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Medigap Insurance: Update on Regulation Under the Baucus Amendment

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Subcommittee on Commerce,
Consumer Protection,
and Competitiveness
Committee on Energy and Commerce
House of Representatives

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SUMMARY

In June 1980, the Congress enacted a provision of law, commonly known as the Baucus Amendment, that established minimum requirements for state regulation of insurance policies marketed to the elderly as Medicare supplemental, or Medigap, policies. These requirements included standards for benefits and loss ratios. The loss ratio of an insurance policy is the percentage of earned premiums returned to policyholders for claims or added to claim reserves. It is sometimes considered a measure of the policy's economic value.

Our review of Medigap insurance regulation included 11 states and the District of Columbia. We reviewed state laws and regulations concerning Medigap insurance, obtained financial information covering 1984 and earlier years for 394 individual and 4 group policies, and reviewed 142 insurance policy forms authorized for sale in the states. We later updated the financial data to cover 1985 for 62 policies.

We concluded that:

-- The Baucus Amendment was meeting its objectives. All but four states now have Medigap insurance regulations at least as stringent as the federal standards.

-- Although all is not perfect with sales of Medigap policies, the elderly have better protection against substandard and overpriced policies than before the Amendment was enacted.

-- A Medicare beneficiary can buy a Medigap policy in the states that have adopted the Baucus Amendment standards with reasonable assurance that the policy will comply with the minimum standards, but benefits of existing Medigap policies vary widely, and a policyholder may still face significant out-of-pocket costs. We believe our work demonstrates that it is important for consumers to shop carefully to find the policy with coverage benefits that fit their needs at a reasonable price.

-- The actual loss ratios of most policies we obtained data on were below the Baucus Amendment targets of 60 percent for policies sold to individuals and 75 percent for group policies. The policies offered by most of the Blue Cross/Blue Shield plans and the Prudential Life Insurance Company had loss ratios above the targets, and these were the policies most commonly purchased. For 1985, the loss ratios of the policies we obtained data on were basically the same as for 1984, changing by only a few percentage points.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the report that we prepared last year on the federal standards designed to protect the elderly from substandard and overpriced Medigap insurance policies. That report,[1] done at the request of the Subcommittee on Health, House Committee on Ways and Means, focused on how well the objectives of the standards were being met in view of what was envisioned when they were enacted in 1980.

Overall, we concluded that, although abuses in the sale of Medigap policies still occurred and many individual policies continued to return a relatively low percentage of premiums as benefits, the federal Medigap regulatory law was meeting its basic objectives. In other words, while the "Medigap world" was far from perfect, it was much better than it was when the law was enacted.

Baucus Amendment Standards

In June 1980, the Congress established requirements that insurance policies must meet to be marketed to the elderly as Medicare supplemental, or Medigap, policies. The Congress acted because of revelations that some policies were providing very low benefits in relation to their premiums and because of abuses that had occurred in the marketing and selling of policies. The provision of law enacted in 1980, commonly known as the Baucus

[1] Medigap Insurance: Law Has Increased Protection Against Substandard and Overpriced Policies (GAO/HRD-87-8), Oct. 17, 1986.

Amendment for its principal sponsor in the Senate, established minimum standards for loss ratios, set requirements for minimum benefits, and provided criminal penalties for abusive sales practices. The Baucus Amendment was designed to encourage state regulation of Medigap policies. It included a federal policy-certification program to enable marketing of Medigap insurance in states that did not regulate Medigap insurance in accordance with the federal standards.

The loss ratio of an insurance policy represents the percentage of premiums collected that are paid in benefits; it is computed by dividing the amount of incurred claims by the amount of earned premiums for the reporting period. This is usually expressed as a percentage. The Baucus Amendment standard for anticipated loss ratios is 60 percent for policies sold to individuals and 75 percent for group policies. The law does not require actual loss ratios to meet those targets, but the actuarially determined expected loss ratio must meet the targets.

We understand that the Subcommittee is particularly interested in the methodology of our earlier work and the loss ratios of Medigap insurance policies.

