

**The MEGA Life and Health Insurance Company**

**Targeted Market Conduct Examination**  
**with regard to compliance with**  
**R. I. Gen. Laws §§ 27-50, *et seq.*,**  
**Small Employer Health Insurance Availability Act**

**Final Report**  
**May 19, 2007**

**Hinckley, Allen & Tringale LP**  
**DeWeese Consulting, Inc.**

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

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May 19, 2007

Honorable Christopher Koller  
Health Insurance Commissioner  
State of Rhode Island

Dear Commissioner Koller:

In accordance with your instructions and pursuant to statutes of the State of Rhode Island, a targeted Market Conduct Examination with regard to compliance with R. I. Gen. Laws §§ 27-50, *et seq.*, the Small Employer Health Insurance Availability Act (“Chapter 27-50”) was conducted of:

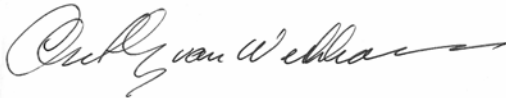
**The MEGA Life and Health Insurance Company**

The MEGA Life and Health Insurance Company is domiciled in Oklahoma, and conducts its business from an administrative office located in North Richland Hills, Texas.

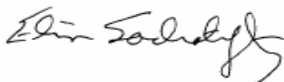
This examination was done to support the periodic market evaluation required by R.I.G.L. § 27-50-9. The examination was conducted by Hinckley, Allen & Tringale LP and DeWeese Consulting, Inc. (the “examiners”) of Boston, MA and Canton, CT. It was conducted in accordance with the standards contained in the NAIC Market Conduct Examiners Handbook. The examination involved review and analysis of records of the company. The results of the examination are reported here on a test basis.



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# **The MEGA Life and Health Insurance Company Market Conduct Examination**

## **1. Introduction**

R.I.G.L. §§ 27-50, *et seq.*, the Small Employer Health Insurance Availability Act (“Chapter 27-50”) requires that an independent actuarial study and report be prepared to analyze the effectiveness of Chapter 27-50 in promoting rate stability, product availability, and coverage affordability. The report may contain recommendations for actions to improve the overall effectiveness, efficiency, and fairness of the small group health insurance marketplace. The report shall address whether carriers and producers are fairly and actively marketing or issuing health benefit plans to small employers in fulfillment of the purposes of the chapter. The report may contain recommendations for market conduct or other regulatory standards or action (R.I.G.L. § 27-50-9). The initial report of this type was prepared as of June 30, 2002. Subsequent reports are required on a scheduled basis. The Office of the Health Insurance Commissioner of Rhode Island (“OHIC”) contracted with Hinckley, Allen & Tringale (“HAT”) to prepare this report. In order to collect data in connection with the report and to determine compliance with Chapter 27-50, OHIC directed that HAT and its actuarial subcontractor, DeWeese Consulting, Inc. (“DCI”) perform targeted market conduct examinations of the companies active in the small employer market. Those companies include Blue Cross & Blue Shield of Rhode Island (“Blue Cross”), UnitedHealthcare of New England/UnitedHealthcare Insurance Company (collectively, “United”), and The MEGA Life and Health Insurance Company (“MEGA”).

MEGA was not identified initially as a small employer carrier during the examination period. As a result of the filing by MEGA of the annual report required by Regulation 82(10)(G) and the actuarial certification required by R.I.G.L. § 27-50-5(h)(2), the examiners and OHIC became aware that MEGA was a small employer carrier and OHIC determined that a market conduct examination should be performed. MEGA subsequently provided copies of Rhode Island small employer actuarial certifications for

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the years 2001 through 2004 which had apparently been prepared contemporaneously, but which the examiners had not previously been aware of.

The examiners assigned to perform the targeted market conduct examination of MEGA and to collect actuarial data to support the small employer market report were Charles C. DeWeese, FSA, MAAA and Anthony J. van Werkhoven, PhD, FSA, MAAA of DCI and Elinor Socholtzky of HAT.

The examination extended from March 30, 2006 through December 15, 2006. The examination was begun by the submission of a preliminary request for data to MEGA. Analysis by the examiners of the responses resulted in certain additional requests for information or requests for a more detailed explanation of what had been provided previously. This examination report addresses compliance with Chapter 27-50 on a test basis. It also addresses the profile of MEGA's small employer business and the effect on MEGA and its customers of Chapter 27-50.

Because of the timing of the examination, the data obtained from MEGA was not fully integrated into the report on the Rhode Island small employer health insurance market by HAT. Should the need arise an addendum to the report will be issued to address policy issues raised by the MEGA market conduct examination.

MEGA personnel have been given an opportunity to review this report. Their comments are included in a section titled "MEGA Comments on the Report".

### **2. Executive Summary**

The MEGA Life and Health Insurance Company ("MEGA") is a wholly owned subsidiary of a privately held insurance holding company, HealthMarkets. HealthMarkets was formerly a publicly held organization named UICI, and became privately held in April 2006. MEGA is domiciled in Oklahoma and maintains its

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principal administrative offices in Texas. MEGA offers a range of life and health insurance products through different operating divisions.

MEGA's Administrative Services division offers small group and association group health care policies in Rhode Island, covering approximately 1,000 subscribers and 1,500 total members. Except for the Standard and Economy health plans that had previously been described in R.I.G.L. § 27-50-10, MEGA health insurance plans are only available to members of certain member associations. MEGA health plans in Rhode Island have been issued through the National Association of the Self Employed ("NASE"), the Americans for Financial Security ("AFS"), and the Alliance for Affordable Services. While the bulk of MEGA's Rhode Island business has been issued to members of NASE, six MEGA association health plans have been issued to Rhode Island members of AFS and two MEGA health plans have been issued to Rhode Island members of the Alliance for Affordable Services. MEGA agents also represent the associations and solicit from health plan prospects an application for membership in conjunction with the marketing of MEGA health insurance. OHIC has determined that MEGA's small group and association health insurance business is subject to the requirements of Chapter 27-50. Correspondence regarding this determination is included in Appendix 5 of this report.

In addition, as of the start of the examination period, MEGA's Student Resources Group offered limited benefit health insurance policies to college and secondary school students through their schools. Based on investigation by the examiners, MEGA covers<sup>1</sup> approximately 20,000 Rhode Island college students through student health insurance products. These products are not subject to Chapter 27-50.

OHIC and the examiners had not initially been aware that MEGA was issuing health insurance plans to Rhode Island small employers. However, MEGA filed a report describing the enrollment in what it describes as its small group health insurance products

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<sup>1</sup> Health Markets announced in an October 23, 2006 press release that it had reached an agreement to sell its Student Resources Group to UnitedHealth Group.

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and an actuarial certification as required by Regulation 82(10)(G) and R.I.G.L. § 27-50-5(h)(2) respectively on March 13, 2006, leading to further investigation and the commencement of a market conduct examination. MEGA subsequently provided copies of Rhode Island small employer actuarial certifications for the years 2001 through 2004 which had apparently been prepared contemporaneously, but which the examiners had not previously been aware of.

The person assigned by MEGA to respond to the examination data requests was Susan Johnson, Director, Regulatory Affairs.

After review of the initial data response, the examiners became aware of the association business, and expanded the data request. MEGA submitted information to OHIC supporting their understanding that its association business was not subject to Chapter 27-50 because the people enrolled did not enroll as employers, but as individuals. After review, OHIC determined that self employed individuals are included in the definition of small employers under Chapter 27-50, and that MEGA's association business is subject to Chapter 27-50. MEGA therefore submitted additional information in response to the data requests to include all its association health insurance business written in Rhode Island.

During the course of the examination, a number of MEGA's practices with regard to its small employer and/or association group health insurance business were identified as not in compliance with Chapter 27-50. In particular, non-complying practices were identified in the following areas:

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1. Applying medical underwriting in ways not permitted by Chapter 27-50, including a practice of declining coverage or offering coverage with exclusions to people who do not meet health status underwriting standards. Chapter 27-50 requires that all products be available to all small employers.
2. Rating variables and practices not permitted by Chapter 27-50, including:
  - Rating by geographic area and tobacco use,
  - Failure to comply with the requirement that the highest rate for any plan of benefits and demographic type be no more than four times as high as the lowest rate (“4:1 compression”) for each family composition type,
  - Premium rates which vary by individual age, as opposed to Chapter 27-50’s requirement that a carrier may not use age brackets smaller than five year increments beginning with age thirty and ending with age sixty-five.
  - Health status adjustments in excess of the permitted range. Based on information provided in response to examination requests, MEGA has been active in the small employer market in Rhode Island since at least 1999. However, they did not make the filing required by Regulation 82 Section 11 A as of December 6, 2001 indicating that they intended to operate as a small employer carrier under Regulation 82 in Rhode Island. Under Chapter 27-50 and Regulation 82, they would be permitted to use health status as a rating variable if they were a small employer carrier and if they used health status as a rating variable as of June 1, 2000. If so permitted, the health status adjustment can result in rates no more than 10% higher or lower than the adjusted community rate.
3. MEGA’s rate manual is incomplete. It does not include information supporting the calculation of the rates, and does not include rates for all products offered by MEGA. It also does not contain information required to demonstrate the rate relativity between plans.



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4. The examiners concluded that the associations through which the MEGA health plans are marketed are not bona fide associations as defined in Chapter 27-50. As a result, the membership fees charged by the associations are subject to limitations on administrative fees imposed by Chapter 27-50 and Regulation 82. The administrative fees, including monthly association membership dues, are greater than those permitted by Chapter 27-50 and an initial enrollment fee is not permitted by Chapter 27-50.
5. Failure to offer coverage equally to all eligible groups of 50 employees or fewer.

MEGA's association and small group business is different from the small employer insurance issued by other carriers in the Rhode Island market in several ways.

A major difference is that the products provide more limited benefits than other Rhode Island small employer policies, and at lower cost. The average premium for a single subscriber for MEGA health insurance is approximately \$230 per month, as compared to the average for other carriers ranging from approximately \$350 to more than \$400 per month, depending on the benefit plan chosen.

MEGA pays graded commissions at a much higher level than for other group insurance. Commissions paid by other carriers are paid based on a per subscriber per month basis, and commissions and bonuses for those carriers average 4 to 6% of premiums. MEGA pays first year commissions of 39% of premium, grading down to 26% in year two and 13% in subsequent renewal years. Even considering that MEGA premiums are, on average, about 60% of premiums for health insurance provided by other Rhode Island small employer carriers, the average dollar amount of commissions paid for the sale of a MEGA product is at least twice as much as is paid for the sale of other small employer coverage in Rhode Island on a per member basis.

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MEGA's health insurance business that is the subject of this examination experiences very high termination rates. Of those MEGA subscribers who were active on December 31, 2004, 43% terminated by December 31, 2005. In addition, of approximately 600 new business subscribers first written in 2005, 30% had also terminated by the end of 2005. In total, there were almost 600 terminations in 2005, while average enrollment was just under 1,000. It appears from the termination rates and from the reason codes that MEGA maintains with regard to terminations that many people may regard purchasing MEGA insurance as temporary, and that many MEGA insureds ultimately seek more extensive coverage from another carrier. On the other hand, a significant number of insureds who terminated MEGA insurance did so because they found it unaffordable, which could imply that the more expensive products offered by the other carriers would be even more unaffordable for those individuals. Some Rhode Island purchasers of MEGA association health plans may find that MEGA plans are relatively more affordable for them than are the more comprehensive products offered by the other Rhode Island small employer carriers. However, affordability of a health insurance plan is a combination of the premium cost and the cost sharing paid at the time health benefits are used. It is a complex issue, and the effects will vary by person.

MEGA's experience loss ratio for Rhode Island association business has been at or below 35% in each of the last three years. This contrasts with their pricing assumption of a 55% loss ratio, and with the medical loss ratio experienced by the other Rhode Island small employer carriers of 76% to 84%. This is one consequence of MEGA's high commission distribution methods, but in general shows that MEGA insurance returns much less in benefits per dollar of premium than the other carriers. There is no minimum loss ratio requirement for Rhode Island small employer business, however.

Because MEGA offers low cost, low benefit plans, and because MEGA declines applicants who do not meet its medical underwriting standards, it is likely that MEGA attracts a segment of the small employer market that includes lower than average utilizers of health services. MEGA's involvement in the market could therefore have the effect of

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segmenting the market and increasing costs for the other small employer carriers if healthier individuals enroll in MEGA plans instead of Blue Cross or United health plans. However, if MEGA members would not otherwise purchase insurance, MEGA would not be acting to segment the market.

In connection with completing this examination, the examiners requested a sample of complaint files for review. A detailed review of this sample is included in the report.

The examiners also requested a sample of files to enable review of the rating of individual MEGA subscribers for accuracy in compliance with MEGA's rate manual.

This report contains recommendations designed to bring MEGA into compliance with Chapter 27-50.

### **3. Summary of Recommendations**

1. It is recommended that MEGA include in its marketing materials for both the Standard and Economy plans a statement that the applicant is not required to purchase a membership in one of the associations represented by MEGA agents.
2. It is recommended that MEGA limit any monthly fee to a maximum of \$5.00 per subscriber per month.
3. It is recommended that MEGA terminate its practice of charging a one-time fee to applicants for small employer health plans.
4. It is recommended that MEGA identify subscribers who have been overcharged as a result of its non-complying practice of charging a one-time fee to applicants and charging a monthly fee in excess of the allowed maximum for small employer health plans and the amount of such overcharges for the period January 1, 2004 and forward.

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5. It is recommended that the company include rates in its rate manual for all plans that it offers in the small employer market, including the Standard plan.
6. It is recommended that MEGA revise its rates to use age brackets of not less than five year increments and that the last five year age bracket end with age sixty-five.
7. It is recommended that MEGA include rates applicable to eligible employees over age 63 in its rate manual.
8. It is recommended that MEGA change its rating methodology such that, for a given small employer group, MEGA charges the same rate for each family composition category, as required by R.I.G.L. § 27-50-5(a)(1) and Regulation 82(5)(A)(1) .
9. It is recommended that MEGA eliminate the usage of a rating variable that is based on tobacco usage.
10. It is recommended that MEGA eliminate the usage of a rating variable that is based on geographic location.
11. It is recommended that MEGA institute a step in its rating process that ensures that rates charged to small employers meet the 4:1 compression requirement as defined in R.I.G.L. § 27-50-5(a)(5).
12. It is recommended that MEGA develop and submit a list of any employers that were charged rates that were greater than 4 times the lowest rate charged to any group, including the amount that the rates charged to those employers exceeded 4 times the lowest rate charged. This list should be prepared for the period from January 1, 2004 forward.

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13. It is recommended that MEGA determine the adjusted community rate for its various products and based on the adjusted community rate determine if it meets the health status adjustment threshold. If appropriate, MEGA should modify its practices to ensure that it meets the requirements of R.I.G.L. § 27-50-5(a)(2).

14. It is recommended that MEGA develop and submit a list of groups that were assigned health status adjustment factors that exceeded 10% of the adjusted community rate and determine for each of the groups the excess premium charged. This list should be prepared for the period from January 1, 2004 forward.

15. It is recommended that MEGA cease its practice of declining to issue or modifying the covered benefits of certain applicants for its small employer products.

16. It is recommended that MEGA identify all certificates issued by MEGA that include an exclusion of coverage for a specified condition or disease, for all certificates issued or in force during the period from January 1, 2004 forward.

17. It is recommended that MEGA develop and submit a list of any claims submitted to MEGA that were denied under an exclusion for a specified condition or disease, including the amount of each claim. This list should be prepared for the period from January 1, 2004 forward.

18. It is recommended that MEGA identify all applicants whom MEGA declined to issue due to the existence of a specified condition or disease, for the period from January 1, 2004 forward.

19. It is recommended that MEGA develop and maintain a rate manual in accordance with the requirements of R.I.G.L. § 27-50-5(h), R.I.G.L. § 27-50-5(d), and Regulation 82(5)(B)(1).

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20. It is recommended that MEGA include a description in its rate manual of any fees included in its premium rates or charged in addition to its premium rates.

21. It is recommended that MEGA include in its rate manual a description of its process for allocating administrative expenses to small employer health plans.

