



# Texas Department of Insurance

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**April 16, 1996**

## **COMMISSIONER'S BULLETIN NO. B-0021-96**

**TO: ALL INSURANCE COMPANIES, CORPORATIONS, EXCHANGES, MUTUALS, RECIPROCALLS, ASSOCIATIONS, LLOYDS OR OTHER INSURERS WRITING SMALL EMPLOYER HEALTH INSURANCE IN THE STATE OF TEXAS AND TO THEIR AGENTS AND REPRESENTATIVES AND THE PUBLIC GENERALLY**

**RE: Rating Provisions of Chapter 26, Texas Insurance Code, relating to Small Employer Health Benefits Plans and the Availability and Affordability of Health Insurance for Small Employers**

**PURPOSE** This bulletin is intended to serve as a reminder of the rating requirements for small employer health benefit plans; to clarify those requirements; and to provide information concerning compliance with the requirements contained in Chapter 26, Texas Insurance Code (TIC), and Chapter 26, Texas Administrative Code (TAC). The enclosed attachment contains information on compliance with the rating requirements of the statutes and rules and was developed to assist you in complying with these requirements. Refer to Chapter 26, TIC, for complete definitions and requirements.

**RATING REQUIREMENTS** The rating requirements of the statute are a key component in improving the availability and affordability of health insurance for small employers. The rating provisions of the statute limit the use of health status in establishing rates, limit the amount of any increase in rates, and limit the spread between the lowest and highest rate charged to small employers. Rating adjustments which are based on health status must be determined in accordance with the defined criteria of your small employer rating manual.

**REQUIRED COMPLIANCE** The Department has received information that indicates many carriers and agents may not be in compliance with the rating requirements for small employer health benefit plans. As of September 1, 1995, according to the statute (Chapter 26, TIC), ALL carriers were required to comply with the rating requirements. This applies to all health benefit plans (except certain HMO plans) issued to small employers, including those plans that are otherwise grandfathered by rule from other requirements of the law. Therefore, each carrier is now expected to be in full compliance with the rating requirements of Chapter 26, TIC, and Chapter 26, TAC.

**HMOs** The rating provisions of Chapter 26, TIC, and Chapter 26, TAC, do not apply to HMO small employer health benefit plans that meet federal guidelines and are state approved; however, HMO plans that are based on the promulgated HMO plan must comply with the requirements of Chapter 26, TIC, and Chapter 26, TAC, IF those plans are not in compliance with the rating requirements applicable to federally qualified plans.

**ENFORCEMENT** Noncompliance with the rating provisions of Chapter 26, TIC, and Chapter 26, TAC, is subject to enforcement action in accordance with the Texas Insurance Code. To ensure compliance by your company and agents and to avoid enforcement action by this Department, you should: (1) review your current practices and procedures in rating small employer health benefit plans, and (2) inform your staff and your agent force of the rating requirements of the applicable laws and rules.

If you have any questions concerning this bulletin or the information provided in the attachment, please contact Jan Gibson or Tony Huang, staff actuaries, in the Life/Health Group at 512/322-3401.



ELTON BOMER  
COMMISSIONER OF INSURANCE

Attachment

**Attachment for Commissioner's Bulletin No. B-0021-96**

**Important Rating Definitions**

**Classes of Business**

Carriers are allowed to establish different classes of business to reflect substantial differences in expected claim experience or administrative costs based only on the following:

- the carrier uses different systems of marketing the plans to small employers,
- the carrier has acquired the class of business from another health carrier, or
- the carrier provides coverage to one or more employer-based association groups.

**Case Characteristics**

Criteria used by the small employer carrier in setting premium rates, such as the geographic area in which that employer's employees reside, the age and gender of the individual employees and their dependents, industry classification and the number of employees and dependents. The term does not include risk characteristics of the group such as claims experience, health status or duration of coverage.

**Base Premium Rate**

The lowest premium rate available to small employers with similar case characteristics and coverage and within the same class of business. Generally, the base premium rate will be the same as the carrier's new business premium rate.

**Index Rate**

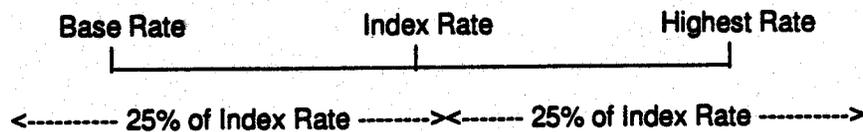
The simple arithmetic average of the base premium rate and the corresponding highest rate for groups with similar case characteristics and coverage and within the same class of business.