GAO's Methodology

When the Baucus Amendment was enacted, 9 states had minimum standards governing Medigap policies; by the end of 1985, 46 states, the District of Columbia, and Puerto Rico had been certified by the Supplemental Health Insurance Panel[2] as having regulations in place that were at least as stringent as those required by the Baucus Amendment. Massachusetts, New York, Rhode Island, and Wyoming also have regulations governing Medigap insurance, but their regulations did not meet all of the requirements of the Baucus Amendment and thus did not qualify for certification by the Panel.

In our review of Medigap insurance regulation, we included the certified jurisdictions of Arizona, California, Colorado, Florida, Maryland, Missouri, New Jersey, Pennsylvania, Washington, and the District of Columbia and the noncertified states of Massachusetts and Rhode Island. We selected these jurisdictions judgmentally to include

-- several areas of the country,

-- states with a substantial population of Medicare beneficiaries (about 30 percent of the beneficiaries live in the states we selected), and

-- both certified and noncertified states.

Generally, in the states we visited we worked at both the state insurance department and the state office on aging. At the insurance departments, we reviewed the state laws and regulations governing Medigap insurance, obtained copies of selected Medigap

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[2]This panel was established by the Baucus Amendment to review state insurance regulatory programs and to certify those that met the minimum standards. Members of this panel are the Secretary of Health and Human Services and four state insurance commissioners or state superintendents of insurance appointed by the President.

policies, and obtained financial reports of the companies licensed to do business within the state. We also reviewed the files and interviewed state officials of the insurance departments and offices on aging regarding consumer complaints about Medigap insurance and the states' actions to investigate complaints and correct the problems.

At the state insurance departments, we tried first to identify all the companies licensed to offer a Medigap policy in the state. We then tried to obtain the most recent financial reports submitted by those companies. Those reports normally include data on premiums collected and benefits paid by policy. The financial reports we obtained covered 394 individual and 4 group policies sold by 93 commercial firms and 12 Blue Cross/Blue Shield plans. The commercial policies we obtained data for collected about $1.3 billion in premiums in 1984. The Blue Cross/Blue Shield Association told us that, nationwide, the premiums for its Medicare complementary insurance for 1984 totaled over $3.7 billion. Thus, we estimate the total Medigap market for 1984 to be about $5 billion and premiums collected nationwide on the 394 individual commercial and Blue Cross/Blue Shield plans on which we obtained data to total about $2.1 billion in 1984, or about 42 percent of the total.

We used the financial data to help us choose Medigap policies to review for compliance with the Baucus Amendment standards and for coverage exceeding the minimum requirements. At each state visited, we reviewed all Blue Cross/Blue Shield plan policies, the five commercial policies with the highest amount of premiums collected in 1984, and five other policies selected at random. After eliminating duplicates, we reviewed the benefits offered by 142 different policies.

We also reviewed files and interviewed officials at the headquarters of the Health Care Financing Administration (HCFA) in Baltimore and in the HCFA regional offices in Atlanta, Boston, Denver, New York, Philadelphia, San Francisco, and Seattle.

From our work at the state insurance departments, offices on aging, and HCFA offices and our review of Medigap policies, we concluded that:

-- The Baucus Amendment was meeting its objectives. It had encouraged states to adopt Medigap insurance regulations at least as stringent as the federal standards. As a result, this type of insurance is now subject to more uniform regulation, and the elderly have better protection against substandard and overpriced policies than before the Amendment was enacted.

-- Abuses still occur in the sale of Medigap policies, but many states have attempted to prevent abuse through monitoring sales and advertising practices, revoking or suspending agents' licenses, and issuing cease and desist orders to insurers.

-- A Medicare beneficiary can buy a Medigap policy in the certified states with reasonable assurance that the policy either meets the minimum benefit standards or is required by state law to be in compliance with the minimum standards. However, we must also point out that the benefits provided by Medigap policies vary widely, and a Medicare beneficiary who purchases a Medigap policy may still face significant out-of-pocket costs, because such policies are not required to pay the deductibles under parts A or B, may limit coverage of part B coinsurance to $5,000 per year, usually do not cover costs that exceed Medicare's approved charges, and usually do not cover services that are not covered by Medicare. On the other hand, several policies we reviewed also provided some coverage beyond the minimum requirements.

For consumers, it is important that they shop carefully to find the policy with coverage benefits that fits their individual needs.