22. It is recommended that MEGA review the development of the rating factors in its rate manual to determine if they satisfy the requirements of Regulation 82(5)(b)(2), and record the analysis in the rate manual.

23. The examination revealed discrepancies between the rate manual and the rate calculation for three of seven sample groups. These discrepancies involved use of a rate for the wrong plan of benefits and the application of the Region Factor for the Accumulated Covered Expense Rider. It is recommended that MEGA review these discrepancies and, if appropriate, make prospective and retrospective adjustments in the billed premium for any affected Rhode Island certificate holders, for rates effective January 1, 2004 and forward.

24. It is recommended that MEGA include consideration of its Association Business in the annual Certification required by R.I.G.L. § 27-50-5(h)(2) and submit a corrected certification to OHIC for calendar year 2005.

25. It is recommended that the Certification include, if appropriate, a statement that the certifying actuary meets the qualifications required by Insurance Bulletin 2002-4.

26. It is recommended that MEGA's Actuarial Certification identify instances of non-compliance, the number of such instances, the nature of the non-compliance, and the steps taken to correct the non-compliance, both prospectively and retrospectively.

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27. It is recommended that the certifying actuary include with the Certification various exhibits as may be required to support the conclusions and opinions stated in the Certification.

28. It is recommended that MEGA require that its agents market its small employer products to all small employers without regard to health status, pregnancy, or other underwriting criteria not permitted by Chapter 27-50 or Regulation 82.

29. It is recommended that MEGA provide a list of all applications for health insurance that were denied due to the existence of a pregnancy of the applicant or of an eligible dependent, for the period January 1, 2004 forward.

30. It is recommended that MEGA offer to all small employers, including sole proprietors, all plans in its portfolio, including the Association Plans.

31. It is recommended that MEGA provide guidance to its agents and to small employers with respect to the requirements of Chapter 27-50 as they relate to employee eligibility.

32. It is recommended that MEGA state whether or not it was a small employer carrier as of June 1, 2000.

33. It is recommended that MEGA indicate if it used health status as a rating variable for its small employer business as of June 1, 2000.

34. It is recommended that MEGA review the resolution of the complaints discussed here and investigate and respond as to any additional action that is appropriate in light of this report.

35. It is recommended that MEGA revise its underwriting and claim adjudication procedures in order to identify applicants and insureds with prior creditable coverage and

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limit its pre-existing condition exclusion period for such applicants and insureds as required by R.I.G.L. § 27-50-7(d)(2).

36. It is recommended that MEGA revise its contracts to ensure that it does not implement a waiting period longer than 60 days for wellness and dental benefits.

37. It is recommended that MEGA prepare a list of all claims for wellness and/or dental benefits that have been denied since January 1, 2004 because of the application of a waiting period longer than 60 days.

38. It is recommended that MEGA provide disclosure to prospects for its small employer health plans of the relationships between MEGA, its parent company, and the membership associations, as provided by the settlement of a class action lawsuit and announced by UICI in an October 18, 2004 news release.

39. It is recommended that MEGA use a definition of pre-existing condition that is not more restrictive than that provided in R.I.G.L. § 27-50-3(cc).

40. It is recommended that MEGA prepare a list of all claims that have been denied due to the use of a definition of pre-existing condition that does not meet the requirements of Chapter 27-50, for the period from January 1, 2004 and forward.

41. It is recommended that MEGA remove from its pre-existing condition limitation any limitation on pregnancy related benefits otherwise covered by the health plan.

42. It is recommended that MEGA develop a listing of all claims submitted to MEGA January 1, 2004 and later that were denied due to its application of a pre-existing condition limitation for pregnancy related benefits that would have otherwise been covered by the health plan.



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43. It is recommended that MEGA change its definition of dependent to include any full-time student who is under the age of twenty-five. Additionally, MEGA should be aware of changes<sup>2</sup> to the eligibility provisions for dependents that were enacted by the Rhode Island legislature and that are effective for every group health insurance contract, plan, or policy delivered or issued for delivery in Rhode Island.

44. It is recommended that MEGA include in the application packages for its Association Plans an employer application form.

45. It is recommended that MEGA replace the Statement of Eligibility Status form with one that can be used to determine small employer eligibility, based on the definition of small employer provided in R.I.G.L. § 27-50-3(kk).

46. It is recommended that MEGA meet the requirements of R.I.G.L. § 27-50-5(g) by providing disclosure of the following items as part of all small employer health plan proposals: the carrier's right to change premium rates and the factors, other than claims experience, that affect changes in premium rates; the provisions relating to renewability; the provisions relating to any pre-existing condition provision; and a listing of and descriptive information, including benefits and premiums, about all the benefits for which the small employer is qualified.

47. It is recommended that MEGA include a definition of the term "pre-existing condition" in its certificate.

48. It is recommended that MEGA report to OHIC the definition of "pre-existing condition" that it has used for the purpose of adjudicating claims.

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<sup>2</sup> See <http://www.rilin.state.ri.us/Billtext/BillText06/SenateText06/S2211Aaa.pdf>

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49. It is recommended that MEGA allow a participating employer to elect for all employees a normal workweek requirement as low as 17.5 hours for the purpose of determining eligibility for the health plan.

50. It is recommended that MEGA include a definition of “eligible employee” on its Small Employer Group Application that is consistent with that provided by § 27-50-3 (m).

51. It is recommended that MEGA remove the reference to “underwriting requirements” for late enrollees from the Small Employer Group Application.

52. It is recommended that MEGA make provision for employer certification of the employee’s refusal to sign the waiver form.

#### **4. Overview of Chapter 27-50**

Chapter 27-50 defines the small employer market and requirements of carriers in the small employer market to promote the availability of health care. Among the key provisions of Chapter 27-50:

- The small employer market is defined as containing all employer sponsored groups with at least one and no more than 50 employees eligible for health insurance. To be eligible, an employer must be actively engaged in business and the majority of the employees must work in Rhode Island or, if there is no state in which a majority of the employer's employees work, the employer must have its primary business location in Rhode Island.
- All permanent employees who work full-time (at least 30 hours per week) are eligible, with the ability, at the employer’s option, to cover employees who work at least 17.5 hours per week. Temporary employees are not eligible, even if they work full-time.

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- All small employer groups are eligible for coverage, as long as they meet a minimum participation requirement. The minimum participation requirement can be no higher than 75%. No groups or individual employees within those groups can be denied coverage or terminated for reasons other than non-payment of premiums, failure to meet minimum participation standards, or fraud or intentional misrepresentation of material facts.
- There are rules to govern the continuance of small employer eligibility for groups that become larger than 50 eligible employees.
- Insurers are required to verify the eligibility of each group on an annual basis, and to maintain documentation of waivers of coverage for eligible employees and their dependents who choose not to enroll. Small employer carriers are required to obtain appropriate supporting documentation and terminate or non-renew any small employer that fails or refuses to provide it, as provided by Regulation 82(6)(b) and Insurance Bulletin 2002-5.
- Rates must be determined on a four-tier composite basis. That is, there must be separate rates for each family composition type. The four family composition types are enrollee, enrollee plus spouse, enrollee plus child or children, and enrollee plus spouse and children. Rates must be determined on a composite basis by group, such that each employee within a group with the same family status will pay the same rate.
- The only rating variables allowed from group to group are age, gender, family composition and health status. Health status factors can vary by no more than +/- 10% from the adjusted community or average rate. The combination of age, gender and health status is limited so that the highest rate charged for a given plan of insurance and family composition type can be no higher than four times the lowest rate.
- In addition to any other plans of insurance they offer, insurers must offer two statutory plans of insurance, known as the Standard and Economy plans.
- Small employer carriers must actively market all plans.

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- Chapter 27-50 applies to all small employer groups, except that groups that purchase insurance through the Rhode Island Builders Association are exempt from R.I.G.L. § 27-50-5 (the rating provisions of Chapter 27-50).

Subsequent to the period covered by the examination, Chapter 27-50 was amended by the legislature. Among other changes, the requirement to sell the Standard and Economy plans has been removed, and the provision allowing carriers to impose a 100% participation requirement for the smallest groups effective October 1, 2006 has been removed.

Appendix 2 provides an over view of the various changes to Chapter 27-50 since 2000.

### **5. Examination Methodology**

A preliminary list of data requests was transmitted to MEGA on March 31, 2006. MEGA provided the examiners with responses to these data requests during the period April through June, 2006.

MEGA initially responded with regard to only the segment of its business that it considers small group business, and not for association business that covers sole proprietors. After a review by OHIC, it was determined that the association business is subject to Chapter 27-50, and a request for complete data on the association business was forwarded to MEGA. MEGA responded to that request in August 2006. Requests for additional information were submitted to MEGA on October 2, 2006, October 31, 2006, and November 10, 2006.

This report contains results of the compliance audit on a test basis.

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Substantial data was collected and analyzed to enable the development of an overview of MEGA's small employer business and MEGA's rating structure. The statistical data, when combined with that of all Rhode Island small employer carriers provides an overview of the small employer market.

### **6. Profile of MEGA's Small Employer Business**

MEGA is a life insurance company domiciled in Oklahoma with its principal administrative offices located in North Richland, Texas. MEGA offers insurance products to small employers, educational institutions (student insurance products), and large employers (products for temporary and part-time employees). Small employer products include health insurance to which the small employer may add dental, vision, disability, and term life insurance coverage. The health insurance products sold by MEGA are primarily either a scheduled benefits plan<sup>3</sup> or a catastrophic plan. The company also offers a PPO plan and a comprehensive plan, both of which have relatively few subscribers. The catastrophic plan is designed to be supplemented with a Health Savings Account (HSA), which can be implemented through MEGA.

MEGA is one of several insurance subsidiaries of an insurance holding company formerly named UICI. UICI was a New York Stock Exchange listed company but it was taken private effective April 5, 2006. The principal investors who took UICI private were Blackstone Group, Goldman Sachs Capital Partners, and DLJ Merchant Banking Partners. The holding company is now named "HealthMarkets".

Based on information provided by MEGA, MEGA is the only insurance subsidiary of HealthMarkets that issues small employer business in Rhode Island.

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<sup>3</sup> A scheduled benefit plan of the type offered by MEGA reimburses the insured an amount based on actual charges, up to a scheduled maximum (after taking into account the effect of deductibles, copays, coinsurance, and plan maximums) for each specific procedure, visit, service, or test.

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MEGA has structured its organization along market lines. Four different divisions serve different markets:

- Administrative Services Group (also known as the Self Employed Agency division or “SEA”) –association and small employer plans
- Student Insurance Division –student insurance products sold through educational institutions
- Star HRG –limited benefit health plans marketed to large employers for their part-time and temporary employees
- Oklahoma City Division –life and annuity insurance and some ancillary individual health plans.

The focus of this market conduct examination is the activities of the Administrative Services Group with regard to Rhode Island issued business.

MEGA differentiates internally between small employer health insurance business and association health insurance business. MEGA has internally defined small employer business as business that it acknowledges is subject to the Rhode Island’s small employer statute, Chapter 27-50, and the accompanying Regulation 82. MEGA’s association business consists of health plans sold to sole proprietors. MEGA has taken the position that the health plans sold to sole proprietors are not subject to Chapter 27-50. Upon review, OHIC has determined that MEGA’s association business, to the extent that it is issued to small employers, is subject to Chapter 27-50 and has so informed the company. Correspondence regarding this determination is included in Appendix 5 of this report. In the course of this examination report the examiners consider the association business to be subject to Chapter 27-50.

R.I.G.L. § 27-50-4(a) states that the Chapter 27-50, the Small Employer Health Insurance Availability Act, applies to any health benefit plan that provides coverage to the employees of a small employer in Rhode Island if any of four conditions are met:

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- (1) Any portion of the premium or benefits is paid by or on behalf of the small employer;
- (2) An eligible employee or dependent is reimbursed, whether through wage adjustments or otherwise, by or on behalf of the small employer for any portion of the premium;
- (3) The health benefit plan is treated by the employer or any of the eligible employees or dependents as part of a plan or program for the purposes of Section 162, Section 125, or Section 106 of the United States Internal Revenue Code, 26 U.S.C. § 162, 125, or 106; or
- (4) The health benefit plan is marketed to individual employees through an employer.

R.I.G.L. § 27-50-3(kk) makes clear that “[t]he term small employer includes a self-employed individual.” MEGA markets its insurance to self-employed individuals through memberships in associations that target small employers as its members. Since MEGA’s insurance products insurance are marketed to self-employed individuals in their capacity as self-employed individuals, MEGA meets the requirements of R.I.G.L. § 27-50-4(a)(4). In addition, Regulation 82(3)(A)(1)(b) makes clear that the policy or certificate need not be issued in Rhode Island for the Small Employer Health Insurance Availability Act to apply.

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Unless otherwise specified within this report, the terms small employer, small employer business, and small employer health plans will encompass all Rhode Island business of MEGA's Administrative Services Group. The terms "Association Business" and "Association Plans" will refer to the business that MEGA refers to as its association business and that OHIC has determined is subject to Chapter 27-50.

An employee enrolled in a MEGA small employer health insurance plan is also referred to in this report as a "subscriber" or a "contract". In this report these terms are used interchangeably. Dependents are also covered under small employer health insurance plans. All the people covered under a small employer health insurance plan taken together are referred to by the examiners as "members," a term which includes both the subscribers and the dependents.

MEGA markets plans with benefits that are consistent with those described in Chapter 27-50 as the Economy Plan and the Standard Plan on a guaranteed issue basis to Rhode Island small employers, with no rate adjustment for health status.

MEGA's Association Plans, on the other hand, are issued subject to medical underwriting. In the event that MEGA determines that an application does not meet its medical underwriting standards, MEGA will take one of three options: decline the application, issue it with exclusions for certain diseases or conditions, or charge an additional premium. Chapter 27-50 does not allow a small employer carrier to decline to issue coverage due to health status or to exclude coverage for certain diseases or conditions. Chapter 27-50 allows the small employer carrier to vary rates for health status by a maximum of 10% from the adjusted community rate. It appears that MEGA employs rate adjustments for health status in excess of 10% in connection with its association business.

As of December 31, 2005 approximately 975 Rhode Island subscribers and 1,530 total members were enrolled in MEGA small employer health plans. MEGA's most popular



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product is a plan with scheduled benefits (Form 25875), which had 775 subscribers enrolled as of December 31, 2005. The next most popular plan is a catastrophic expense plan (Form 25876) which can be accompanied by a Health Savings Account (“HSA”). MEGA also markets a PPO plan (Form 25877) and a comprehensive plan (Form 25982), both of which have relatively few subscribers.

For each of MEGA’s plans, the core benefit is the hospital and surgical component. Other components of the typical health plan are optional and can be added by rider. Each of the riders has its own benefit limits and cost sharing. In contrast to health plans offered by the other Rhode Island small employer carriers, MEGA’s plans generally require a much greater level of member cost sharing.

Approximately 80% of MEGA’s subscribers are enrolled in the Health Choice Advantage Benefit Plan (Form 25875), which provides scheduled hospital and surgical benefits as its core. The applicant can select a plan with a deductible that ranges from \$1,000 to \$5,000, and a daily room and board limit that ranges from \$300 to \$1,000. The plan requires 80%/20% coinsurance for the surgeon and surgical facility benefit, with various maximums per procedure.

Approximately 15% of MEGA’s subscribers are enrolled in the Signature Benefit Plan (Form 25876). This plan is a catastrophic hospital expense plan. The plan can be designed to meet the requirements for a qualified health savings account (HSA). The core plan provides hospital and surgical benefits. Coverage is also provided for chemotherapy and radiation therapy, transplant procedures, and durable medical equipment. The applicant can elect either an individual or family plan. The individual plan provides for a \$2,500 deductible and 80%/20% coinsurance until the coinsurance maximum of \$2,500 is reached. The family plan has a deductible of \$5,000 and the applicant can select 50%/50% or 80%/20% coinsurance, with a coinsurance maximum of \$5,000. Covered benefits are paid at 100% once the coinsurance maximum is reached for the remainder of the calendar year.