**Determining the Premium Rate Charged to a Small Employer Group**

28 TAC §26.11 (c)(5) defines the rating development as a two-step process. First, a premium rate is determined based on class, case characteristics and plan design, but without regard to any risk characteristics of the group. Second, the rate may be adjusted by a risk load to reflect risk characteristics of the group. This adjustment must be applied uniformly to the rates charged to all members of the group.

**Testing for Compliance Within a Class of Business**

Article 26.32(c) of the Texas Insurance Code requires that the rates charged to a group may not vary from the index rate by more than 25%. Therefore, to test for compliance, a carrier must determine that the actual premium rate charged for each group falls within the following rate scale:

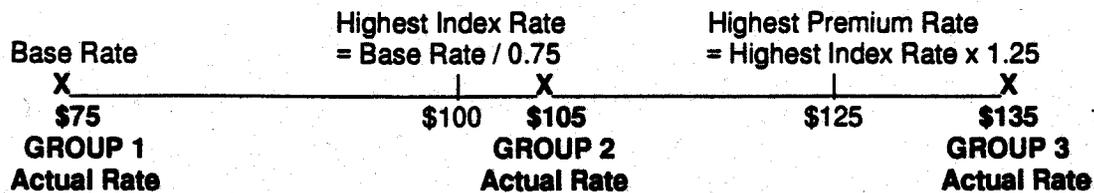


**Rate Scale Demonstrating Allowable Range for Actual Premium Rate Charged to Each Group**

For example, suppose a carrier provides coverage to three small employer groups and the class and case characteristics (in this example, age and gender) are the same for each group. The base rates, risk loads and actual rates are determined by the carrier and are shown below:

	GROUP 1				GROUP 2				GROUP 3			
	Female Age 40	Male Age 50	Female Age 60	Total	Female Age 40	Male Age 50	Female Age 60	Total	Female Age 40	Male Age 50	Female Age 60	Total
Base Rate	20	25	30	75	20	25	30	75	20	25	30	75
Risk Load	0	0	0	0	8	10	12	30	16	20	24	60
Actual Rate	20	25	30	75	28	35	42	105	36	45	54	135

Using the base rate of \$75 for each of these three groups, the highest allowable index and premium rates can be derived and are illustrated by the following rate scale:



As illustrated above, the premium rates for both Group 1 and Group 2 comply since the rates charged are within the range of the rate scale. The premium rate for Group 3 fails to comply since it exceeds the highest allowable rate by \$10. The carrier must make adjustments to its rating manual resulting in a premium rate for Group 3 of under \$125.

### Testing for Compliance Between Classes

Article 26.32(b) of the Texas Insurance Code requires the index rate for a rating period for any class of business not to exceed the index rate for any other class of business by more than 20%. In order to test for compliance, each and every group within a rating class would have to be rated according to the criteria of each and every one of the carrier's other rating classes. This results from the fact that the index rate is defined in terms of groups with similar case characteristics and plan design. The following steps demonstrate the compliance testing procedure for each class of business which the carrier has established:

**Step 1:** Determine the index rate for groups with similar case characteristics and coverage under the rating manual used by the class of business whose rating manual is being tested and each of the other classes of business established by the carrier.

**Step 2:** For groups with similar case characteristics and coverage, choose the lowest index rate calculated in step 1 among all the classes of business and the corresponding highest index rate.

**Step 3:** Highest index rate should not exceed lowest index rate by more than 20%.

Steps 1 through 3 are repeated for each class of business that the carrier has established.

Unfortunately, as the number of groups within a class of business grows, checking for compliance quickly becomes impractical; therefore, a carrier may devise an alternative method to exhibit compliance. The alternative method used must be clearly documented and technical compliance remains mandatory. The procedure under one acceptable method is described below:

- Step 1: Randomly select a sufficient sample set of groups within the class of business whose rating manual is being tested.
- Step 2: Determine the index rate for the groups selected in step 1 under the rating manual by the class of business whose rating is being tested and each of the other classes of business that the carrier has established.
- Step 3: Determine the aggregate index rate for each class of business by adding together the corresponding index rates determined in step 2.
- Step 4: Choose the lowest aggregate index rate calculated in step 3 and the corresponding highest index rate.
- Step 5: The highest aggregate index rate should not exceed the lower aggregate index rate by more than 20%.

Repeat Steps 1 through 5 for each class of business that the carrier has established.

In applying the procedure above, the carrier must keep detailed records of the samples chosen, the basis for choosing the sample, and the actual results of the test. The carrier should initially pick a minimum of 100 actual groups if applicable. For some large classes, 100 groups may not be sufficient. Therefore, the carrier is allowed to increase the size of the sample if it is necessary to demonstrate compliance. However, the expanded sample must include the groups originally chosen in the sample of 100. It is not appropriate for the company to choose alternate samples of 100 until it finds one that passes the compliance test.