



United States
General Accounting Office
Washington, D.C. 20548

Health, Education and Human Services Division

B-271651

April 19, 1996

The Honorable William S. Cohen
Chairman, Special Committee on Aging
United States Senate

Dear Mr. Chairman:

Many senior citizens who are covered by Medicare also purchase Medicare supplemental insurance, commonly known as a Medigap policy. Such policies cover all or a part of the deductibles and coinsurance required under the Medicare program. Some Medigap policies also cover certain services not covered by Medicare such as prescription drugs and services received while out of the country.

In January 1996, Medigap premiums rose by 26 percent on average for the plans offered through the American Association of Retired Persons (AARP) and underwritten by the Prudential Insurance Company of America (Prudential). The magnitude of the premium increases led to numerous inquiries to your office about why rates went up so much. You asked us to determine the reasons for the premium increases.

To respond to your request, we contacted AARP and Prudential to obtain information about why premiums were increased for 1996. To put the rate increases in perspective, we obtained information on rate increases and premium refunds and credits from 1990 to 1996 and policy performance data for 1995. We also reviewed the rate increase proposals submitted to state commissioners of insurance and reviewed information on Medigap policy performance reported to and computerized by the National Association of Insurance Commissioners (NAIC). Our work was done in March 1996 in accordance with generally accepted government auditing standards.

BACKGROUND

Section 1882¹ of the Social Security Act establishes federal requirements for the marketing, benefits, and performance of Medigap policies. Consistent with the law, starting in 1992, policies sold must conform to 1 of 10 standardized sets of benefits--referred to as policies A through J. These standardized policies are required to return as benefits at least 75 percent of premiums--the loss ratio--for group policies and at least 65 percent for individual policies. Provisions of the Social Security Act Amendments of 1994 (P.L. 103-432, Oct. 31, 1994) extended the 65-percent loss ratio requirement to earlier, nonstandardized individual policies.

Policies that fail to meet loss ratio requirements must make refunds or give credits of sufficient value to bring the loss ratio up to the requirement. However, the method for computing whether a loss ratio meets the requirement does not consider just the benefit-to-premium ratio for the year. Rather a formula is used that is designed to assure that the cumulative loss ratio over 15 years meets the requirement. The formula also makes allowances for lower loss ratios for policies that cumulatively have fewer than 10,000 covered life years.

The standardized policies generally cover more benefits the higher the letter designation. For example, standard policy A covers Medicare coinsurance and policy C also covers the inpatient hospital deductibles. Moreover, policy J also covers several services not covered by Medicare, such as prescription drugs. AARP offers its members all the standardized policies, and prestandardized policies can be retained by members who enrolled in these policies before 1992. Prudential currently underwrites all AARP's Medigap policy offerings, but AARP has stated that it intends to compete the underwriting for 1998.

1996 AARP MEDIGAP PREMIUM INCREASES

Effective January 1, 1996, the premiums for over 3 million policyholders with Medigap policies offered through AARP increased 26 percent on average. Although this represents the highest average increase from 1990 to 1996, it was the

¹42 U.S.C. 1395ss.

first general increase since 1993. Premium increases varied among states, ranging from no increase in the Virgin Islands to a 40-percent increase in Hawaii for standardized policies and from no increase in the Virgin Islands to a 39-percent increase in Hawaii for prestandardized policies. Enclosure 1 presents information by year for 1990 to 1996 on the number of states with premium increases and the national average percentage increase.

For policies sold in most states, premiums did not increase in 1994 or 1995. Only 8 states had increases in 1994 and 10 in 1995. Moreover, AARP policyholders in 47 states received credits with a national average value of \$75 for prestandardized and \$79 for standardized policies toward their 1994 premiums because benefit payments were less than expected in 1993. Also, in 1992, refunds with a national average value of \$47 were issued to policyholders in 45 states because of lower than expected benefit payments in 1991.

Each year Prudential recommends to AARP Medigap premium rates for the upcoming year. AARP retains an independent actuary to review the rates to assure that they are based on sound assumptions about health service use and cost. The AARP insurance trustees review proposed rates based on Prudential's recommendations and the opinion of the actuary. If AARP agrees to the level of the proposed rates, Prudential then files the rates with each state insurance department for approval. According to an AARP spokesperson, AARP concluded that the 1996 Medigap rate increases were justified. State insurance departments also reviewed the rates and approved them.²

According to Prudential, it recommended Medigap premium rate increases for 1996 because of rising medical costs and an increased number of claims. The number of services received by policyholders and the costs associated with services

²State procedures for reviewing and approving Medigap premiums vary considerably across the country. Most states require insurers selling Medigap insurance to file premium adjustments with the state insurance commissioners. Rate reviewers use a variety of techniques to assess rate filings, including loss ratio data, actuarial memoranda that explain the rationale for the rate adjustment request, and individual rate reviewer judgment and experience.

began increasing substantially more than had been estimated in the fourth quarter of 1994. This in turn, meant that Prudential had to pay out more in benefits.