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As indicated above, the hospital and surgical benefits form the core of MEGA's health plans. More comprehensive health benefits can be obtained by adding various optional riders to the core benefit. Each of the riders has its own defined cost sharing and inside limits. For example, the following riders are available for the Health Choice Advantage Benefit Plan:

- Return of premium benefit at age 65 (a benefit that returns part of the excess of premiums over paid claims)
- Outpatient benefits for diagnostic X-ray, laboratory exams, physical therapy
- Outpatient accident expense benefit
- Physician office visit benefit
- Accumulated covered expense benefit (pays 100% once covered expenses under the certificate reach a specified maximum; applicant can elect a maximum of \$75,000 or \$100,000)
- Chemotherapy and radiation therapy benefit
- Air ambulance benefit
- Continued Care benefit
- Pregnancy and childbirth benefit
- Emergency Room benefit
- Wellness benefit
- Pharmacy benefit

In addition, MEGA offers a Critical Care benefit as a stand-alone supplemental product. This benefit provides a lump sum payment on diagnosis of a specified disease or condition, following a qualification period. The applicant can elect the benefit face amount, ranging from \$10,000 to \$60,000. Upon completion of the qualification period the selected face amount is payable, except that 25% of the selected face amount is payable for angioplasty and by-pass surgery. R.I.G.L. § 27-50-3(t)(4)(i) excludes

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products of this type from the definition of “Health Benefit Plans”, and therefore Chapter 27-50 does not otherwise apply to this product.

In conjunction with the sale of small employer health plans (including the riders), MEGA sells vision, dental, and term life insurance plans. MEGA’s product brochures for the Association Plans describe the features of these plans. The application forms for the Association Plans allow the applicant to select any of these supplemental coverages by means of checking the appropriate boxes and providing the required supplemental information.

Each subscriber receives a certificate of coverage. Coverage is provided via various policies that are issued by MEGA. Except for the Standard and Economy plans, membership in one of several specified associations is required in order to obtain access to a MEGA health plan. The associations are the National Association of the Self-Employed (“NASE”), Americans for Financial Security (“AFS”), and the Alliance for Affordable Services (“AAS”). MEGA has stated that there are currently only two Rhode Island certificates in force for members of AAS. Except for the statutory plans, in order to be eligible to apply for a MEGA health insurance plan, MEGA requires that the employer must be a member of an association. As a member of an association, the employer can apply for an association sponsored health plan issued by MEGA. MEGA has stated that association membership is not required for the statutory plans. However, MEGA’s application package for the statutory plans refers to association membership and dues.

Small employer health plans and supplemental products are sold by independent agents who are appointed as agents of MEGA. The agents operate as independent contractors. The agents are also appointed as representatives of the associations and are authorized to accept applications for membership in the associations.

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The examiners requested an extract of enrollment data for MEGA's small employer business. MEGA provided a summary of data for those enrolled in the Standard and Economy plans and subsequently provided detailed data for the Association Business.

According to the database of group level information provided by MEGA in connection with this examination, MEGA had approximately 975 Rhode Island small employer groups in force as of December 31, 2005. Each of the groups was reported by MEGA to consist of a single subscriber. MEGA had approximately 1,531 Rhode Island members under its small employer plans on December 31, 2005. Approximately seven of the groups had selected one of the statutory small employer plans required to be offered by Chapter 27-50-10, either the Economy or the Standard Plan. Each of the seven groups has a single subscriber and the seven groups have a total of thirteen members. Approximately 69% of MEGA's Rhode Island small employer subscribers purchase single coverage, 11% purchase Husband and Spouse coverage, 13% purchase Parent and Children coverage, and 7% purchase Family coverage. The average contract consists of 1.6 members.

The average monthly premium for the "enrollee only" tier for MEGA coverage as of 2006 is approximately \$228. The average full family premium is approximately \$560. These amounts are 30% to 40% lower than average premiums charged by the other Rhode Island small employer carriers. MEGA is able to offer lower premiums by offering much more limited benefits than those offered by the other carriers.<sup>4</sup>

MEGA experiences a very high lapse rate, MEGA had 959 active certificates as of 12/31/2004 and 417 of these certificates terminated by 12/31/2005. MEGA issued 599 Association Plans during 2005. Of these, 173 terminated prior to December 31, 2005 and 313 in total terminated by July 31, 2006. There were almost 600 total terminations in 2005, while the average enrollment was just under 1,000 subscribers. The three most

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<sup>4</sup> A comparison of the premium provides only a partial indication. As stated previously, the loss ratio experienced by MEGA is substantially lower than that experienced by the other small employer carriers and the agent compensation is more than double that of the other major small employer carriers.

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common reasons cited for termination were “More coverage for less money”, “New job with insurance”, and “unhappy with coverage.”

MEGA has the smallest market share of the three companies in the Rhode Island small employer market. MEGA provides health plans to approximately 1.6% of the market, based on number of subscribers.

Regulation 82(10)(G)(1) requires that each small employer carrier report in March of each year the number of plans that it insures as of the end of the preceding year. MEGA filed such a report for the first time in March, 2006 and the report reflected only the required information for the statutory plans. As noted earlier in this report, MEGA has not considered the Association Plans issued to sole proprietors, business that it refers to as “association business”, as subject to Chapter 27-50. In its report to the OHIC, MEGA limited its response to the Standard and Economy plans and indicated that it had renewed 21 groups and that 10 groups had lapsed during 2005.

MEGA’s Rhode Island small employer revenue including both the Association business and the Standard and Economy plans increased from \$3.0 Million in 2003 to \$3.5 Million in 2005. For the entire period 2003-2005, MEGA experienced a loss ratio of approximately 32%, based on the four most popular plans that represent 98% of MEGA’s small employer business. The loss ratio was 34.5% in 2005. In response to a request for the target loss ratio reflected in its product pricing, MEGA has indicated that its target loss ratio is 65% for the Standard and Economy plans and 55% for its Association Plans. Chapter 27-50 does not contain a minimum loss ratio requirement.

Based on an exhibit of per member per month claim cost provided by MEGA, it appears that MEGA’s recent health care cost trend is approximately 10% for scheduled benefit plans and approximately 12% for comprehensive plans. This is consistent with trends observed at other health insurers, both in Rhode Island and in other jurisdictions.

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MEGA's rates for each contract are calculated as the sum of the rates for the subscriber and the rates for each dependent member. MEGA's rates vary by age. Consequently, MEGA's premium billing is a form of list billing. Regulation 82(10)(A)(1) requires that a small employer carrier actively market each of its small employer health benefit plans to small employers, including employers with more than one employee. If MEGA were to offer coverage to small employers with more than one employee, its current rate manual would not allow them to calculate rates on a compliant basis. A theoretical MEGA quote using its current rate manual for a group with two subscribers, each of which had a different attained age, would result in different rates for each of the subscribers. This form of rating is not permitted by Chapter 27-50 which requires composite group rating.

MEGA obtains health status information at the time of the initial application for its Association Plans, and determines a loading and/or exclusion, or may decline to issue the coverage. MEGA's underwriting and rating methodology for health status are not permitted by Chapter 27-50. MEGA's rating by age/gender also does not meet the requirements of the Chapter 27-50. MEGA does not have a step in its rating process to manage the variation in rates due to age/gender and health status within the required 4:1 compression ratio.

MEGA markets its small employer products through independent agents. The independent agents are compensated with commissions which vary by policy duration. The commission scale provides for commission rates of 39% of premium in the first policy year, 26% in the second year, and 13% in subsequent policy years.

The NASE and AFS membership associations actively promote the availability of MEGA health insurance products on their respective websites. A search of the internet using Google indicates that there are a number of websites that appear to belong to individual MEGA agents. These websites promote the availability of "affordable" health insurance products and invite the site visitor to contact the agent for a quote. The examiners

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specifically reviewed a site at <http://www.savumoney-ins.com/>. This site has a specific link for “Rhode Island Plans;” however the link provides only generic information. The particular agent who maintains <http://www.savumoney-ins.com/> provides an email contact, but provided no office address or office phone number.

### **7. Management Structure for Small Employer Business**

MEGA markets its products through four different divisions, each of which is focused on a particular market. The Administrative Services Group is responsible for the marketing of small employer plans.

The Administrative Services Group is made up of operations located in North Richland Hills (“NRH”), Texas and Norwalk, Connecticut. The NRH offices of MEGA administer what is described by MEGA as association group insurance and small employer group insurance plans.<sup>5</sup> The Norwalk offices administer small employer group insurance plans, but not in Rhode Island. NRH offices of MEGA administer all Rhode Island small employer plans.

### **8. Marketing to Small Employers**

MEGA’s small employer products are marketed in Rhode Island through independent agents appointed by the company. The agent contracts with UGA, the marketing division of MEGA. Agents appointed by MEGA also represent the associations for the purpose of soliciting membership applications.

MEGA has considered only the health plans sold as Standard and Economy as subject to Chapter 27-50, and has not considered the plans it refers to as association business as subject to Chapter 27-50. Therefore, we discuss the marketing process for the Standard

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<sup>5</sup> What is described by MEGA as “association group insurance business” consists of sole proprietor business that MEGA believed was not subject to Chapter 27-50. MEGA defines “small employer plans” as business that is subject to Chapter 27-50. Association Business consists of those applicants who indicated on the “Statement of Eligibility Status” form that “I am not establishing or participating in a Small Employer Group Health Plan as defined above.”

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and Economy plans separate from that for the other health plans available to sole proprietors.<sup>6</sup>

### Marketing of the Standard and Economy Plans

According to the description provided, MEGA determines if an applicant is a small employer using the Statement of Eligibility Status form that is contained in the “Required Forms Package.” If the applicant checks a box on the form that states “I am establishing or participating in a Small Employer Health Plan as defined above,” the agent provides the applicant with information about the Economy and Standard Benefit plans using the product brochures for these plans, along with the premiums for these plans. The agent asks the prospect to review and sign a “Confirmation of Presentation, Disclosures and Receipt” form (Form M/CDR 12/05-4/06). In particular, the form states that the agent:

...has delivered to me a copy of the “Disclosures regarding the MEGA Life and Health Insurance Company and Association Relationship.”

The agent provides a copy of the product brochure for the plan selected for each applicant and collects the initial premium from the small employer and/or the employees and submits all application materials and the initial premium to MEGA for processing.

The Small Employer Group Application includes a section that is used to calculate the initial premium. The premium calculation includes an adjustment for quarterly and annual premium modes. The premium calculation also includes a step for adding \$8 per month per employee as “Association Dues.” The initial premium is further increased by a “One time Association Group Administration Fee” of \$120 per employee for the first four employees. MEGA, in response to an inquiry from the examiners, indicated that membership in an association is not a requirement for the purchase of either the Economy or the Standard plan and that the application form used in Rhode Island is a generic form that is used in other states. However, there is no indication on this form, or on any of the marketing materials provided to the examiners, to tell either the agent or the applicant

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<sup>6</sup> Based on the data provided by MEGA, all Economy and Standard plans consist of a single subscriber.



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that membership in an association is not a requirement to obtain either the Standard or the Economy health plan.

**Recommendation 1:** It is recommended that MEGA include in its marketing materials for both the Standard and Economy plans a statement that the applicant is not required to purchase a membership in one of the associations represented by MEGA agents.

### Marketing of Association Plans

If the prospect checks the box on the Statement of Eligibility Status form for the statement “I am not establishing or participating in a Small Employer Group Health Plan as defined above,” the agent assists the prospect with the next step. In this step he is guided through questions to determine if he/she is HIPAA eligible and thereby eligible for guaranteed issue coverage.

A HIPAA eligible prospect is given Form “M HEI HCA SIG RI 10/06.” This brochure describes the benefit plan options available to a HIPAA eligible prospect.

The following plans are available to HIPAA eligible prospects on a guaranteed issue basis:

- A Basic Hospital/Medical-Surgical Expense Insurance Plan (Form 25875-C). This plan has a \$3,000 deductible per confinement and a \$300 per day maximum room and board benefit
- A Catastrophic Hospital Expense Insurance Plan (Form 25876-C). This plan has a \$5,000 calendar year deductible.

Enrollment in one of the HIPAA plans requires association membership.

Each of the Association Plans (i.e. excluding the Economy and Standard plans) has its own application package. Each of these application packages contains the “Statement of Eligibility Status” form that was discussed in an earlier section. The application form

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uses a “check the box” approach that allows the applicant to select from the various options of the core plan<sup>7</sup> and then select from the available riders that have their own inside limits and maximums. The application form allows both individual coverage and coverage of additional family members. The application includes a list of health questions.

The application package includes a premium calculation worksheet. The initial premium is calculated by the agent and is based on a rate manual that is provided by MEGA. The premium calculation worksheet provides for a quarterly and annual premium mode in addition to monthly premiums, with the quarterly premium calculated as three times the monthly premium and the annual premium calculated as eleven times the monthly premium. MEGA provides software to its agents to facilitate the determination of the appropriate premium rate.

The premium calculation worksheet provides for the “Association Administration Fee” and the “Association Dues.” The premium calculation worksheet does not indicate the amount of the fees.

### Association Relationships

MEGA agents represent MEGA for the purpose of marketing insurance products and they represent certain associations through which MEGA insurance products are available. MEGA agents represent the associations for the purpose of soliciting membership applications. Except for the Standard and Economy plans, membership in one of the associations is required in order to be eligible to apply for an association sponsored health plan.

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<sup>7</sup> Each of the Association Plans has as its core a hospital/surgical benefit plan. For this reason, the examiners refer to the Hospital/Surgical benefit as the core plan.

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MEGA stated that, except for two certificates, Rhode Island association membership is limited to NASE and AFS. NASE and AFS maintain websites at <http://www.nase.org/> and <http://www.afswebsite.org/default.asp> respectively.

Both NASE and AFS provide two levels of membership:

- The Access level of membership at \$120 per year, and
- The Premier Resource level of membership at \$480 per year.

According to information posted at the association websites, a one-time fee of \$75 is charged at the time an application is submitted. Both associations allow the submission of an application without the assistance of an agent through their websites.

The NASE website states that:

“(t)he National Association for the Self-Employed (NASE) is the nation's leading resource for the self-employed and micro-businesses (up to ten employees), providing a broad range of benefits and support to help the smallest businesses succeed.”

The benefits offered by NASE and AFS appear to be mostly discount arrangements, including some that have a subscription charge associated with them. The Premier Resource membership includes certain insurance benefits and additional services. Based on a comparison of the benefits provided by NASE and AFS, as described on their respective websites, the benefits offered by each of these associations appear to be very similar.<sup>8</sup>

Each of the associations includes on its website a webpage titled “Disclosures and Policies.” This page describes the relationship between the association and MEGA and other affiliated entities. A copy of this page is included in this report as Appendix 3.

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<sup>8</sup> A listing of the benefits offered to members of NASE can be found at <http://benefits.nase.org/Benefits.asp> and a listing of benefits offered to members of AFS can be found at <http://benefits.afswebsite.org/Benefits.asp>

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MEGA provided the examiners with a similar disclosure statement that is provided to prospects who are sold a membership by a MEGA agent.

A Wall Street Journal article<sup>9</sup> provides background information that is not included in the above cited disclosure statement:

- Ronald Jensen founded UICI, the parent company of MEGA in 1984
- In 1985 Mr. Jensen took control of NASE
- Mr. Jensen's son Jeffrey founded AFS in 1992
- NASE pays approximately 50% of its first year membership dues to the agent who enrolled the new association member
- All daily operations of NASE are performed by Specialized Association Services Inc. ("SAS"), which is paid a per member fee for its services to the association
- SAS was founded by Ronald Jensen and sold to his son, Jeffrey Jensen
- Jeffrey Jensen is responsible for reviewing the performance of UICI and its insurance subsidiaries in providing services to the association and determining if better policies are available

The disclosure statement for AFS, analogous to the NASE disclosure statement referenced above, indicates that SAS also performs administrative services for AFS.

The websites for both associations state that they engage in lobbying activity on behalf of their members and that, as a result of this lobbying activity, \$7 of the annual dues are not tax deductible.

The websites for both associations extensively promote "affordable health insurance." The online membership applications for both associations elicit information about the applicant's current health insurance status. As noted previously, other than the association's website, the marketing of association membership appears to be limited to

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<sup>9</sup> Wall Street Journal November 21, 2002

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activities of insurance agents who market the membership as a condition for obtaining MEGA health insurance products.

