



AMERICAN ACADEMY *of* ACTUARIES

August 17, 2006

To: Mr. Guenther Ruch, Chair, NAIC Medigap Modernization Subgroup of the Senior Issues Task Force

From: Mike Carstens, Chair, American Academy of Actuaries¹ Medicare Supplement Work Group

Re: Transition issues with Medicare Supplement modernization

Dear Mr. Ruch:

Per the request of the NAIC's Medigap Modernization Subgroup (Subgroup) of the Senior Issues Task Force, the American Academy of Actuaries (Academy) Medicare Supplement Work Group has identified potential transitional issues which will need to be addressed as part of Medicare Supplement modernization that the Subgroup has recently taken up.

Insurers are required to demonstrate compliance with, or reasonable progression to, the applicable lifetime loss ratio for Medicare Supplement blocks of business. This is known as the refund formula, since, if the demonstration shows that loss ratios do not achieve the benchmarks, refunds may be required. Reasonable progression is defined by basic assumptions regarding persistency, trend, selection wear-off, and an application of credibility. As such, any transition plan that will impact these basic assumptions may result in refunds that may not otherwise occur, or may prevent refunds that would otherwise occur. Aside from any issues that may arise in this way, the refund formula is suitable to handle transition situations (e.g. closed blocks) as well as it does today. It should be noted that comments from the Centers for Medicare and Medicaid Services commissioned study by Reden and Anders, and the subsequent report by a subgroup of the Medicare Supplement Work Group², have identified some shortcomings of the

¹ The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

² March 2004 report to the Accident and Health Working Group of the NAIC. A copy of the report can be found [online](#) at the Academy's website.

current refund formula. Should the NAIC request the authority to make changes to the standardized benefit packages, we believe that it would be beneficial to also obtain the authority to make any necessary changes in the refund formula.

As part of modernization, other issues may arise as a result of the new benefit plans. In previous analyses³, we have documented significant differences in claim costs and trends that might not otherwise be anticipated from a simple viewing of the benefit designs. While the proposed plans may not appear to be significantly different from existing plans, experience may emerge differently. Specific elements that may lead to a divergence in experience are included in the proposed Plan D (with the inclusion of Part B Deductible coverage and lesser coverage of the Part A Deductible) as well as in the proposed Plan E (where fixed-dollar cost sharing may increase trends due to leveraging). Other elements will only become apparent as experience emerges.

Premium changes will be a part of the modernization process and a number of issues should be considered. With the introduction of the new benefit designs, new rates will be filed. With the implementation of any new premium schedule, the timing is important. Will all states be on the same timetable, similar to the mandate of prescription drug coverage removal in 2006? Going forward, as we move towards modernization, premium changes for new plans may differ from existing, similar plans to maintain alignment with claim costs, consistent with the discussion of benefits above. Finally, the changes with modernization will add new policy forms with the same standardized “label.” The Model Regulation states that an issuer may offer up to four additional policy forms of the same type. Any regulation should clearly note that the introduction of these new policy forms does not reduce the number of possible policy forms a company may have within one plan.

We appreciate the opportunity to provide this input. If there are any questions regarding these comments, I invite you to contact Geralyn Trujillo, staff liaison to the Medicare Supplement Work Group, at (202) 785-6924 or trujillo@actuary.org.

Sincerely,

Mike Carstens
Chair, Medicare Supplement Work Group
American Academy of Actuaries

CC: Jane Sung, NAIC Staff
Mike Abroe, American Academy of Actuaries, State Health Committee

³ Report on Medicare Supplement Experience, 1996-2000, made to the NAIC. A copy of the report can be found [online](#) at the Academy’s website.