

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
OFFICE OF THE HEALTH INSURANCE COMMISSIONER
1511 Pontiac Avenue, Bldg. 69-1
Cranston, Rhode Island 02920**

In the Matter of:	:	
	:	
Blue Cross and Blue Shied of Rhode Island	:	OHIC No.
	:	
Respondent.	:	
	:	

**ORDER TO SHOW CAUSE, NOTICE OF HEARING AND APPOINTMENT OF
HEARING OFFICER**

Pursuant to R.I. Gen. Laws §§ 42-14.5-1 *et seq.*, 42-14-5, 42-14-16 and 42-35-9 the Office of the Health Insurance Commissioner (“OHIC”) hereby issues this Order to Show Cause, Notice of Hearing and Appointment of Hearing Officer (“Order”) to Blue Cross and Blue Shield of Rhode Island (“Respondent”) requiring an authorized representative of Respondent to appear before OHIC to answer why the Health Insurance Commissioner (“Commissioner”) should not issue an order requiring Respondent (1) to cease and desist from using a rating methodology in the small employer market that applies a health status adjustment in a manner inconsistent with R.I. Gen. Laws § 42-50-5, OHIC Regulation 11 and OHIC guidance; (2) to pay restitution to its customers pursuant to R.I. Gen. Laws § 42-14-16; (3) to pay whatever penalty is determined to be appropriate pursuant to R.I. Gen. Laws § 42-14-16; and (4) to take such actions as are necessary so that it complies with title 27 of the General Law, regulations promulgated thereunder and guidance provided by the OHIC as detailed below.

The Commissioner issues this Order for the following reasons:

1. Respondent is a nonprofit hospital service corporation and a nonprofit medical service corporation organized under R.I. Gen. Laws §§ 27-19-1 *et seq.* and 27-20-1 *et seq.*
2. Respondent is subject to the regulation of OHIC pursuant to R.I. Gen. Laws §§ 42-14.5-1 *et seq.* and 42-14-5.
3. Respondent offers health insurance to Rhode Island small employers, as defined by R.I. Gen. Laws §§ 27-50-3(kk). Therefore, pursuant to R.I. Gen. Laws §§ 27-50-4, Respondent is subject to the requirements of the Small Employer Health Insurance Availability Act, R.I. Gen. Laws §§ 27-50-1 *et seq.* (the “Act”) and regulations promulgated thereunder.
4. The Act and its implementing regulations impose strict limitations on how rates may be determined in the small employer market. Pursuant to R.I. Gen. Laws § 27-50-5, a carrier in the small employer market must develop its rates for a small employer group based on an adjusted community rate and may only vary the adjusted community rate for age, gender and family composition. In addition, a carrier in the small employer market may apply a health status adjustment to the adjusted community rate for a small employer group, but that adjustment may only result in an adjusted community rate that varies, up or down, by no more than ten percent. In particular, a carrier is required to “determine the dollar amount of deviations for health status from average rates, and take steps to ensure that the total of downward deviations due to health status is approximately equal to the total of upward deviations due to health status.” *See* OHIC Regulation 11, Section 5(b)(2).

5. In the Spring of 2008, OHIC was presented with information that Respondent was not following the required rating methodology in the small employer market.
Specifically, OHIC was concerned that Respondent was using the health status adjustment in a manner inconsistent with R.I. Gen. Laws § 42-50-5, OHIC Regulation 11 and OHIC guidance.
6. OHIC then initiated a market conduct examination of Respondent pursuant to R.I. Gen. Laws § 27-13.1-1 *et seq.* to determine whether Respondent was in compliance with the requirements of the Act, OHIC Regulation 11 and OHIC guidance with respect to Respondent's use of the health status adjustment.
7. During the course of the market conduct examination, OHIC determined that the Respondent was not in compliance with respect to its use of the health status adjustment. Based on the data collected during the market conduct examination, it appears that Respondent has been out of compliance since July of 2006.
8. Respondent has not been in compliance with respect to its use of the health status adjustment in several aspects of its rating methodology:
 - a. Respondent has failed to "determine the dollar amount of deviations for health status from average rates, and take steps to ensure that the total of downward deviations due to health status is approximately equal to the total of upward deviations due to health status," in violation of OHIC Regulation 11, Section 5(b)(2);
 - b. Respondent has allowed health status adjustment factors that exceed the community average by more than ten percent, contrary to R.I. Gen. Laws § 27-50-5, OHIC Regulation 11 and guidance provided by OHIC; and