R.I.G.L. § 27-50-3(e) provides a definition of Bona fide association:

"Bona fide association" means, with respect to health benefit plans offered in this state, an association which:

- (1) Has been actively in existence for at least five (5) years;
- (2) Has been formed and maintained in good faith for purposes other than obtaining insurance;
- (3) Does not condition membership in the association on any health-status related factor relating to an individual (including an employee of an employer or a dependent of an employee);
- (4) Makes health insurance coverage offered through the association available to all members regardless of any health status-related factor relating to those members (or individuals eligible for coverage through a member);
- (5) Does not make health insurance coverage offered through the association available other than in connection with a member of the association;
- (6) Is composed of persons having a common interest or calling;
- (7) Has a constitution and bylaws; and
- (8) Meets any additional requirements that the director may prescribe by regulation.

Membership in either association is not conditioned on health status and any association member can apply for a health plan endorsed by the association and underwritten by MEGA. However, MEGA may rate or decline the application based on its underwriting standards.

The examiners reviewed the articles of incorporation and the current by-laws for both NASE and AFS. The examiners noted that both associations do not allow its members to

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vote by proxy and recognize only votes that are cast in person at a meeting of the members.

In the opinion of the examiners, the NASE and AFS fail to meet the definition of a “bona fide association” in the following ways:

- The associations were formed and/or primarily for the purpose of marketing MEGA’s health products;
- The common interest of the members of the association appears to be primarily to obtain access to MEGA’s health insurance products. This is demonstrated to the examiners by the fact that the primary sources of association membership are MEGA agents; and
- MEGA may rate or decline the application for insurance from the association member based on MEGA’s underwriting standards.

Further observations within this report are consistent with the determination by the examiners that NASE and AFS are not “bona fide associations” as defined in Chapter 27-50.

### **Membership Dues and Application Fee**

Regulation 82(5)(B)(3)(a) states that “Except as provided in Section 5(B)(3)(b) of this Regulation, a premium charged to a small employer for a health benefit plan shall not include a separate application fee, underwriting fee, or any other separate fee or charge.” Section 5(B)(3)(b) allows a carrier to charge a separate fee with respect to a health benefit plan provided the fee is no more than \$5 per month per employee and is applied in a uniform manner to each health benefit plan.

Membership dues for an association which is a “bona fide association” do not constitute fees subject to the restrictions stated in Regulation 82(5)(B)(3). However membership fees charged by an association that is not a “bona fide association” are subject to the

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restrictions stated in Regulation 82(5)(B)(3) because to do otherwise would make this restriction meaningless. Specifically, the monthly (or annual) membership fees and the one-time application fees charged by NASE and AFS are subject to the restrictions of Regulation 82(5)(B)(3).

The fees charged by MEGA as monthly association dues exceed the fee level allowed by Regulation 82(5)(B)(3). A one-time fee such as the “One time Association Administration Fee” is not allowed by Regulation 82(5)(B)(3)(a).

**Recommendation 2:** It is recommended that MEGA limit any monthly fee to a maximum of \$5.00 per subscriber per month.

**Recommendation 3:** It is recommended that MEGA terminate its practice of charging a one-time fee to applicants for small employer health plans.

**Recommendation 4:** It is recommended that MEGA identify subscribers who have been overcharged as a result of its non-complying practice of charging a one-time fee to applicants and charging a monthly fee in excess of the allowed maximum for small employer health plans and the amount of such overcharges, for the period January 1, 2004 and forward.

### Commission Structure

MEGA pays agents based on a commission scale that is a percentage of premiums and graded by duration. The first year commission is 39% of premium, the second year commission is 26% of premium, and in subsequent years the commission is calculated as 13% of premium.

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MEGA's commission structure is very high relative to that of the other Rhode Island small employer carriers, which are structured on a per subscriber per month basis, and are equivalent to an approximate range of 4-6% of premium, including broker bonuses.

The grading of commissions by duration is also rather unusual in the group health insurance field.

Chapter 27-50 and Regulation 82 do not impose any limitations on the level of compensation paid to producers.

### **Lapse Rate**

The data extract provided to the examiners by MEGA allowed the examiners to calculate the termination rate for its association business. MEGA had 959 Rhode Island certificates in force on December 31, 2004. During 2005 MEGA experienced 417 terminations of certificates that were in force on December 31, 2004, implying a lapse rate of 43% among subscribers that had been there the prior year. The lapse rate for first year business is somewhat higher. MEGA issued 599 association certificates to Rhode Island residents in 2005 and 313 of these certificates were terminated as of July 31, 2006, suggesting a first year lapse rate in excess of 50%.

As indicated in the prior paragraph, MEGA issued 599 association certificates in 2005. MEGA experienced 590 terminations in 2005 (including the termination of 173 of the 2005 issues), so the business volume was approximately the same at the beginning and end of the year. There were 968 association certificates in force on December 31, 2005. In aggregate, therefore, with average enrollment in 2005 of less than 1,000, there were almost 600 terminations.

On a basis consistent with the reporting requirements under Regulation 82(10)(G)(1), MEGA had 590 terminations in 2005, new business of 599 enrollees and somewhere



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between 542 and 959 renewals, depending on how many of those in force at the beginning of the year renewed coverage. That implies a termination rate of between 38% and 56%. The comparable termination rates reported by the other Rhode Island small employer carriers ranged from 9% to 13% by number of groups. Since it might be expected that the smaller groups would be more likely to terminate than larger ones, termination rates by number of enrollees would be even lower for those other carriers.

MEGA's records include termination reason codes. Many of the terminations are coded to reflect that either people are not satisfied with MEGA coverage or are obtaining other coverage through employment or through a spouse. Others indicated that they were dropping MEGA coverage because they found it unaffordable, which may imply that they would not find the more expensive coverage offered by other small employer carriers in Rhode Island affordable either.

### **9. Rating Methodology for Small Employer Business**

This market conduct examination includes a review of the rate manual and rating methodology, an analysis of rating variables and rates by group to develop data to assist in an overall understanding of the small employer market and to determine the effect of current regulatory limitations in small employer rating, and to provide a statistical basis to evaluate the impact of potential changes in rating.

The examiners requested data to enable analysis of rating variables and rates and a review of sample individual rate calculations for accuracy and compliance with R.I.G.L. § 27-50-5 and Regulation 82(5).

#### **Rating Methodology Review Process**

The examination staff reviewed the following items with regard to the rating manual, rating methodology, rating compliance and statistical analysis of rating variables:

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- Complete small employer rating manual with rates that are effective as of September 2006.
- Actuarial statement of certification of compliance prepared and submitted to the OHIC by MEGA's actuary, Charles M. Schneeberger FSA MAAA, in March of each year 2002 through 2007..

MEGA Rate Manual

The rate manual that was provided does not indicate an effective date.

A review of the manual indicates that it includes rates for all health plans marketed by the Administrative Services Group, except the Standard plan. The manual has starting rates for each plan of benefits that is marketed by MEGA. This contrasts to the approach used by other carriers in the Rhode Island market under which a rate is developed for a single plan and the starting rate for other plans is obtained by a plan relativity factor. For each health plan, the rate manual includes tables of adjustment factors to allow adjustment of the starting rate for various plan variables, such as deductibles, coinsurance and plan maximums. For each health plan, the manual contains rate tables and supporting adjustments for various riders that can be added to the core benefit.

A review of the rate manual indicates many areas in which MEGA is not in compliance with Chapter 27-50. This section contains numerous recommendations for change that are required in order for MEGA to come into compliance with Chapter 27-50 and with Regulation 82.

The manual contains rates for the Economy plan, but it does not contain rates for the Standard plan. Recently enacted legislation amends Chapter 27-50 such that small employer carriers are no longer required to offer the Standard and Economy plans. MEGA indicated to the examiners that both of these plans remain in the carrier's

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portfolio. Regulation 82(5)(A) requires that rates be computed solely from the carrier's rate manual.

**Recommendation 5:** It is recommended that the company include rates in its rate manual for all plans that it offers in the small employer market, including the Standard plan.

R.I.G.L. § 27-50-5(a)(3) requires that age brackets are not smaller than five year increments and that the last age bracket end with age sixty-five. MEGA's last age bracket for the Economy plan applies to ages 60 to 63. MEGA is required to make available its small employer health plans to any eligible employee, regardless of age, and therefore its rate manual should include rates for eligible employees over age 63.

For the core benefit component of MEGA's Association Plans, the rate manual has age/sex factors for each individual age, except age groupings "0-19" and "64 and older". A distinct age factor is included for "Dependent Child." Such tables result in rates that do not comply with R.I.G.L. § 27-50-5(a)(3), because MEGA's rates can vary by brackets smaller than five years. For certain of the riders to Association Plans, rates are provided only for individuals below the age of 64. MEGA is required to make available its small employer health plans to any eligible employee, regardless of age, and therefore its rate manual should include rates for its riders for eligible employees and their dependents over age 63.

**Recommendation 6:** It is recommended that MEGA revise its rates to use age brackets of not less than five year increments and that the last five year age bracket end with age sixty-five.

**Recommendation 7:** It is recommended that MEGA include rates applicable to eligible employees over age 63 in its rate manual.

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R.I.G.L. § 27-50-5(a)(1)(iii) allows family composition as a rating variable. Regulation 82(5)(A)(2) specifies that a small employer carrier shall include all categories of family composition: single, Employee and Child(ren), Employee and Spouse, and Family.

The rate manual has rates for the Economy plan for “Child”, “Male”, and “Female” at the various age categories. According to the rate calculation worksheet, MEGA calculates the rate for a subscriber by adding the appropriate rates for the individual members. This approach is generally referred to in the industry as “list billing.” A consequence of this approach is that for a given small employer, the rate for two subscribers of the same family composition may be different.<sup>10</sup> However, rate differences for family composition are limited by R.I.G.L. § 27-50-5(a)(1) and R.I.G.L. § 27-50-3(p) to “Enrollee”, “Enrollee, Spouse and children”, “Enrollee and Spouse”, and “Enrollee and children.” Thus, for a specific small employer group, MEGA is limited to a single premium rate for each of the family composition categories.

MEGA has indicated that all its statutory plans and its association plans consist of a single subscriber and as a result there are no instances such that MEGA has different rates for a specific family composition category. However, if MEGA offers its small employer plans to all small employers, as required by R.I.G.L. § 27-50-7(b), it will need to change its methodology for calculating premium rates for each family composition category.

Though not stated in the rate manual, MEGA indicated in a response to an inquiry from the examiners that the Association Plan subscriber rates are calculated in the same manner as described for the Economy Plan in the prior paragraph.

**Recommendation 8:** It is recommended that MEGA change its rating methodology such that, for a given small employer group, MEGA charges the same rate for each family

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<sup>10</sup> MEGA has indicated that all Standard and Economy health plans that were active as of December 31, 2005 consist of a single subscriber. MEGA’s enrollment materials make provision for the enrollment of more than one subscriber in a Standard or Economy plan.

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composition category, as required by R.I.G.L. § 27-50-5(a)(1) and Regulation 82(5)(A)(1) .

MEGA uses a “Marital Factor” which is applied to the rate contribution of each of the spouses if both are enrolled. The Marital Factor is in effect consistently applied to the different family composition types and is therefore a permitted adjustment. The rate manual does not include a demonstration that the factor is based on commonly accepted actuarial assumptions and is in accordance with sound actuarial principles, as required by R.I.G.L. § 27-50-5(h).

MEGA uses an increase adjustment factor for tobacco use. Tobacco usage is not a rating variable that is allowed by R.I.G.L. § 27-50-5(a)(1).

**Recommendation 9:** It is recommended that MEGA eliminate the usage of a rating variable that is based on tobacco usage.

MEGA uses three digit zip code groupings as a rating variable. For certain health plans and riders MEGA has different rating factors for Rhode Island zip code groupings 028 and 029. Geographic location is not a rating variable that is allowed by R.I.G.L. § 27-50-5(a)(1).

**Recommendation 10:** It is recommended that MEGA eliminate the usage of a rating variable that is based on geographic location.

R.I.G.L. § 27-50-5(a)(5) requires that the highest premium rate for each family composition type shall not exceed four times the premium rate that could be charged to a small employer with the lowest premium rate for that family composition. This requirement in the rating process is referred to as 4:1 compression. MEGA’s rate manual does not provide for a rating step that limits the upper bound and/or the lower bound of a rate such that the 4:1 compression requirement is satisfied. MEGA does not meet the

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requirements of R.I.G.L. § 27-50-5(a)(5) without such a step in the rating process for various plans, except for the Economy plan. This can be readily observed by comparing age factors for each benefit plan. For example, for the core benefit of the Catastrophic Hospital Expense Benefit, Plan 25876, the ratio of the age factor of a sixty year old male (2.916) to the age factor of a twenty year old male (0.592) is 4.9.<sup>11</sup>

**Recommendation 11:** It is recommended that MEGA institute a step in its rating process that ensures that rates charged to small employers meet the 4:1 compression requirement as defined in R.I.G.L. § 27-50-5(a)(5).

**Recommendation 12:** It is recommended that MEGA develop and submit a list of any employers that were charged rates that were greater than 4 times the lowest rate charged to any group, including the amount that the rates charged to those employers exceeded 4 times the lowest rate charged. This list should be prepared for the period from January 1, 2004 forward.

R.I.G.L. § 27-50-5(a)(2) allows the use of health status as a rating variable, provided however that the maximum adjustment to the rate due to health status is plus or minus 10% of the adjusted community rate. The Standard plan and the Economy plan are issued on a guaranteed issue basis and health status information is not collected. Thus, by default, the rating of the Standard and the Economy plans meet the requirement of R.I.G.L. § 27-50-5(a)(2). The Association Plans sold by MEGA are adjusted for health status. The examiners received an extract of in force Association business from MEGA. This extract indicates for each contract the risk class to which it had been assigned: Standard, Risk Class 1 (up to 22.2% rating), or Risk Class 2 (rating in excess of 22.2% or exclusion for certain conditions). Chapter 27-50 defines the limitation on the health status adjustment in terms of the “adjusted community rate.” The starting rate in MEGA’s rate manual is not the adjusted community rate. In effect, the adjusted community rate is somewhat higher because all of MEGA’s health status adjustments are increases.

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<sup>11</sup> The test for 4:1 compression includes the effect of health status adjustments.

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However, since there are groups with a health status adjustment in excess of 22%, it is demonstrable that there are groups with health status adjustments that do not meet the requirements of R.I.G.L. § 27-50-5(a)(2).

**Recommendation 13:** It is recommended that MEGA determine the adjusted community rate for its various products and based on the adjusted community rate determine if it meets the health status adjustment threshold. If appropriate, MEGA should modify its practices to ensure that it meets the requirements of R.I.G.L. § 27-50-5(a)(2).

**Recommendation 14:** It is recommended that MEGA develop and submit a list of groups that were assigned health status adjustment factors that exceeded 10% of the adjusted community rate and determine for each of the groups the excess premium charged. This list should be prepared for the period from January 1, 2004 forward.

As part of its health status underwriting process, MEGA identifies applicants who do not meet its underwriting standards. For those applicants, MEGA either declines to issue a policy or offers to issue a policy with an exclusion for certain conditions. R.I.G.L. § 27-50-7(b)(2) requires that a small employer carrier issue any health plan to any eligible small employer that applies for the plan and agrees to make premium payments. The process of excluding applicants or requiring an exclusion for certain conditions is not allowed by Chapter 27-50 and is not consistent with the applicant's right to access any small employer policy in the carrier's portfolio.

**Recommendation 15:** It is recommended that MEGA cease its practice of declining to issue or modifying the covered benefits of certain applicants for its small employer products.

**Recommendation 16:** It is recommended that MEGA identify all certificates issued by MEGA that include an exclusion of coverage for a specified condition or disease,

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including all certificates issued or in force during the period from January 1, 2004 forward.

**Recommendation 17:** It is recommended that MEGA develop and submit a list of any claims submitted to MEGA that were denied under an exclusion for a specified condition or disease, including the amount of each claim. This list should be prepared for the period from January 1, 2004 forward.

**Recommendation 18:** It is recommended that MEGA identify all applicants whom MEGA declined to issue due to the existence of a specified condition or disease, for the period from January 1, 2004 forward.