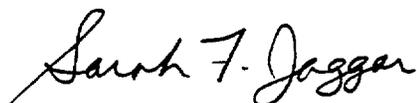
Between 1991 and 1993, Prudential's average Medigap loss ratio declined from 91 percent to 81 percent. However, in 1994, the last year data were available from NAIC, the average loss ratio increased to 93 percent. For prestandardized policies the average loss ratio was 98 percent. These policies are the ones owned by the majority of AARP members enrolled in its Medigap policies. The average loss ratio for standardized policies in 1994 was 82 percent. According to Prudential, the nationwide average 1995 loss ratio was about 100 percent, and it estimated that the 1996 loss ratio without a rate increase would be 112 percent. Enclosure 2 shows the 1994 and 1995 average loss ratios and the premium rate increases for 1996 by state for AARP's prestandardization and standardized Medigap policies.

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We discussed a draft of this letter with AARP representatives who agreed that the information in it is accurate. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this letter until 14 days after its issue date. At that time, we will send copies to AARP and will make it available to others on request.

This letter was prepared under the direction of Tom Dowdal, Assistant Director. Please contact Mr. Dowdal at (202) 512-6588 if you have any questions. Others who made contributions to this letter include William Hamilton, Michael Piskai, and Wayne Turowski.

Sincerely yours,



Sarah F. Jaggar
Director, Health Financing
and Public Health Issues

Enclosures - 2

NATIONAL AVERAGE PERCENTAGE INCREASE
IN MEDIGAP PREMIUM RATES, BY YEAR

Year	Number of jurisdictions ^a where rates increased	Average percent increase		
		Prestandardized policies	Standardized policies ^b	All policies
1990	53	17	--	17
1991	53	13	--	13
1992	51	19	--	19
1993	35	8	8	8
1994	8	1	1	1
1995	10	1	0	1
1996	52	29	23	26

Note: Averages are weighted by the number of policyholders in a state. States without an increase are included.

^aThere are 53 Medigap rating jurisdictions, consisting of the 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands.

^bStandardized policies were issued beginning in 1992.

Source: Prudential Insurance Company of America.

AARP MEDIGAP INSURANCE AVERAGE LOSS RATIOS IN 1994
AND 1995 AND PREMIUM RATE INCREASES IN 1996, BY STATE

Figures in percent

State	Prestandardized			Standardized		
	Loss ratio 1994	Loss ratio 1995	Premium increase 1996	Loss ratio 1994	Loss ratio 1995	Premium increase 1996
Alabama	82	106	25	80	103	25
Alaska	99	111	9	68	85	3
Arizona	96	95	27	90	89	23
Arkansas	94	107	32	74	92	24
California	104	103	38	97	105	37
Colorado	84	110	22	77	94	20
Connecticut	92	119	29	76	89	25
Delaware	90	94	17	49	76	4
District of Columbia	109	122	37	105	124	32
Florida	96	96	29	88	94	29
Georgia	108	108	38	82	88	26
Hawaii	128	119	39	148	106	40
Idaho	92	93	28	75	78	12
Illinois	96	110	38	90	95	32
Indiana	98	101	15	76	91	15
Iowa	88	110	26	67	93	16
Kansas	90	106	37	90	97	36
Kentucky	92	103	20	75	85	20
Louisiana	95	93	21	73	86	18

State	Prestandardized			Standardized		
	Loss ratio 1994	Loss ratio 1995	Premium increase 1996	Loss ratio 1994	Loss ratio 1995	Premium increase 1996
Maine	107	113	39	79	87	35
Maryland	82	119	20	71	89	13
Massachusetts	95	101	33	108	125	39
Michigan	89	85	27	73	75	16
Minnesota	61	104	15	40	68	8
Mississippi	83	107	13	69	82	12
Missouri	96	105	37	81	90	25
Montana	89	119	28	70	87	12
Nebraska	81	92	19	69	85	16
Nevada	86	105	23	82	95	20
New Hampshire	54	116	37	66	91	23
New Jersey	105	102	12	78	94	12
New Mexico	89	108	14	78	86	11
New York	118	81	18	92	87	16
North Carolina	92	115	32	76	96	19
North Dakota	118	116	13	81	95	12
Ohio	100	107	37	75	90	30
Oklahoma	96	102	39	81	91	29
Oregon	82	94	13	73	88	13
Pennsylvania	103	114	32	85	102	31
Puerto Rico	105	140	5	352	200	7
Rhode Island	93	89	36	85	95	33
South Carolina	104	101	28	86	95	26

State	Prestandardized			Standardized		
	Loss ratio 1994	Loss ratio 1995	Premium increase 1996	Loss ratio 1994	Loss ratio 1995	Premium increase 1996
South Dakota	111	95	35	76	88	21
Tennessee	86	105	13	72	90	7
Texas	103	99	33	90	92	30
Utah	94	119	37	74	97	25
Vermont	98	114	37	82	87	22
Virginia	92	97	19	78	88	13
Virgin Islands	128	-47	0	100	-4	0
Washington	94	108	33	77	88	14
West Virginia	94	110	22	72	89	17
Wisconsin	109	111	38	71	92	18
Wyoming	116	119	37	73	86	23
Nationwide	98	102	29	82	92	23

Source: 1994 loss ratio data are from NAIC; other data are from the Prudential Insurance Company of America.

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