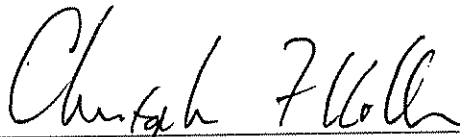
- c. Respondent has, under the guise of a health status adjustment, employed a durational rating methodology that results in renewal business rates that are 6% higher on average than new business rates, in violation of R.I. Gen. Laws § 27-50-5 and OHIC Regulation 11.
9. On July 25, 2008, OHIC sent a letter to Respondent (“the July 25 Letter”) explaining in detail how Respondent’s use of the health status adjustment was contrary to the Act, OHIC Regulation 11 and prior OHIC guidance. The July 25 Letter also provided guidance to the Respondent as to how it should come into compliance. Finally, OHIC asked Respondent to notify OHIC by August 1, 2008 of its intent to comply with the guidance set out in the July 25 Letter. The July 25 Letter is attached hereto as Exhibit A.
10. On August 1, 2008 Respondent responded to the July 25 Letter by (1) asserting that it is in compliance with the Act and OHIC Regulation 11 and (2) that, since the market conduct examination is not yet complete, the Commissioner is without the authority to require Respondent to come into compliance with the Act and OHIC Regulation 11. The Respondent’s August 1, 2008 letter is attached hereto as Exhibit B.
11. Upon information and belief, Respondent continues to apply the health status adjustment in a manner contrary to the Act, OHIC Regulation 11 and prior OHIC guidance, to the detriment of both the small employer market and Respondent’s customers.

Therefore, pursuant to R.I. Gen. Laws §§ 42-6-8 and 42-35-9, the Commissioner orders a representative of the Respondent to appear for a prehearing conference pursuant to Rule 5 of Adopted DBR Central Management Regulation 2 and this Order before a Hearing Officer at the

OHIC on August 18, 2008 at 2:00 p.m. at the OHIC's offices located at 1511 Pontiac Avenue, Bldg. 69-1, Cranston, Rhode Island 02920 to schedule a date for a hearing to show cause why the Commissioner should not issue an order to Respondent to take whatever action or pay whatever penalties the Commissioner deems necessary and allowable pursuant to R.I. Gen. Laws § 42-14-16, as discussed above.

The Commissioner hereby appoints Elizabeth Kelleher Dwyer as Hearing Officer for the purpose of conducting the hearing and rendering a decision in this matter. The proceedings shall be conducted in conformity with R.I. Gen. Laws §§ 42-35-1 *et seq.*

Dated this 5th day of August 2008.



Christopher F. Koller
Health Insurance Commissioner

CERTIFICATION

I hereby certify that on this 5th day of August 2008 a copy of this Order to Show Cause, Notice of Hearing and Appointment of Hearing Officer was sent by email and first class mail postage prepaid to

Mr. James E. Purcell
Blue Cross & Blue Shield of Rhode Island
444 Westminster Street
Providence, RI 02903-3279

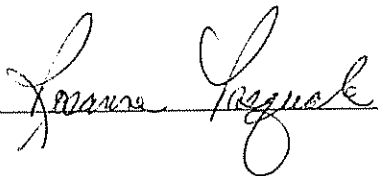
Michele B. Lederberg
Blue Cross & Blue Shield of Rhode Island
444 Westminster Street
Providence, RI 02903-3279

and by email and hand delivery to

John Aloysius Cogan Jr.
Office of the Health Insurance Commissioner
1511 Pontiac Avenue, Bldg. 69
Cranston, Rhode Island 02920

Elizabeth Kelleher Dwyer
Department of Business Regulation
1511 Pontiac Avenue, Bldg. 69
Cranston, Rhode Island 02920

Joseph Torti III
Associate Director
Superintendent of Insurance and Banking
Department of Business Regulation
1511 Pontiac Avenue, Bldg. 69
Cranston, Rhode Island 02920





OFFICE OF THE
HEALTH INSURANCE COMMISSIONER
STATE OF RHODE ISLAND

July 25, 2008

Mr. James E. Purcell
President & Chief Executive Officer
Blue Cross & Blue Shield of Rhode Island
444 Westminster Street
Providence, RI 02903-3279

Re: Small Group Rating Practices (by U.S. Mail and email)

Mr. Purcell:

As you are aware, the Office of the Health Insurance Commissioner is conducting a market conduct examination of Blue Cross & Blue Shield of Rhode Island related to the company's rating practices in the small employer market. During the course of the examination, it has come to our attention that Blue Cross has engaged in rating practices with regard to health status that are not permitted by R.I. Gen. Laws § 27-50-5 or by OHIC Regulation 11. Specifically, it appears from the data collected during the course of the examination that Blue Cross fails to comply with Chapter 27-50 and Regulation 11 in the following three ways:

1. Blue Cross has failed to "determine the dollar amount of deviations for health status from average rates, and take steps to ensure that the total of downward deviations due to health status is approximately equal to the total of upward deviations due to health status" (Reg. 11, Section 5(b)(2));
2. Blue Cross has allowed health status adjustment factors that exceed the community average by more than 10%, contrary to Regulation 11, Section 5(b)(1) and guidance provided by this Office during the course of the 2006 market conduct examination; and
3. Blue Cross employs a *de facto* durational rating methodology that results in renewal business rates that are 6% higher on average than new business rates, contrary to § 27-50-5 and OHIC Regulation 11.

Blue Cross was aware during the 2006 market conduct examination, specifically through the draft report provided on March 22, 2006 and the final report dated September 11, 2006, that its then-current methodology of setting the average health status factor at 1.0 "complies with the requirements of R.I.G.L. § 27-50-5(a)(2). In particular, the average health status rating is

Protecting Consumers • Ensuring Solvency • Engaging Providers • Improving the System

www.ohic.ri.gov
1511 Pontiac Avenue • Building #69, First Floor • Cranston, RI 02920
401 462 9517 • 401 462.9645 fax • TTY: 711

approximately 1.00, which results in no variation from the average greater than 10%.” Nevertheless, Blue Cross changed its health status methodology. In response to inquiries made by the examiners during the current market conduct exam, Blue Cross stated that, effective July 1, 2006, Blue Cross “took steps to protect our SG risk pool from the anti-selection we believed was taking place. *We set our average health status factor at .97, deliberately below 1 for the first time.*” (emphasis added) This resulted in those groups rated with a health status factor of 1.10 having rates more than 10% higher than the community average rate, in violation of Chapter 27-50 and Regulation 11.

Also in the context of the current market conduct examination, Blue Cross told the examiners that “For our 3rd quarter 2007 renewals and ever since we have been balancing to an average health status factor of 1.” However, the examiners have found that the average health status factor for 2008 renewal groups was .98 and for 2008 new business groups was .92. In addition, it appears that the normalization methodology used by Blue Cross for renewal groups does not independently normalize health status factors to 1.0, but instead normalizes age/gender and health status factors together. The result of this has been an average health status factor of less than 1.0, resulting in some groups being charged more than 10% above the community average rate, again in violation of small employer rating laws and regulations.

Finally, Blue Cross’s practice with regard to new business groups results in what appears to be *de facto* durational rating. While most new business in the small employer market typically receives a highly favorable health status adjustment of .90, and the average for all new business groups is .92, renewal business receives, on average, a health status adjustment of approximately .98. In response to an inquiry from the examiners, Blue Cross explained this discrepancy by stating, “since first year loss ratios tend to be lower than our loss ratios on the balance of our business it must also be true that the average health status of new business is distinctly better than that of renewal business.” Duration is not a permitted rating factor under Chapter 27-50 or Regulation 11. Therefore, a rating methodology that imposes lower or higher rates based on a group’s status as new or renewal business is illegal.

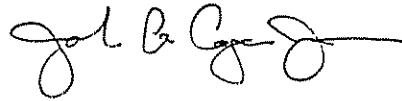
In order to come into compliance with the requirements of Chapter 27-50 and Regulation 11, Blue Cross must immediately take the following steps:

1. Blue Cross must compute the adjusted community rate for all small employer business without regard to health status;
2. Blue Cross must separately verify that health status factors themselves balance to 1.00 for all business, and that the dollar amount of upward deviations is approximately equal to the dollar amount of downward deviations;
3. Blue Cross must employ a consistent methodology between new business and renewal groups so that there will not be a bias toward a lower health status factor and thereby lower rates for new business than for renewal business; and
4. Blue Cross must provide verification that these steps have been taken.

July 25, 2008
Page 3 of 3

Blue Cross must notify this Office, in a letter directed to my attention, of its intent to comply with the terms of this letter by no later than 4 p.m. on August 1, 2008. Should Blue Cross fail to so notify this Office of its intent to comply, administrative action may be taken against Blue Cross to compel compliance. In addition, please be aware that nothing in this letter should be construed as precluding this Office from taking further administrative action, including but not limited to seeking penalties and restitution for Blue Cross' failure to comply with Chapter 27-50 and Regulation 11, as authorized by R.I. Gen. Laws §§ 27-13.1-1 *et seq.* and 42-14-16.