R.I.G.L. § 27-50-5(h) requires that MEGA maintain at its principal place of business a complete and detailed description of its rating practices and renewal underwriting practices, including information and documentation that demonstrate that its methods and practices are based on commonly accepted actuarial assumptions and are in accordance with sound actuarial principles. R.I.G.L. § 27-50-5(d) requires that rating factors produce premiums for identical groups that differ only by amounts attributable to plan design and do not reflect differences due to the nature of the groups assumed to select particular health benefit plans. Regulation 82(5)(B)(1) requires that the rate manual clearly illustrate the relationship among the base premium rates charged for each health benefit plan.

MEGA's rating manual is deficient in that (i) the rate manual does not include a description of its renewal underwriting practices, (ii) the rate manual does not include documentation that demonstrates that its methods and practices are based on commonly accepted actuarial assumptions and are in accordance with sound actuarial principles, (iii) the rate manual does not include documentation to support the requirement that rating factors produce premiums for identical groups that differ only by amounts attributable to plan design and do not reflect differences due to the nature of the groups assumed to



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select particular health benefit plans, and (iv) the rate manual does not indicate the relationship among the base premium rates charged for each health benefit plan.

**Recommendation 19:** It is recommended that MEGA develop and maintain a rate manual in accordance with the requirements of R.I.G.L. § 27-50-5(h), R.I.G.L. § 27-50-5(d), and Regulation 82(5)(B)(1).

Regulation 82(5)(A)(4) requires that premium rates charged to small employers be computed solely from a rate manual. With the following exceptions MEGA meets this requirement:

- Purchasing MEGA products requires that an Association Administration Fee be paid in addition to or as part of the first monthly premium and
- Purchasing MEGA insurance requires that a fee for monthly association dues be paid in addition to or as part of each month's premium.

Neither of these fees is reflected in the rate manual.

MEGA has advised the examiners that these fees are billed and collected by MEGA under an administrative service agreement and MEGA then remits them to the Association. MEGA apparently believes that since these fees are remitted to the Association, they are not required to include them in their rate manual. The examiners believe that they are required charges paid by the small employers as part of the transaction of buying health insurance, and that they are therefore subject to the requirement that they be included in the rate manual.

The examiners believe that, if provided a completed application form with the demographic and plan data included, the examiners could compute a rate except for any adjustment that may be made as the result of the health status of the applicant.

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**Recommendation 20:** It is recommended that MEGA include a description in its rate manual of any fees included in its premium rates or charged in addition to its premium rates.

Regulation 82(5)(B)(4) requires that the small employer carrier describe in the rate manual the method of allocating administrative expenses to the small employer health plans. MEGA's rate manual does not include the required description of the allocation of administrative expenses.

**Recommendation 21:** It is recommended that MEGA include in its rate manual a description of its process for allocating administrative expenses to small employer health plans.

Regulation 82(5)(b)(2) requires that differences in premium rates for health plans be based solely on differences in the design and benefits of the plan, except as otherwise permitted. There is no indication in the rate manual for support that this requirement is satisfied. MEGA, in response to a request, did not provide any analysis of plan relativities.

**Recommendation 22:** It is recommended that MEGA review the development of the rating factors in its rate manual to determine if they satisfy the requirements of Regulation 82(5)(b)(2), and record the analysis in the rate manual.

### Evaluation of Sample Rate Calculations

The examiners requested sufficient demographic and plan data for a selected sample of seven association groups for the purpose of calculating the rates for each of the groups from the rate manual and to compare the calculated rates in this fashion to the current billing rates.

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Based on the data provided by MEGA and the rate manual previously provided, the examiners were able to reproduce the billing rates in all instances except those noted below.

- **Certificate A<sup>12</sup>**: Based on the rate manual, the Region Factor for the Accumulated Covered Expense Rider was not applied correctly.
- **Certificate B**: Based on the plan data provided, the Physician Office Rider provides for a \$15 per visit copayment and a limitation of two office visits per quarter. The premium reflected in the billed premium is based on a \$15 per visit copayment and a limitation of one visit per quarter.
- **Certificate C**: Based on the rate manual, the Region Factor for the Accumulated Covered Expense Rider was not applied correctly.

**Recommendation 23:** The examination revealed discrepancies between the rate manual and the rate calculation for three of seven sample groups. These discrepancies involved use of a rate for the wrong plan of benefits and the application of the Region Factor for the Accumulated Covered Expense Rider. It is recommended that MEGA review these discrepancies and, if appropriate, make prospective and retrospective adjustments in the billed premium for any affected Rhode Island certificate holders, for rates effective from January 1, 2004 and forward.

### Actuarial Certification

R.I.G.L. § 27-50-5(h)(2) requires that MEGA file on an annual basis an actuarial certification (the “Certification”) that certifies that the company is in compliance with Chapter 27-50 and that the rating methods of the small employer carrier are actuarially sound. Insurance Bulletin 2002-4 provides the requirements for the Certification:

- The certification should be prepared in accordance with Actuarial Standard of Practice 26 (“ASOP 26”),

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<sup>12</sup> Actual certificate numbers are contained in the examination work papers.

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- Certification must include the following areas of compliance:
  - Restrictions related to premium rates in R.I.G.L. § 27-50-5
  - Provisions related to renewability of coverage in R.I.G.L. § 27-50-6,
  - Provisions related to availability of coverage in R.I.G.L. § 27-50-7,
  - Provisions related to certification of creditable coverage in R.I.G.L. § 27-50-8.
- The certification should include identification of instances of non-compliance, the number of such instances, the nature of non-compliance, and the steps taken to correct the non-compliance, both prospectively and retrospectively
- The certification should include a statement describing the extent to which the actuary relied on the work of others. If the actuary relied on others, a statement from the person(s) relied upon describing the accuracy and completeness of the work should be attached.
- The certification should be prepared and signed by a qualified actuary. In order to meet the definition of being qualified, an actuary must be:
  - A Member of the American Academy of Actuaries,
  - Familiar with the requirements of Chapter 27-50,
  - Qualified to sign Prescribed Statements of Actuarial Opinion regarding compliance with small employer group health laws and regulations,
- The certification must be submitted on or before March 15 of the year following the calendar year that is covered by the certification.

The examiners reviewed the Certification for calendar year 2005, filed in March 2006 with the Insurance Division of the Rhode Island Department of Business Regulation.

The Certification was prepared and submitted by Charles M. Schneeberger, FSA, MAAA and is dated March 13, 2006.

It is the understanding of the examiners, though not specifically stated in the Certification, that the Certification included for consideration only MEGA's Economy

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and Standard plans. The basis for this limitation was MEGA's stated belief to the examiners that the Association business was not subject to Chapter 27-50.

Based on its analysis of MEGA's association business, OHIC has determined that the association business is subject to Chapter 27-50 and has so informed MEGA. As a result, the Certification prepared by MEGA should not be limited to the Economy and Standard plans, but should include the Association business.

**Recommendation 24:** It is recommended that MEGA include consideration of its Association Business in the annual Certification required by R.I.G.L. § 27-50-5(h)(2) and submit a corrected certification to OHIC for calendar year 2005.

The Certification states that Mr. Schneeberger is an employee of MEGA, that he is a member of the American Academy of Actuaries and that the Certification was prepared in accordance with Actuarial Standard of Practice 26 ("ASOP 26"). The Certification should be prepared and signed by a qualified actuary. The Certification does not include a statement to the effect that the certifying actuary is qualified to sign Prescribed Statements of Actuarial Opinion regarding compliance with small employer group health laws and regulations.

**Recommendation 25:** It is recommended that the Certification include, if appropriate, a statement that the certifying actuary meets the qualifications required by Insurance Bulletin 2002-4.

The certification includes the following statements:

- (MEGA) is in compliance with restrictions related to premium rates in R.I. Gen. Laws § 27-50-5, except for subparagraphs (a)(1),(3),and (5), where in force rate adjustments may be needed
- At this time the Company has some rating issues in the small group market.

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Insurance Bulletin 2002-4 requires that the Certification identify instances of non-compliance, the number of such instances, the nature of the non-compliance, and the steps taken to correct the non-compliance, both prospectively and retrospectively. MEGA's Certification does not identify the instances of non-compliance, does not identify the number of such instances of non-compliance, and does not identify steps taken to correct any instances of non-compliance.

**Recommendation 26:** It is recommended that MEGA's Actuarial Certification identify instances of non-compliance, the number of such instances, the nature of the non-compliance, and the steps taken to correct the non-compliance, both prospectively and retrospectively.

Insurance Bulletin 2002-4(C)(1) requires that the Certification be in the form of a written report, signed by the appointed actuary, and **include such additional exhibits as may be required to support the conclusions and opinions stated in the certification** (emphasis added).

The Certification includes various statements of compliance and identifies general areas in which certain MEGA small employer rates do not comply with Chapter 27-50. The Certification does not include any supporting exhibits that indicate the process and tests that the certifying actuary performed and allowed the certifying actuary to reach the conclusions presented in the Certification. ASOP 26 Section 3.4 provides an outline of documentation that should be developed to support the Certification. This documentation should be the basis for exhibits that accompany the Certification.

**Recommendation 27:** It is recommended that the certifying actuary include with the Certification various exhibits as may be required to support the conclusions and opinions stated in the Certification.

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MEGA has provided copies of certification statements prepared for each of the years 2001 through 2006. All are essentially similar. To the extent certification statements in prior years referenced “rating issues”, no resolution of those issues was planned or reported in subsequent statements.

### **10. Underwriting Methodology for Small Employer Business**

Regulation 82(5)(A)(2) requires that the carrier maintain rating information and documentation relating to rating practices and renewal underwriting practices. In response to a request from the examiners for the required documentation, MEGA indicated that it does not maintain an underwriting manual for the Economy and Standard plans since these plans are issued without regard to health status. With respect to the Association business, MEGA provided the examiners with a document titled “New Business/Underwriting/Fulfillment - Rhode Island,” dated May 26, 2006. The introduction to the document states:

“These procedures indicate all the processes and actions required by New Business, Underwriting and Fulfillment to accurately process Rhode Island files according to state and company guidelines. This document includes state requirements and forms, as well as instructions for using them.”

This document also identifies the quality control measures that are in place to validate that the required process is followed.

MEGA also provided the examiners with a document titled “The Underwriting Guide.” This document appears to be intended for use by the sales organization, since the introduction states: “You the salesperson play the most important part in risk selection for life and health insurance.”<sup>13</sup> This manual provides guidance to the agent in risk selection and whether certain medical conditions would result in a “decline” decision, a “rating”

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<sup>13</sup> The comment related to risk selection is contrary to the intents of Chapter 27-50.

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decision, or exclusion of the condition from coverage. MEGA also provided the “Underwriter’s Resource Guide.” The Underwriter’s Resource Guide appears to be focused on department administrative issues, with its focus on job titles, qualifications, training, quality control, and periodic audits.

The Underwriting Guide directs the agent to “Select good risks – those who are in reasonably good health and are of sound moral character.” The Underwriting Guide also states that MEGA will not issue coverage if the proposed insured or eligible family member is currently pregnant (even if the pregnant family member is not included for coverage on the application).

The guidance provided by MEGA to its agents does not meet the requirement of R.I.G.L. § 27-50-7(b), that it actively offer to small employers all health benefit plans that it actively markets.

**Recommendation 28:** It is recommended that MEGA require that its agents market its small employer products to all small employers without regard to health status, pregnancy, or other underwriting criteria not permitted by Chapter 27-50 or Regulation 82.

**Recommendation 29:** It is recommended that MEGA provide a list of all applications for health insurance that were denied due to the existence of a pregnancy of the applicant or of an eligible dependent, for the period from January 1, 2004 forward.

MEGA stated in its responses to the examiners that, for its Association Business, the renewal action consists of applying the rate structure in effect at the renewal date at the attained age of the insured. Any health status adjustment in effect at the time of issue is maintained as part of the renewal rate. MEGA’s approach is typical of that seen in the individual health insurance market but differs from that utilized by Blue Cross and



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United in the Rhode Island small employer market. Blue Cross and United both re-evaluate health status at each renewal.

R.I.G.L. § 27-50-7(b) requires that a small employer carrier actively market to small employers all its small employer health plans. As previously described, MEGA markets only its Economy and Standard plans to prospects that check the box on the Statement of Eligibility Status form that has the statement “I am establishing or participating in a Small Employer Health Plan as defined above.” All other plans (“Association Plans”) are marketed only to those prospects who check the box on the Statement of Eligibility Status form that has the statement “I am not establishing or participating in a Small Employer Health Plan as defined above.”

MEGA’s prospects for Association Plans are sole proprietors, who are deemed by the company to be establishing a plan that is not a small employer plan and therefore deemed by the company to not be subject to Chapter 27-50. The definition of “small employer” is stated in R.I.G.L. § 27-50-3(kk). There is no provision in Chapter 27-50 for an employer to waive status as a “small employer” by checking a box on an enrollment form. Since OHIC has determined that MEGA’s Association plans are small employer plans, MEGA should have been offering its prospects who are small employers, including sole proprietors, all its plans – the Economy and Standard plans and all the Association plans.

MEGA provided the examiners with a data extract of its Association Business and a summary of its inforce certificates with either the Standard or Economy plans. Based on this information, the examiners conclude that MEGA’s book of business consists entirely of groups with one enrolled subscriber. This suggests that MEGA limits its marketing to only a segment of the small employer market. Chapter 27-50 requires that MEGA actively market all its small employer plans to all small employers.

**Recommendation 30:** It is recommended that MEGA offer to all small employers, including sole proprietors, all plans in its portfolio, including the Association Plans.

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Chapter 27-50 requires that a small employer carrier verify that a group applying for a small employer plan is a small employer, as defined in R.I.G.L. § 27-50-3(kk).

The Statement of Eligibility Status form should be the means by which MEGA determines small employer status. However, the form is not appropriate for the Rhode Island small employer market in that the text defines a small employer as “an employer group of two to fifty\* eligible employees”, with the asterisk referring the prospect to a footnote that explains that “Group size includes sole-proprietors/self employed individuals in ....Rhode Island.....”

MEGA does not collect any evidence that applicants for its Economy and Standard meet the requirements for small employer status as stated in Chapter 27-50.

MEGA’s application packages, including the “Required Forms Package” used for the Standard and Economy plans, include the following statement:

If you are an employer please note that by offering an insurance benefit to your employees, you may be establishing an "employee benefit plan" under federal laws, such as the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). If an employee benefit plan is established, whether intentionally or unintentionally, the employer may be considered a fiduciary who has certain duties, responsibilities, and limitations, including responsibilities relating to reporting and disclosure, and other fiduciary duties.

The prior statement, while undoubtedly correct, may result in certain small employers electing to check the box that indicates that they are not establishing a small employer health plan.

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The carrier is required by Regulation 82(6)(B)(1) to obtain a listing of eligible employees and dependents and supporting documentation, such as the W-2 Summary Wage and Tax Form, to verify eligibility. Regulation 82(6)(B)(2) requires that the carrier obtain from every eligible employee who declines coverage a waiver form for the employee and the employee's dependents. The waiver form requires that the employee indicate the reason for the waiver. If the employee refuses to sign the waiver form the employer is required to provide written certification of this fact.

MEGA's application package for the Standard and Economy plans includes a form (FORM: M/25600 Rev 12/03) that requires a listing of eligible employees. This form does not provide guidance to either the agent or the small employer as to the definition of "eligible employee," as defined in R.I.G.L. § 27-50-3(m). MEGA does not obtain the required supporting documentation, such as the W-2 Summary Wage and Tax Form, to verify employee eligibility.

**Recommendation 31:** It is recommended that MEGA provide guidance to its agents and to small employers with respect to the requirements of Chapter 27-50 as they relate to employee eligibility.

MEGA provided form M/COMBO APP as the form used for employee and dependent enrollment. This enrollment form requests detailed health status information. When questioned about the use of this form, MEGA responded that it does not use responses to the health questions to determine an applicant's eligibility for coverage under the small employer statutory plans. However, MEGA stated that such information may be used by the Claims Department for the investigation of claims that may involve a potential pre-existing condition.

