyed carriers as to their use of RAFs at the end of the first year that they could be fully utilized (September 2005) and again a year later (September 2006).

The following conclusions can be drawn from analysis of these survey results:

1. The small group market has been eroding or declining since 2000 but has shown a slight increase in both the number of groups and covered lives between year-end 2005 and September 2006. To determine whether this trend will continue, the Division will track these numbers through the 2006 Small Group Activity Report which will be available in Spring 2007.
2. Each market segment reviewed in this analysis shows very similar results in the percentages of small groups whose rates were discounted and issued at a premium on 9/30/05 and 9/30/06. A little over 60% of these groups received a discount and about half of that number of groups, or almost 30%, were rated up on 9/30/05 and 9/30/06. Between 2005 and 2006, there was movement of both groups and lives to the minimum and maximum RAF-adjusted premium amounts (0.75 to 1.10 of the index rate).
3. The aggregate health status of the small group market as measured by the number of groups with a discount, at a RAF of 1.0, and with an increase under rating flexibility shows a slight worsening.
4. Carriers perceive that the ability to use RAFs and rating flexibility has attracted new small groups to them, improved the overall risk profile of small groups, created stability in the small group market, and increased the carriers' willingness to remain and expand their participation in the small group market.

Appendix

Small Group Survey

This survey pertains to the rate adjustment factors permitted to be used in setting small group rates by §10-16-105(8.5), C.R.S. Please have the actuary responsible for your small group rate filings, or his/her designee complete the survey. This is important as the questions involve some research and a good understanding on the development of your small group rates.

Indicates required field

Company Name:	(Click here to choose) ▼
NAIC Number	
Preparer's Name	
Preparer's Title	
Preparer's Phone Number	
Preparer's fax Number	
Address	
Address Continued	
City	
State	(Click here to choose) ▼
Zip	

	On 9/30/05	On 9/30/06
1. What was your Company's total number of small group plans in effect		
2. What was the total number of covered lives in all of your Company's small group plans		
3. What was the total number of health savings account qualifying high deductible plans sold to small groups during the period 10/1/04 - 9/30/05?		
4. What was the total number of health savings account		

qualifying high deductible plans sold to small groups during the period 10/1/05 - 9/30/06?

5. Does your Company utilize the small group rate adjustment factors permissible under §10-16-105 (8.5), C.R.S.?

Yes No

If the answer to this question is no, you need not complete the remainder of this survey, but do need to certify and submit this survey.

6. Which of the permitted criteria does your Company use (claims experience, health status, and/or standard industrial classification)?

7. When did you first file to begin using these adjustments?

On 9/30/05 On 9/30/06

8. What was the range of your filed adjustments

9. Please complete this table for all of your small group plans (SGs)

	On 9/30/05	On 9/30/06
Total number of SGs in effect	<input type="text"/>	<input type="text"/>
Total number of lives covered under all SGs in effect	<input type="text"/>	<input type="text"/>
Total number of SGs rated with an RAF in the range of (.75 - .85)	<input type="text"/>	<input type="text"/>
Total number of SGs rated with an RAF in the range of (.86 - .95)	<input type="text"/>	<input type="text"/>
Total number of SGs rated with an RAF in the range of (.96 - .99)	<input type="text"/>	<input type="text"/>
Total number of SGs rated with an RAF of exactly 1.0	<input type="text"/>	<input type="text"/>
Total number of SGs rated with an RAF the in range of (1.01 - 1.05)	<input type="text"/>	<input type="text"/>
Total number of SGs rated with an RAF in the range of (1.06 - 1.10)	<input type="text"/>	<input type="text"/>

10. Please complete this table for all of your business group of one plans (BG1s)

	On 9/30/05	On 9/30/06
Total number of BG1s in effect	<input type="text"/>	<input type="text"/>
Total number of lives covered under all BG1s in effect	<input type="text"/>	<input type="text"/>

Total number of BG1s rated with an RAF in the range of (.75 - .85)	<input type="text"/>	<input type="text"/>
Total number of BG1s rated with an RAF in the range of (.86 - .95)	<input type="text"/>	<input type="text"/>
Total number of BG1s rated with an RAF in the range of (.96 - .99)	<input type="text"/>	<input type="text"/>
Total number of BG1s rated with an RAF of exactly 1.0	<input type="text"/>	<input type="text"/>
Total number of BG1s rated with an RAF in the range of (1.01 - 1.05)	<input type="text"/>	<input type="text"/>
Total number of BG1s rated with an RAF in the range of (1.06 - 1.10)	<input type="text"/>	<input type="text"/>
The average RAF for all BG1s (Include plans with an RAF of 1.0)	<input type="text"/>	<input type="text"/>
The average RAF in effect for all SGs (Include SGs with an RAF of 1.0)	<input type="text"/>	<input type="text"/>

11. Please complete this table for your small group plans issued to small groups with 2 - 15 employees (2-15 plans)

	On 9/30/05	On 9/30/06
Total number of (2-15 plans) in effect	<input type="text"/>	<input type="text"/>
Total number of lives covered under all (2-15 plans) in effect	<input type="text"/>	<input type="text"/>
Total number of (2-15 plans) rated with an RAF in the range of (.75 - .85)	<input type="text"/>	<input type="text"/>
Total number of (2-15 plans) rated with an RAF in the range of (.86 - .95)	<input type="text"/>	<input type="text"/>
Total number of (2-15 plans) rated with an RAF in the range of (.96 - .99)	<input type="text"/>	<input type="text"/>
Total number of (2-15 plans) rated with an RAF in the range of (1.01 - 1.05)	<input type="text"/>	<input type="text"/>
Total number of (2-15 plans) rated with an RAF in the range of (1.06 - 1.10)	<input type="text"/>	<input type="text"/>
The average RAF for all (2-15 plans) (Include plans with an RAF of 1.0)	<input type="text"/>	<input type="text"/>

12. Please complete this table for your small group plans issued to small groups with 16 - 50 employees (16-50 plans)

	On	On
<input type="text"/>	<input type="text"/>	<input type="text"/>

	9/30/05	9/30/06
Total number of (16-50 plans) in effect	<input type="text"/>	<input type="text"/>
Total number of lives covered under all (16-50 plans) in effect	<input type="text"/>	<input type="text"/>
Total number of (16-50 plans) rated with an RAF in the range of (.75 - .85)	<input type="text"/>	<input type="text"/>
Total number of (16-50 plans) rated with an RAF in the range of (.86 - .95)	<input type="text"/>	<input type="text"/>
Total number of (16-50 plans) rated with an RAF in the range of (.96 - .99)	<input type="text"/>	<input type="text"/>
Total number of (16-50 plans) rated with an RAF exactly of 1.0	<input type="text"/>	<input type="text"/>
Total number of (16-50 plans) rated with an RAF in the range of (1.01 - 1.05)	<input type="text"/>	<input type="text"/>
Total number of (16-50 plans) rated with an RAF in the range of (1.06 - 1.10)	<input type="text"/>	<input type="text"/>
The average RAF for all (16-50 plans) (Include plans with an RAF of 1.0)	<input type="text"/>	<input type="text"/>

In your opinion, has the rating flexibility allowed under §10-16-105(8.5)

13. Attracted more new small groups to your Company?

- Yes
 No

14. Improved the overall risk profile of your small group cohort, compared to the profile prior to the implementation of this section?

- Yes
 No

15. Created more stability in the small group market?

- Yes
 No

16. Increased your willingness to either remain in the small group market, or to expand your writings?

- Yes
 No

17. Other Comments?

I, , do hereby certify that the following information provided is true and correct.

Submit

Reset