Sincerely,



John Aloysius Cogan Jr.

cc: Charles C. DeWeese, FSA, MAAA (by email only)
Anthony J. van Werkhoven, FSA, MAAA, PhD (by email only)
John J. Lynch, FSA, MAAA (by email only)
Michele B. Lederberg (by email only)
Joseph Torti III (by email only)

VIA E-MAIL (Original will not follow)

August 1, 2008

Mr. John Aloysius Cogan Jr.
Executive Assistant for Policy & Program Review
Office of the Health Insurance Commissioner
1511 Pontiac Avenue, Building 69-1
Cranston, RI 02920

Re: Blue Cross & Blue Shield of Rhode Island ("Blue Cross")

Dear Mr. Cogan:

I am writing in response to your letter to Jim Purcell dated July 25, 2008, which directs Blue Cross to take four separate actions in order to come into compliance with Chapter 27-50 of the Rhode Island General Laws ("RIGL") and Office of Health Insurance Commissioner Regulation 11 ("Reg. 11"). Blue Cross believes that its use of health status in rating is consistent with RIGL Chapter 27-50 and the applicable regulations, and it has been approved as such in every market conduct examination to date. Blue Cross is more than willing to address the issues raised in your letter in the ordinary course of the current market conduct examination. However, your letter suggests that the Commissioner already has made the findings of fact and conclusions of law on which the actions required by your letter are based, without having sought or received any response from Blue Cross, as required by applicable law.

The current market conduct examination has not reached the point that orders of the type described in the letter are procedurally appropriate. Before the Commissioner can order Blue Cross to take actions to cure purported violations of law identified in the current market conduct examination, all of the following must occur:

- The examination must be completed [RIGL § 27-13.1-5(b)];
- The verified, written examination report must be filed with the Commissioner [RIGL § 27-13.1-5(b)];
- The Commissioner must transmit a copy of the report to Blue Cross, plus a notice requiring a response [RIGL § 27-13.1-5(b)];
- Blue Cross must file its response, including rebuttals or plans re: how and when recommendations and comments will be implemented [RIGL § 27-13.1-5(b)];
- After the end of the period allowed for the response, the Commissioner must "fully consider and review the report, together with any written response or rebuttal and any relevant portions of the examiner's workpapers" [RIGL § 27-13.1-5(c)];
- Enter an order adopting the report and, "[i]f the examination report reveals that the company is operating in violation of any law, regulation, or prior order of the

Mr. Cogan
August 1, 2008
Page 2 of 2

director, the director may order the company to take any action the director considers necessary and appropriate" [RIGL § 27-13.1-5(c)(1)].

It is Blue Cross' understanding that the current market conduct examination is not yet completed. Even if the examination were completed and the Commissioner had a copy of the verified report, Blue Cross has not been given the report nor an opportunity to respond to the report. Since the market conduct examination is still underway, and the Commissioner can not have fully considered and reviewed Blue Cross' responses, the procedural requirements have not been met for the Commissioner to require that Blue Cross take actions "to come into compliance with the requirements of Chapter 27-50 and Regulation 11". See RIGL § 27-13.1-5(c).

As a result, Blue Cross takes exception with any requirement that Blue Cross immediately amend its practices with respect to the use of a health status rating factor before the Commissioner has sought or received any response from Blue Cross. This is particularly the case with respect to the first item required by your letter – that Blue Cross compute the adjusted community rate for all small employer business without regard to health status - since Chapter 27-50 explicitly permits Blue Cross to continue to use health status as a rating factor until January 1, 2009.

As stated above, Blue Cross will address the issues raised in your letter in the ordinary course of the current market conduct examination. However, there is one substantive issue that requires immediate response. Your letter implies that Blue Cross changed its rating practices in knowing violation of the law. To be clear, no such misconduct took place. At all times, Blue Cross believed its conduct to be consistent with the law and with the conduct of its competitors. We look forward to the opportunity to respond to the report accordingly.

Sincerely,



Monica A. Neronha, Esq.
AVP Legal Services &
Associate General Counsel

cc: Commissioner Christopher F. Koller
James E. Purcell
Thomas A. Boyd
James Joy
Michele B. Lederberg, Esq.
John Lynch, FSA, MAAA
Charles C. DeWeese, FSA, MAAA
Joseph Torti III