The examiners reviewed MEGA's Waiver of Coverage form (Form: M/WoC 6/02). The form meets the requirements of Regulation 82(6)(B)(2).

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R.I.G.L. § 27-50-6-7(d) requires that any pre-existing condition limitation be limited to not more than six months following the enrollment period (or the first date of the waiting period for enrollment). Late enrollees may be subjected to a pre-existing condition limitation for up to twelve months. A carrier cannot impose a pre-existing condition limitation with respect to pregnancy.

The Summary of Benefits for the Standard and Economy plans provide for a six month pre-existing condition limitation and a twelve month pre-existing limitation for late enrollees, as required by Chapter 27-50.

R.I.G.L. § 27-50-6-7(d)(9) allows a carrier to impose a minimum participation requirement. The minimum participation requirement cannot be greater than 75% of eligible employees for business issued after October 1, 2004. MEGA's Small Employer Group Application (Form: M/25600 Rev 12/03) indicates that the company imposes a minimum participation requirement for its Standard and Economy plans of 75% of eligible employees, excluding from the denominator of the ratio those eligible employees who have other coverage. It is the understanding of the examiners that MEGA's Association Plans have been sold only to sole proprietors, for which a minimum participation rule is irrelevant.

MEGA does not require a waiting period for new enrollees in its Standard and Economy plans. MEGA allows the small employer to elect a waiting period that applies to new enrollees. If a small employer elects to require a waiting period, MEGA limits its length to a maximum of three months. An employer specified waiting period is allowed by Chapter 27-50. Therefore, MEGA complies with the requirements of Chapter 27-50 with regard to waiting periods.

R.I.G.L. § 27-50-7(d)(10) requires that the small employer carrier offer enrollment to all eligible employees and their dependents who apply for coverage. The small employer carrier is prohibited from modifying a health plan with respect to a small employer or any

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employee or dependent by restricting or excluding coverage or benefits for specific diseases, medical conditions, or services covered by the plan.

MEGA offers its Standard and Economy plans on a guaranteed issue basis to all small employers. MEGA does not request health status information from eligible employees who wish to enroll and does not modify or restrict coverage for any eligible employee or their dependent. For the Association Plans, MEGA collects health status information as part of the enrollment process. Based on its medical underwriting process, MEGA may choose to not issue coverage to a particular applicant or dependent of that applicant, or exclude from coverage certain medical conditions or diseases. Recommendation 14 above addresses this issue.

R.I.G.L. § 27-50-5(a)((2) allows a small employer carrier who, as of June 1, 2000 varied rates by health status, to vary the adjusted community rate for health status by 10%, provided that the rates comply with all other rating requirements. MEGA filed the report that is required by Regulation 82(10)(G) for the first time in March 2006 for calendar year 2005. Therefore, it is not apparent that MEGA was eligible by R.I.G.L. § 27-50-5(a)(2) to use health status as a rating variable for the purpose of computing small employer rates. Regulation 82(11)(A) requires that each carrier providing health benefit plans in the State of Rhode Island make a filing no later than December 6, 2001 that indicates whether the carrier intends to operate as a small employer carrier under the terms of Regulation 82. The examiners are not aware that such a filing was made by MEGA by the required deadline.

**Recommendation 32:** It is recommended that MEGA state whether or not it was a small employer carrier as of June 1, 2000.

**Recommendation 33:** It is recommended that MEGA indicate if it used health status as a rating variable for its small employer business as of June 1, 2000.

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MEGA does not vary the rates of the Standard and Economy plans by the health status of the eligible employees and dependents that enroll. MEGA does vary the rates of the Association plans based on the health status of the enrolled individuals. Based on a data extract provided by MEGA, MEGA has groups in effect with rate adjustments in excess of 22%. However, the adjustment is applied to a rate that is less than the adjusted community rate. Therefore, the adjustment as a percentage of the adjusted community rate will be lower. MEGA needs to review its procedures to ensure that any rate adjustment for health status meets the requirements of Chapter 27-50. Recommendation 12 addresses this issue.

### **11. Review of Company Process for Responding to Complaints**

MEGA has put into place an extensive process to manage and respond to complaints in a timely manner. The manual labeled “UICI Complaint Manual” (the “Manual”) serves as a training guide for customer service representatives and an overview of the process. The manual contains a section titled Consumer Complaint Philosophy that states:

“Customer complaints represent a very important part of the huge volume of business a company transacts every day. They are opportunities for the company to show their dedication to meeting customer’s needs and exceeding their expectations.

A company’s bottom line will be well served with employees who view complaints as ‘gifts’ and never as irritants or interference’s with their job. Complaints point out where the company may need to change procedures so that they can prevent future complaints. Through customers’ inquiries and grievances, a company is given the opportunity (gift) to earn the customers’ trust and confidence and to develop a keen understanding of their needs and concerns.

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Resolving complaints efficiently can increase customer satisfaction and company business, while handling complaints poorly can have a tremendous negative effect. Studies indicate, for example, those unhappy customers tell an average of 10 other people about their bad experiences.”

The Manual contains a section designed to assist customer service representatives prepare letters that communicate effectively and avoid the usage of phrases that “wound” the consumer.

The Manual provides the customer service representative with the features of a communication that make it a complaint, a grievance, or an inquiry.

MEGA has a well defined and detailed process for managing complaints that may be received from an insurance department, from a consumer, or from someone on behalf of the consumer.

Detailed descriptions for the workflow process, depending on whether the complaint was received from an insurance department (“DOI”) or a consumer, whether the complaint was received in writing or orally, and whether the complaint was sent to the President of HealthMarkets are contained in the Manual. For example, for complaints received by the Consumer Affairs Department (“CAD”) from an insurance department the process takes the following steps:

- The envelope is date stamped and the envelope and its contents are scanned
- The documents are routed for entry into the Legal Tracking System (“LTS”)
- The letter and documents are reviewed to determine the nature and origin of the complaint
- A Complaint Coversheet is completed (except for the date of “Final Reply”, “Amount Paid”, and “Company Disposition”)
- The complaint information is entered into the LTS
- The complaint file is forwarded to an individual assigned to respond

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- Follow-up letters and requests for additional information are also date stamped, imaged, and forwarded to the appropriate individual.

A similar process is followed for other categories of complaints.

If in the course of investigating a complaint it is determined that an agent did not appropriately represent MEGA, the complaint investigator completes an “Agent Training Opportunity Form”. The completed form contains the complainant’s name and other identifying information and describes the agent related issue. The completed form is forwarded to the marketing arm of MEGA, presumably to apprise and educate the agent.

The examiners requested that MEGA provide a listing of complaints received during 2005 and related to small employer health plans issued in Rhode Island. The response from MEGA was to include the name of the insured, the date the complaint was received, the nature of the complaint, and other items of information. MEGA responded with a listing of eight complaints. Two of the complaints pertained to the same individual and the same issues and are differentiated by the fact that one complaint came directly from the consumer and the other came from the consumer’s attorney. For purposes of this discussion, we have considered the two complaints as a single complaint. Several complaints raised more than one issue. Three complaints pertain to agent misrepresentation of the benefits. Five complaints are related to benefit eligibility and denial of coverage. Of the five benefit-related complaints, four pertain to denial of a claim due to a pre-existing condition. One complaint was received from, as identified by MEGA, the Rhode Island Department of Building Operations regarding a violation of a sign ordinance<sup>14</sup>.

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<sup>14</sup> Rhode Island does not have a state department with this title. Perhaps the complaint referenced originated with a department of the City of Providence or another Rhode Island municipality.



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The examiners selected 5 of the complaints and requested that MEGA provide a copy of the complete file to enable a detailed review by the examiners. The following paragraphs provide a summary of this review.

Complaints CM0545224 and CM0545346: These complaints relate to the same insured. The application for insurance was signed by the applicant and spouse on December 9, 2004. The coverage was issued December 28, 2004. The insured contacted MEGA May 17, 2005 and was told that the pregnancy rider attached to the policy under which he and his wife had coverage provided for no pregnancy related benefits during the first 10 months of the policy, 50% coinsurance for months 11-24, and a 100% benefit thereafter for pregnancy related expenses up to a maximum benefit of \$6,000. The spouse was pregnant and due to deliver in July 2005. The insured told MEGA that they were not aware of either the waiting period or the pre-existing condition clause and that the agent was aware that the spouse was pregnant at the time the application was submitted. MEGA told the insured that the pregnancy related expenses would not be covered.

The insured sent a letter to MEGA canceling the health insurance effective midnight, May 31, 2005.

The insured retained an attorney, who contacted MEGA. The attorney alleged that the agent's actions were fraudulent and in bad faith.

MEGA responded by citing that the spouse answered "No" to the question on the application related to pregnancy. MEGA also provided the Certificate schedule and a copy of the pregnancy rider, which explained the waiting period for pregnancy related expenses.

Examiner Comments: The examiners conclude that MEGA handled the claim consistent with the language of the certificate that was issued to the insured. However, R.I.G.L. § 27-50-6-7(d)(5) requires that a small employer carrier cannot impose a pre-existing

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condition limitation for pregnancy related expenses. Thus, if the MEGA policy provision had met the requirements of Chapter 27-50, the pregnancy related expenses in question would have been covered expenses and benefits should have been paid if the policy had remained in force.

Complaint CM0542494: The application was signed by the applicant on December 19, 2003. The application included various questions related to the health status of the insured. The applicant indicated in the application that his last visit to a doctor was in 2002 for a “check-up.” In response to the question if he/she ever had symptoms, received medical advice or been treated for back, spine, or leg disorder, the applicant checked the “No” box. The insured was issued a certificate effective January 1, 2004. Upon referral from a chiropractor, a surgeon recommended a surgical procedure on the insured’s spine. The procedure was performed June 25, 2004. This was followed by a series of physical therapy sessions. In December 2004 the insured received various letters from MEGA indicating that the medical expenses were not covered due to the pre-existing conditions exclusion in the policy.

MEGA told the insured that the certificate defined a pre-existing condition as:

“a medical condition, Sickness or Injury not excluded by name or specific description for which:

1. Medical advice, Consultation, or treatment was recommended by or received from a Physician within the two year period before the Effective Date of Coverage; or
2. Symptoms existed which would cause an ordinarily prudent person to seek diagnosis, care or treatment within the two year period before the Effective Date of Coverage.”

MEGA told the insured that on page 15 of the certificate, under the section titled *Pre-Existing Condition* it states “We will not provide benefits for any loss resulting from a

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Pre-Existing Condition, as defined, unless the loss is incurred at least one year after the effective date of the coverage for an Insured Person.”

As a result of the claim submission, MEGA requested medical records from the insured’s primary care physician. The primary care physician’s records indicated that the insured received treatment for low back pain during the period 10/8/2003-11/14/2003. As a result of these treatments, MEGA concluded that the pre-existing condition exclusion was applicable.

Examiner Comments: R.I.G.L. § 27-50-6-3(cc) provides the definition of Preexisting Condition and limits it to conditions for which medical advice, diagnosis, care, or treatment was recommended or received during the six months immediately preceding the enrollment date of the coverage. § 27-50-6-7(d)(1) limits a pre-existing condition exclusion to six months following the enrollment date and requires that the definition of “preexisting condition not be more restrictive than that provided in R.I.G.L. § 27-50-3(cc). § 27-50-7(d)(2) provides that the small employer carrier must reduce the period of any pre-existing condition limitation by the aggregate of creditable coverage.

The insured stated in the application that health insurance coverage was provided by CIGNA to December 31, 2003. The letter detailing the complaint states that the insured had continuous coverage “for the previous fifteen or so years.” If this information is correct, then the insured’s creditable coverage from the prior carrier is such that the insured does not have a preexisting condition limitation period with MEGA. MEGA could presumably have recourse to recovering the additional health status related premium it would have been owed if this condition had been reported at the time of issue.

Complaint CM545775: The application was completed and signed November 5, 2004. The certificate was issued November 21, 2004. The certificate covered the applicant and two children. The benefit plan consists of a Basic Hospital/Surgical plan and various riders, including a Physicians Office Visit rider, a Wellness Benefit rider, and a Dental

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benefits rider. The Wellness Benefit rider covers (i) annual physical exams with a \$25 copayment up to a \$100 annual maximum, with a 12 month waiting period, (ii) Mammograms for women age 35 and over subject to a \$25 copayment and a \$100 annual maximum, and (iii) Well-child care subject to a \$25 copayment and a \$100 annual maximum. The dental rider provides scheduled maximum benefits for various services. Class I services do not have a waiting period, while Class II and Class III services have a four month waiting period. Certain provider charges for “checkups” were denied by MEGA due to the twelve month waiting period requirement for annual physical exams. Only a portion of the charges for a dental examination and cleaning were paid by MEGA under the dental rider.

The insured claimed that she was not told by the agent of the twelve month waiting period and that she was told that dental cleanings would be paid in full. MEGA was unable to obtain a statement from the agent regarding what the insured was told at the time the health plan was explained by the agent and MEGA agreed to review the claims submitted for physicals in light of the possible misunderstanding on the part of the insured.

Examiner Comments: A review of the claim file indicates that MEGA processed the claims consistent with the certificate and marketing brochure. In particular, claims for physical examinations were denied due to the 12 month waiting period and the payment for dental services was limited by the benefit schedule maximum. R.I.G.L. § 27-50-7(d)(2)(iv) limits a carrier imposed waiting period to no longer than 60 days. The longer waiting periods imposed by MEGA are not allowed by Chapter 27-50.

Complaint CM0546650: The applicant completed an application on February 4, 2004 and the application was approved and the Certificate of Coverage was issued on March 11, 2004. Prior to the effective date the son of the applicant became ill and was ultimately diagnosed as having Crohn’s disease. Various claims for expenses were denied by MEGA due to the pre-existing condition exclusion, as explained in the Certificate. A

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complaint was submitted by the insured's attorney to OHIC on July 27, 2005. The documentation provided included a Certificate of Prior Coverage with Blue CHiP, indicating that the subscriber, spouse, and son had continuous health insurance coverage from April 1, 1998 to February 1, 2004. Based on a copy of the documentation provided by OHIC, MEGA concluded that the insured would have qualified for an insurance plan without a pre-existing condition exclusion. MEGA offered to waive the pre-existing condition with respect to the previously submitted claims.

Examiner Comments: The resolution by MEGA of this complaint was reasonable. The documentation of this complaint did not include the application for insurance that was completed by the applicant. However, based on a review of other complaint files, the examiners are aware that the application form includes questions about other health insurance. Based on the response to this question, assuming it was answered correctly, MEGA's underwriters should have known that the applicant may have been HIPAA eligible. R.I.G.L. § 27-50-7(d)(2) requires the carrier to reduce the period of pre-existing condition exclusion by the aggregate period of prior creditable coverage. In this instance, the prior creditable coverage would have resulted in the elimination of the pre-existing condition exclusion.

**Recommendation 34:** It is recommended that MEGA review the resolution of the complaints discussed here and investigate and respond as to any additional action that is appropriate in light of this report.

**Recommendation 35:** It is recommended that MEGA revise its underwriting and claim adjudication procedures in order to identify applicants and insureds with prior creditable coverage and limit its pre-existing condition exclusion period for such applicants and insureds as required by R.I.G.L. § 27-50-7(d)(2).

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**Recommendation 36:** It is recommended that MEGA revise its contracts to ensure that it does not implement a waiting period longer than 60 days for wellness and dental benefits.

**Recommendation 37:** It is recommended that MEGA prepare a list of all claims for wellness and/or dental benefits that have been denied since January 1, 2004 because of the application of a waiting period longer than 60 days.

### **12. Review of Contracts and Forms**

The review of contracts and forms included the review of the following documents:

- Brochures and Certificates for the Association plans
- Application Packages for Association Plans
- Brochures and Certificates for the Standard and Economy Plans
- Application Package for the Standard and Economy Plans
- Required Forms Package
- Waiver of Coverage Form
- Subscriber enrollment forms

#### Brochures and Certificates for the Association Plans

The sample certificates provided to the examiners by MEGA are in variable language format. They appear to allow all the benefit options described in the corresponding marketing brochures. We therefore use the brochures as our reference source in this review.