Loss Ratios of Medigap Policies

As mentioned above, a loss ratio represents the percentage of premiums collected that are paid in benefits; thus, it is sometimes considered a measure of the policy's economic value. The Baucus Amendment established a minimum standard for anticipated loss ratios of Medigap policies. The expected loss ratio had to be at least 60 percent for individual policies and

75 percent for group policies. This expected loss ratio is a target, not a requirement for actual performance.

The actual loss ratios of most policies we obtained data on were below the Baucus Amendment targets. The loss ratios of the policies offered by most of the Blue Cross/Blue Shield plans and the Prudential Life Insurance Company were above the targets, and these were the policies most commonly purchased. The Blue Cross/Blue Shield individual policies we reviewed had 1984 premiums of $776.6 million and a weighted average loss ratio of 81 percent; the commercial individual policies included in our analysis had nationwide 1984 premiums of $1.3 billion, and Prudential--with a 1984 loss ratio of about 78 percent--had almost 25 percent of that business.

For the individual policies of all commercial insurers studied, the weighted average loss ratio was about 60 percent for 1984. In other words, $770 million in benefits were returned for the $1.3 billion in premiums paid. Thus, for every $1 in premiums, 60 cents were returned as claims payments or used to increase reserves, and 40 cents represented administrative and marketing costs and profits. The same figures for the Blue Cross/Blue Shield plans studied are 81 cents in benefits and 19 cents in costs and profits.

Earlier this year and in preparation for these hearings, we obtained 1985 data (the latest available at that time) to update the loss ratio data for some of the 394 individual policies included in our review. We obtained data on 56 commercial policies and 6 Blue Cross/Blue Shield policies. These policies represented over 53 percent of the 1984 earned premiums for all individual policies included in our review. The 1985 loss ratios were basically the same as those for 1984, generally changing by only a few percentage points. Overall, the 56 commercial policies, with total 1985 earned premiums of $1.1 billion, had a weighted average loss ratio of about 65 percent, the same as in 1984. The six Blue Cross/Blue Shield policies, with total 1985 earned premiums of $453 million, had a weighted average loss ratio of about 89 percent versus a 1984 loss ratio of about 87 percent.

In 1985, Prudential, the largest commercial Medigap insurer, had a relatively high loss ratio of 79 percent (78 percent in 1984), while 64 percent (35 of 55) of the other commercial policies had loss ratios below 60 percent.

Loss ratios should be used carefully. State insurance regulatory officials told us that loss ratios are a useful tool in analyzing insurance policy performance, but caution that they are only a step in any analysis. Loss ratios must be interpreted with care because of the factors that may affect the computations. Early policy experience may result in a relatively low loss ratio because of waiting periods for certain conditions when the policy will not cover services. Also, new policyholders may be relatively healthy and file few claims, so a policy experiencing substantial amounts of new business may experience a relatively low loss ratio. Thus, loss ratios should be viewed over the time that represents "mature" experience. State officials could not give us a clear definition of mature experience, citing periods of 3, 4, or 5 years. Among the states we visited, Pennsylvania asks insurers to report annually their loss ratio data for the last 4 years; Maryland requests data covering 5 years. A reporting format recommended by the National Association of Insurance Commissioners for calendar year 1985 and later requests data on 3 years' experience.

We obtained 3 years' loss ratio experience for 55 commercial policies during our review last year. The combined 1984 earned premiums for those policies were $500 million, and the weighted average 3-year loss ratio was about 61 percent. We also obtained 3 years' experience for 11 Blue Cross/Blue Shield policies. The combined 1984 earned premiums for those policies was $572 million, and the weighted average 3-year loss ratio was 88 percent.

Finally, after updating some of the loss ratio data for 1985, we have 4 years' experience for 19 commercial policies and 6 Blue Cross/Blue Shield plans. The commercial policies had $298 million in premiums in 1985 and a 1982-1985 weighted average loss ratio of 61 percent. The Blue Cross/Blue Shield policies had $453 million in premiums in 1985 and a 1982-1985 weighted average loss ratio of 93 percent.

Mr. Chairman, this concludes my prepared remarks. I will be happy to answer any questions you have.