The Health Choice Advantage Plan (Form 25875), a basic hospital and surgical benefit plan, is the most common inforce plan. Approximately 80% of the Association subscribers were enrolled in this plan. The marketing brochure for this plan is Form

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M/HCA 8/04 (5/05). Comments and recommendations made apply to all Association Plans.

Page 1 of the Form M/HCA 8/04 (5/05) tells the applicant that the health plan is an association sponsored health plan. The introductory paragraph states:

“The Association’s Commitment to You

Your association has long recognized the need for affordable, no-nonsense insurance coverage for the “little guy.” Your association is committed to making quality insurance coverage available to you”

Page 2 of Form M/HCA 8/04 (5/05) introduces the association’s choice of carrier as follows:

“Your Association’s choice of Carrier

The association has elected to make available to its members insurance coverage through the MEGA Life and Health Insurance Company (MEGA). MEGA’s financial resources and dedication to service have made MEGA an industry leader in protecting association members across the nation.”

Nowhere in Form M/HCA 8/04 (5/05) is the association named or is any specific information provided about the association. The brochure does not contain any description of the relationship between the association and MEGA. Similar pages, though with different page numbers, are contained in the brochures for other Association Plans.

In conjunction with a settlement of a class action lawsuit, UICI (the former name of MEGA’s parent company) agreed that its MEGA and Mid-West subsidiaries would include enhanced disclosures in their marketing and sales materials regarding the contractual relationships between UICI and the associations<sup>15</sup>. Based on the initial response to a request for information provided to the examiners, there appears to be no disclosure provided to Rhode Island small employers of the relationships between

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<sup>15</sup> UICI news release dated October 18, 2004

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MEGA, its parent company, and the membership associations. MEGA provided the disclosure to the examiners in response to a follow-up data request. A copy of the disclosure statement that is available from the NASE website is included as Appendix 3 of this report.

**Recommendation 38:** It is recommended that MEGA provide disclosure to prospects for its small employer health plans of the relationships between MEGA, its parent company, and the membership associations, as provided by the settlement of a class action lawsuit and announced by UICI in an October 18, 2004 news release.

Page 15 of the brochure lists health plan exclusions and limitations. The following definition of “pre-existing conditions” is provided:

“a medical condition, sickness, or injury not excluded by name or specific description for which: 1) medical advice, consultation, or treatment was recommended by or received from a physician within the two (2) - year period before the effective date of coverage, or 2) symptoms existed which would cause an ordinarily prudent person to seek diagnosis, care, or treatment within the two (2) –year period before the effective date of coverage.”

R.I.G.L. § 27-50-3(cc)(1) defines a pre-existing condition as one “for which medical advice, diagnosis, care, or treatment was recommended or received during the six (6) months immediately preceding the enrollment date of the coverage.” R.I.G.L. § 27-50-7(d)(1) states that a health benefit plan shall not define a pre-existing condition more restrictively than as defined in R.I.G.L. § 27-50-3. The definition of “pre-existing condition” used by MEGA is substantially more restrictive than that allowed by Chapter 27-50.

**Recommendation 39:** It is recommended that MEGA use a definition of pre-existing condition that is not more restrictive than that provided in R.I.G.L. § 27-50-3(cc).



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**Recommendation 40:** It is recommended that MEGA prepare a list of all claims that have been denied due to the use of a definition of pre-existing condition that does not meet the requirements of Chapter 27-50, for the period January 1, 2004 forward.

MEGA's pre-existing condition limitation applies to pregnancy and childbirth related expenses. R.I.G.L. § 27-50-3(cc)(5) does not allow the small employer carrier to impose a pre-existing condition limitation on pregnancy related benefits otherwise covered by the health plan.

**Recommendation 41:** It is recommended that MEGA remove from its pre-existing condition limitation any limitation on pregnancy related benefits otherwise covered by the health plan.

**Recommendation 42:** It is recommended that MEGA develop a list of all claims submitted to MEGA January 1, 2004 and later that were denied due to its application of a pre-existing condition limitation for pregnancy related benefits that would have otherwise been covered by the health plan.

R.I.G.L. § 27-50-7(d)(5)(ii) states that a small employer carrier cannot impose a pre-existing condition exclusion with regard to a child who is covered within thirty days of birth, adoption, or placement for adoption. R.I.G.L. § 27-50-7(d)(8)(iii)(B) allows enrollment of a newborn dependent as of the date of the birth. MEGA satisfies this requirement by providing coverage from the moment of birth for 31 days. MEGA continues coverage beyond the 31 day period only on receipt of notice from the subscriber requesting the addition of the additional dependent to the certificate. Benefits related to normal newborn child care are not covered.

The marketing brochure does not describe how the MEGA health plan will coordinate with other health plans that the subscriber or dependents may participate in. The

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certificate indicates the MEGA plan will only pay to the extent that covered expenses are not paid by Medicare.

The certificate contains a coordination of benefits provision that is typical of an employer sponsored group health plan.

The certificate indicates that coverage terminates for an insured dependent on the date that the eligible dependent ceases to be an “Eligible Dependent.” The certificate defines an “Eligible Dependent” as including a child under 19 years of age, which is extended to the 24<sup>th</sup> birth date if the child is enrolled as a fulltime student and attends classes regularly at an accredited college or university. The age “24” limitation is bracketed in the sample certificate reviewed and does not indicate an upper limit to the variable. R.I.G.L. § 27-50-3(j) provides a definition of dependent that includes a full-time student under the age of twenty-five.

**Recommendation 43:** It is recommended that MEGA change its definition of dependent to include any full-time student who is under the age of twenty-five. Additionally, MEGA should be aware of changes<sup>16</sup> to the eligibility provisions for dependents that were enacted by the Rhode Island legislature and are effective for every group health insurance contract, plan, or policy delivered or issued for delivery in Rhode Island.

### Application Package for Association Plans

Each of the Association Plans has an associated application package. The application package associated with the Basic Hospital/Surgical plan is Form m/2004 app 8/04 (8/04).

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<sup>16</sup> See <http://www.rilin.state.ri.us/Billtext/BillText06/SenateText06/S2211Aaa.pdf>. See also <http://www.rilin.state.ri.us/Statutes/TITLE27/27-18/27-18-59-1.HTM> and [http://www.dbr.state.ri.us/documents/divisions/healthinsurance/Bulletin\\_2006\\_5.pdf](http://www.dbr.state.ri.us/documents/divisions/healthinsurance/Bulletin_2006_5.pdf)

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MEGA has limited its marketing of Association Plans to self employed individuals. As a result, MEGA's application package is designed as an individual/family application. It was indicated earlier in this report that a small employer carrier is required to market all its small employer health plans to all eligible small employers. As a consequence, the application package should include an employer application requesting to provide the health plan to the employer's eligible employees.

**Recommendation 44:** It is recommended that MEGA include in the application packages for its Association Plans an employer application form.

The Statement of Eligibility Status form included in the package requests that the applicant indicate if he is establishing a "Small Employer Health Plan," based on the definition of a "Small Employer Health Plan" as it appears on this form. This definition and the following warning, contained in a box on the first page of the application package, appear to be designed to steer applicants for health insurance toward stating that they are "not establishing or participating in a Small Employer Health Plan as defined above":

"If you are an employer please note that by offering an insurance benefit to your employees, you may be establishing an "employee benefit plan" under federal laws, such as the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). If an employee benefit plan is established, whether intentionally or unintentionally, the employer may be considered a fiduciary who has certain duties, responsibilities, and limitations, including responsibilities relating to reporting and disclosure, and other fiduciary duties."

Based on review by OHIC, OHIC has determined that MEGA's Association Business is subject to Chapter 27-50. As a result, the Statement of Eligibility Status form does not serve any purpose.

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**Recommendation 45:** It is recommended that MEGA replace the Statement of Eligibility Status form with one that can be used to determine small employer eligibility, based on the definition of small employer provided in R.I.G.L. § 27-50-3(kk).

### Brochures and Certificates for the Standard and Economy Plans

MEGA's Form "Highlights SG EP RI 6/04" is the marketing brochure for the Economy plan. The marketing brochure states that

"a Small Employer has the right to receive premium rate and enrollment information for this plan and any other health benefit plan the Company offers in the small employer market. Ask your agent for a copy of the "SMALL EMPLOYER DISCLOSURE FORM" for a description of the health insurance protections extended to Small Employers under state and federal law. This disclosure form provides information regarding the following topics:

- Guaranteed Issue Coverage;
- Guaranteed Renewable Coverage;
- Rules Applicable to Premiums and Premium Adjustments; and
- Coverage for Pre-Existing Conditions."

R.I.G.L. § 27-50-5(g) requires that a small employer carrier with the offering for sale of any health benefit plan make reasonable disclosure of:

- the carrier's right to change premium rates and the factors, other than claims experience, that affect changes in premium rates,
- the provisions relating to renewability,
- the provisions relating to any pre-existing condition provision, and
- a listing of and descriptive information, including benefits and premiums, about all the benefits for which the small employer is qualified.

The statement contained in the marketing brochure "Ask your agent for a copy of the "SMALL EMPLOYER DISCLOSURE FORM" indicates that the required information is

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only provided on request to the applicant. MEGA's policy of providing the required information only on request does not meet the requirements of R.I.G.L. § 27-50-5(g). The examiners also note that MEGA did not provide the examiners with a copy of the "SMALL EMPLOYER DISCLOSURE FORM" for review.

**Recommendation 46:** It is recommended that MEGA meet the requirements of R.I.G.L. § 27-50-5(g) by providing disclosure of the following items as part of all small employer health plan proposals: the carrier's right to change premium rates and the factors, other than claims experience, that affect changes in premium rates; the provisions relating to renewability; the provisions relating to any pre-existing condition provision; and a listing of and descriptive information, including benefits and premiums, about all the benefits for which the small employer is qualified.

MEGA's Economy plan has a pre-existing condition limitation of 6 months (twelve months for late enrollees). A six month (12 month) pre-existing condition limitation is allowed by R.I.G.L. § 27-50-7(d). The certificate however does not include a definition of the term "pre-existing condition" in the Definitions section.

**Recommendation 47:** It is recommended that MEGA include a definition of the term "pre-existing condition" in its certificate.

**Recommendation 48:** It is recommended that MEGA report to OHIC the definition of "pre-existing condition" that it has used for the purpose of adjudicating claims.

R.I.G.L. § 27-50-3(m) provides a definition of the term "eligible employee." The term is defined as an employee who works full-time with a normal work week of 30 or more hours; however, the employer can elect to reduce the number of hours worked for all employees to as low as 17.5 hours. The certificate limits the definition of eligible employee to one who has a normal work week of 30 hours or more.

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**Recommendation 49:** It is recommended that MEGA allow a participating employer to elect for all employees a normal workweek requirement as low as 17.5 hours for the purpose of determining eligibility for the health plan.

Application Package for the Standard and Economy Plans

The application package for the Standard and Economy plans is Form M/SGP APP 4/04 (4/04). This package includes Form M/PC 12/03. This form is used to determine if there was prior coverage which impacts the application of the pre-existing condition limitation. The “Small Employer Group Application” (Form M/25600 Rev 12/03) collects basic employer information and requests a listing of employees and owners, partners, and contractors who may be eligible employees. It states that those listed should be “.....working for the employer on a full-time or part-time basis.” The application package does not provide a definition of full-time employment to assist the small employer in completing the form.

**Recommendation 50:** It is recommended that MEGA include a definition of “eligible employee” on its Small Employer Group Application that is consistent with that provided by § 27-50-3 (m).

The Small Employer Group Application Form indicates that MEGA requires a minimum participation level of 75% of the eligible employees, excluding eligible employees who have other coverage. MEGA’s minimum participation level meets the requirements of Chapter 27-50.

MEGA allows the small employer to specify a waiting period and limits this to at maximum three months. A waiting period of up to three months is allowed by Chapter 27-50.

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The Small Employer Group Application Form states that late enrollees will be subject to underwriting requirements and/or a pre-existing condition limitation. A late enrollee may be subject to a pre-existing condition limitation of up to twelve months. However, MEGA cannot subject the late enrollee to other underwriting requirements.

**Recommendation 51:** It is recommended that MEGA remove the reference to “underwriting requirements” for late enrollees from the Small Employer Group Application.

The small employer is instructed to attach to the application a quarterly wage and tax statement, waivers for all employees who do not participate in the plan, and Statement of Prior Coverage Form for each employee who is applying for coverage.

The “Small Employer Group Benefits” form (Form M/SG WS) is used to calculate the monthly premium. As was indicated in the rating section of this report, the premium is calculated on an individual by individual basis, taking into account the specific demographics of the employee and the employee’s dependents. This approach to rating is not allowed by Chapter 27-50 because it can result in different rates within the same group for two subscribers with the same family composition type. This approach is generally referred to in the industry as “list billing.” However, rate differences for family composition are limited to R.I.G.L. § 27-50-5(a)(1) and R.I.G.L. § 27-50-3(p) to “Enrollee,” “Enrollee, Spouse and children,” “Enrollee and Spouse,” and “Enrollee and children.” A recommendation with regard to this practice is included in this report in the section titled Rating Methodology for Small Employer Plans.

### Employee Waiver Form

Regulation 82(6)(B)(2) requires that the small employer carrier obtain a waiver from every eligible employee and eligible dependent of such employee who does not

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participate in the health plan and that the waiver be signed by the employee. Regulation 82(6)(B)(2)(c) specifies the format of the form and requires that in the event the eligible employee refuses to sign the form, the small employer certify to such refusal. The carrier is required to maintain waivers and certifications of refusal to sign for a period of six years.

The sample Waiver of Coverage form (Form M/WoC 6/02) meets the requirements of Regulation 82 except as follows: The MEGA form does not provide for certification by the employer in the event that the employee refuses to sign the Waiver of Coverage form.

**Recommendation 52:** It is recommended that MEGA make provision for employer certification of the employee's refusal to sign the waiver form.

### Subscriber Enrollment Forms

In response to a request for a copy of the employee enrollment form for the Standard and Economy plans, the examiners were provided forms "M/Freq Forms (4/06)" and "M/Combo App (3/06)". The forms provided do not appear to be appropriate for the enrollment of eligible employees and their eligible dependents for a health plan that has no medical underwriting because they appear to be designed for MEGA's Association Plans. However, MEGA confirmed that this is the correct form and that the responses to the health status questions are used only for the purpose of determining the applicability of the pre-existing condition exclusion to future claims.

## **13. Conclusions**

MEGA insures approximately 1,000 small employer subscribers and 1,500 total small employer members through association products. All MEGA's small employer subscribers are sole proprietors.



## **The MEGA Life and Health Insurance Company Market Conduct Examination**

MEGA's products appear to appeal primarily to people seeking low cost insurance or temporary coverage.

MEGA employs methods that are not in compliance with Chapter 27-50, including practices related to underwriting, rating, and equal access to all products. Recommendations are contained in this report to bring MEGA into full compliance with Chapter 27-50.

MEGA's products are unusual in the small employer market in Rhode Island because they are low cost and provide limited benefits as compared to those offered by other carriers. As such, they may operate in a different market niche from the other carriers and may not compete for the same risks. However, by using medical underwriting to decline risks and by offering products that do not provide comprehensive benefits, they may be operating in a way that segments the market and makes insurance through other carriers more expensive than it would otherwise be.

MEGA's products exhibit high distribution costs, low loss ratios and high turnover. While these circumstances raise concern about the value to consumers of MEGA's health insurance plans, none of these circumstances is in direct conflict with Chapter 27-50, which does not contain limitations on distribution costs, loss ratios or turnover.

### **14. MEGA's Response to the Report**

To be added when submitted.

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

**Appendices**

**APPENDIX 1**

**Glossary**

**Adjusted Community Rate** – The Community Rate with demographic adjustments allowed by Chapter 27-50 (age, gender, and health status)

**Association Business** – Health plans sold by MEGA that are only available to members of specified associations. MEGA has deemed such business not to be subject to Chapter 27-50.

**Base Rate** – the rate needed from the average contract to generate sufficient revenue to cover all expected claims, administrative expenses, and reserve (or profit) requirements for contracts renewed in a given time period. The base rate has an age/gender factor of 1.00 and a health status adjustment of 1.00

**AFS** – Abbreviation for “Americans for Financial Security”. AFS is a membership association that is one of several associations that make MEGA health plans available to its members.

**Agent** – A person appointed by MEGA and licensed as an insurance producer by the State of Rhode Island who assists individuals and employers with the purchase of health insurance. Typically, an agent receives a commission that is paid by the insurance carrier.

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

**Community Rate** – The rate required from each contract type to generate sufficient revenue to cover expected claims, administrative expense, and reserve requirements

**Contract** – An enrolled employee or “subscriber” is sometimes referred to as a “contract” encompassing the employee and any enrolled dependents of that employee.

**Decline** – A waiver form which indicates that the employee and/or the employee’s dependents are not interested in health insurance coverage even though they do not have other coverage.

**Dependent** – Family members of the employee (e.g., spouse, children)

**Direct Business** – Employer groups who are not represented by an agent.

**Distribution Channel** – the means by which information about health insurance products is provided to potential customers and/or policies are marketed and sold. Examples of distribution channels are agents, brokers, and intermediaries.

**Economy and Standard Plans** – Plans specified in R.I.G.L. § 27-50-10. These plans are available from MEGA on a guaranteed issue basis. MEGA considers the Standard and Economy plans to be subject to the restrictions of Chapter 27-50.

**4:1 Compression** - R.I.G.L. § 27-50-5(a)(5) requires that the most expensive rate for a specific contract type in a given time frame be limited to 4 times the least expensive.

**Medical Underwriting** – A process used to analyze an individual’s health status for the purpose of estimating future claim cost. The basis for this process is information provided by the individual, the employer, or from an analysis of historical claims experience.

## **The MEGA Life and Health Insurance Company Market Conduct Examination**

**Member** - Each person covered under an insurance contract. The subscriber (the employee who is enrolled in the health plan) is a member, as are each of a subscriber's dependents.

**NASE** – Abbreviation for the “National Association of Self-Employed”. NASE is a membership association that is one of several association that make MEGA health plans available to its members.

**PCPM** – per contract per month.

**PMPM** – per member per month.

**Rate Manual** – A compilation of all the data, processes, policies, and procedures used to develop health insurance rates for a given time frame, including the formulas and factors used to rate each small employer.

**Renewal business** – A group which has already had coverage for at least one year.

**Scheduled Benefit Plan** – A scheduled benefit plan of the type offered by MEGA reimburses the insured an amount based on actual charges, up to a scheduled maximum (after taking into account the effect of deductibles, copays, coinsurance, and plan maximums) for each specific procedure, visit, service, or test.

**Subscriber** – The subscriber is the term given to the employee who enrolls in coverage. The number of subscribers is thus the same as the number of total contracts.

**Tier** - The demographic family composition and rate basis for each subscriber. Chapter 27-50 requires four different family composition tiers (or types) – employee; employee and child(ren); employee and spouse; employee, spouse, and child(ren).

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

**Underwriting** – The processes used to determine whether or not an employer group is eligible for a small employer health plan, determine eligibility of each individual within that group, and determine the health status of either the members or the overall group. Medical underwriting is a component of the overall underwriting process.

**Waiver** – A completed waiver form which indicates that the employee and/or the employees' dependents have other health insurance coverage.

**Waiver Form** – The statement by an employee indicating that the employee and/or the employees' dependents decline health insurance coverage offered through the small group employer because of either (i) other health insurance coverage or (ii) they choose not to have health insurance. As permitted by Chapter 27-50, the waiver form can be completed by the employer in the event that an employee fails or refuses to complete one.

## Appendix 2 – Page 1.

### Legislative History of RI Small Employer Law Since Replacement of the 1992 Act by the 2000 Act

SECTION	PUBLIC LAW	CHANGE	EFFECTIVE
27-50-3	PL 2002 Ch. 292 §90	The only changes are editorial, as to form of citations and cross-references	6/28/2002
	PL 2003 Ch. 119	Adds subsection (oo) (redesignated (nn) when compiled), defining “affordable health plan”.	7/10/2003
	PL 2003 Ch. 120	Deletes definition (c) “basic health benefit plan” and re-letters all subsequent definitions.	7/10/2003
	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
	PL 2003 Ch. 375	[Identical to PL 2003, Ch. 119]	7/19/2003
	PL 2003 Ch. 269	Amends subsection (m) to include retirees of certain fire districts as “employees”	7/2/2004
27-50-5	PL 2002, Ch. 41	Extends sunset of health status adjustment from October 1, 2002 to October 1, 2004. [subsection (a)(2)] Extends sunset of “second calculation” from October 1, 2002 to October 1, 2004. [subsection (a)(2)] Postpones change from 4-1 to 2-1 compression from 10/1/2002 to 10/1/2004.	5/30/2002
	PL 2002, Ch. 124	Adds RI Builders’ Association exemption to subsection (a)(7).	10/1/2003
	PL 2002, Ch. 292 §90	Deletes subsection (a)(6) [“second calculation”] and re-numbers the following subsections. Other editorial changes with no change in substance. Note: Not implemented.	6/28/2002
	PL 2002, Ch. 306	[Identical to 2002 Ch. 124]	10/1/2003
	PL 2002, Ch. 366	[Identical to 2002 Ch. 41]	6/28/2002
	PL 2003 Ch. 119	Adds “including those included in an affordable health plan” to last ¶ of subsection (d). Adds new last ¶ to subsection (d) re: “calculation of premium discounts...for affordable health plans”	7/10/2003

## Appendix 2 – Page 2.

SECTION	PUBLIC LAW	CHANGE	EFFECTIVE
27-50-5	PL 2003 Ch. 120	Amends subsection (a)(5) to delete the requirement for 2-1 compression beginning October 1, 2004, leaving compression permanently at 4-1. Deletes subsection (a)(6), “second calculation”.	7/10/2003
	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
	PL 2003 Ch. 375	[Identical to PL 2003, Ch. 119]	7/19/2003
	PL 2004 Ch. 406	Amends subsection (a)(2) to remove the sunset of “health status”, which would have taken place on October 1, 2004	10/1/2004
	PL 2004 Ch. 502	[Identical to PL 2004, Ch. 406]	10/1/2004
27-50-6	PL 2003 Ch. 119	[In substance, the same as PL 2003 Ch. 120, but the compiler used the text of PL 2003, Ch. 120]	7/10/2003
	PL 2003 Ch. 120	Amends subsection (a)(7) to eliminate the requirement that the director must find that a product form is obsolete and being replaced with comparable coverage before it can be discontinued, also removes the requirement to notify all affected state insurance commissioners of the discontinuance. Shortens the notice period for beneficiaries from 180 days to 90 days. Adds subsection (e), providing for uniform modification at renewal.	7/10/2003
	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
	PL 2003 Ch. 375	[Identical to PL 2003, Ch. 119]	7/19/2003
27-50-7	PL 2002, Ch. 41	Extends sunset of the “2 to 50” definition of “small employer” for purposes of “availability of coverage” from October 1, 2002 to October 1, 2004. [subsection (a)]	5/30/2002
	PL 2002, Ch. 292 §90	Deletes all of subsection (a), except the last sentence, “For the purposes...” Note: Not implemented. Deletes subsection (a)(3), which said “Notwithstanding any other provision of this section, between October 1, 2000 and September 30, 2000, a carrier may choose to limit the time during which it will accept new groups for coverage to a period of not less than ninety consecutive days during each twelve month period.” Other editorial changes with no change in substance.	6/28/2002

### Appendix 2 – Page 3.

SECTION	PUBLIC LAW	CHANGE	EFFECTIVE
	PL 2002, Ch. 366	[Identical to PL 2002 Ch. 41]	6/28/2002
	PL 2003 Ch. 120	In subsection (b), changes 3 plans to 2	7/10/2003
27-50-7	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
	PL 2004 Ch. 406	Amends subsection (d)(9)(ii) and adds (d)(9)(iii) to provide that the minimum participation level for employers of 10 and fewer will be 75%, effective from October 1, 2004 until October 1, 2006.	10/1/2004
	PL 2004 Ch. 502	[Identical to PL 2004, Ch. 406]	10/1/2004
27-50-9	PL 2003 Ch. 120	Deletes requirement for an actuarial study and report due September 30, 2003	7/10/2003
	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
27-50-10	PL 2003 Ch. 120	Deletes “basic” from subsection (a) Deletes subsection (d), which provided for development of the basic plan	7/10/2003
	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
27-50-13	PL 2003 Ch. 120	Deletes reference to “basic”	7/10/2003
	PL 2003 Ch. 286	[Identical to PL 2003, Ch. 120]	7/17/2003
	PL 2005 Ch. 171	Makes mastectomy mandates applicable to standard and economy (to achieve HIPAA compliance). Applies to plans issued, delivered or renewed on and after 1/1/2006	1/1/2006

#### List of Public Laws Amending the Small Employer Law

PUBLIC LAW	BILL	EFFECTIVE DATE
PL 2002, Ch. 41	2002-H 8001	5/30/2002
PL 2002, Ch. 124	2002-S 2896, Substitute A	10/1/2003 (enacted 6/14/2002)
PL 2002 Ch. 292 §90	2002-H 7725, Substitute A	6/28/2002
PL 2002, Ch. 306	2002-H 7912, Substitute A as Amended	10/1/2003 (enacted 6/28/2002)
PL 2002, Ch. 366	2002-S 2903	6/28/2002
PL 2003 Ch. 119	2003-H 5905, Substitute B	7/10/2003
PL 2003 Ch. 120	2003-H 6181, Substitute B	7/10/2003



## Appendix 2 – Page 4.

<b>PUBLIC LAW</b>	<b>BILL</b>	<b>EFFECTIVE DATE</b>
PL 2003 Ch. 286	2003-S 834, Substitute A as Amended	7/17/2003
PL 2003 Ch. 375	2003-S 536, Substitute A	7/19/2003
PL 2004 Ch. 269	2004-H 7590, Substitute A	7/2/2004
PL 2004 Ch. 406	2004-S 3103, Substitute A as Amended	10/1/2004 (enacted 7/5/2004)
PL 2004 Ch. 502	2004-H 8516, Substitute A as Amended	10/1/2004 (enacted 7/7/2004)
PL 2005 Ch. 171	2005-S 311	Applies 1/1/2006 (enacted 7/6/05)

The above includes all amendments since the 2000 enactment through the 2005 Session. Only the above sections have been amended. The laws are amended by action of the General Assembly, as edited by the Compiler of the General Laws. At the end of the 2002 Session, the General Assembly reenacted the General Laws; so all changes through the end of the 2002 Session (plus other editorial changes made by the compiler) have been ratified as of the end of the 2002 Session. The effective date is the date, if any, stated in the Public Law; otherwise it is the date that the bill is signed by the governor or the date that it takes effect without his signature. (Unlike the United States, where bills are subject to a “pocket veto” if the President fails to sign; in RI, bills take effect if the Governor fails to veto.)

**The MEGA Life and Health Insurance Company  
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**Appendix 3**

**Disclosures Regarding Business Relationships with Associations**

**Examiner's Comment:** In conjunction with a settlement of a class action lawsuit, UICI (the former name of MEGA's parent company) agreed that its MEGA and Mid-West subsidiaries would include enhanced disclosures in their marketing and sales materials regarding the contractual relationships between UICI and the associations<sup>17</sup>. Based on the initial response to a request for information provided to the examiners, there appears to be no disclosure provided to Rhode Island small employers of the relationships between MEGA, its parent company, and the membership associations. MEGA provided the following disclosure to the examiners in response to a follow-up data request. This statement is also available on the NASE website. A similar statement is provided on the AFS website. As of the date of this report, the disclosure statement has not been updated to reflect the change in name of MEGA's parent company from UICI to HealthMarkets and the change in ownership.

*Disclosures and Policies*

*Disclosures Regarding MEGA's/the NASE's Business Relationship*

*Introduction*

*Set forth below is the information concerning the National Association for the Self Employed (the "NASE") and the MEGA Life and Health Insurance Company ("MEGA") and a description of the relationship between the two organizations.*

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<sup>17</sup> UICI news release dated October 18, 2004

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

***More About NASE***

*The NASE is a membership organization that provides certain benefits to its Members. The NASE is organized under the laws of the State of Texas and its principal place of business is Capital Center, 1235 Main Street, Suite 100, Grapevine, TX 76051. The NASE also has an office in Washington, D.C., from which it carries out many of its legislative and advocacy efforts. The NASE is governed by a board of directors, the members of which are elected in staggered terms by Members of the NASE, with election occurring on one-third of the directors each year. Members of the NASE are entitled to vote on the selection of members of the board of directors at the annual meeting of the NASE. The NASE maintains a website at [www.nase.org](http://www.nase.org). NASE Members are required to pay monetary dues. The NASE has no direct ownership interest in UICI or Specialized Association Services, Inc. (“SAS”).*

***More about MEGA***

*MEGA is an Oklahoma domiciled life and health insurance company with an administrative office located in North Richland Hills, TX. MEGA is licensed to issue health, life and annuity insurance policies to consumers in all states except New York. MEGA is a wholly owned subsidiary of UICI, a Delaware corporation. UICI is a public company that files annual, quarterly and current reports, proxy statements and other information at the public reference facilities maintained by the Securities and Exchange Commission at:*

*Room 1024, Judiciary Plaza, 450 Fifth Street NW, Washington DC 20549*

*or*

*Citicorp Center, 500 West Madison Street, Chicago, IL 60661.*

*You may call the Securities and Exchange Commission at 1-800-SEC-0330 for further information about the public reference facilities. This material may also be obtained from the Securities and Exchange Commission’s worldwide website at <http://www.sec.gov>.*

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*Shares of UICI common stock are traded on the New York Stock Exchange under the symbol "UCI." UICI maintains a website at [www.uici.net](http://www.uici.net).*

***Relationships between MEGA and Affiliates and the NASE***

*The NASE and MEGA entered into an agreement in 1996, pursuant to which the NASE has made available to its members certain MEGA health insurance products. This agreement with MEGA requiring the NASE to continue as the master policyholder and to make MEGA insurance products available to Members of the NASE may only be terminated by MEGA or by the NASE upon not less than one (1) year's advance notice to the other party.*

*The salesperson that a prospective member or a prospective insured speaks with about NASE membership and MEGA insurance products serves both as a licensed insurance agent of MEGA and as a field service representative for new Members for the NASE, for which he or she will receive compensation. The health insurance premiums derived from the sale of health insurance go to MEGA and the membership dues derived from the sale of memberships go to the NASE. The salesperson acts on behalf of MEGA (and not the NASE) when discussing, explaining, and describing MEGA health insurance products and premiums. The salesperson acts on behalf of the NASE (and not MEGA) when discussing, explaining, and describing other NASE benefits. The NASE pays an affiliate of UICI for enrolling new Members and pays MEGA and/or affiliates of MEGA for ongoing membership marketing and administrative services for certain NASE member benefits obtained from MEGA and its affiliates.*

*Ronald L. Jensen serves as Chairman of UICI, and he, together with members of his immediate family and trusts in which he may have an interest, holds in the aggregate approximately 16.4% of the issued and outstanding capital stock of UICI. SAS (which is controlled by Mr. Jensen's adult children) has entered into an agreement with the NASE to provide certain administrative services, including billing, administrative, fulfillment, and benefit procurement services. The NASE pays SAS for these services. SAS has no*

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

*ownership interest in the NASE. A subsidiary of UICI also sells new membership sales leads to the field service representatives and video and print services to the NASE and SAS. UICI nor MEGA has any ownership interest in SAS or the NASE.*

**The MEGA Life and Health Insurance Company  
Market Conduct Examination**

**Appendix 4**

**Statistical Supplement**

This Statistical Supplement provides a descriptive and analytic overview of MEGA's small employer business. In addition to providing an overview of MEGA's small employer business, this data can also assist with the analysis of the impact of policy recommendations for change to the small employer Act. While the policy document prepared by HAT and the examiners does not include the findings of this examination, the information obtained in the course of the examination will be available for use in any further evaluation of the policy recommendations that have been submitted to OHIC. It is important to make this data available to all with an interest in analyzing the impact of recommended changes to Chapter 27-50.

Exhibit 1:

As of December 31, 2005 MEGA reported that it had 968 association certificates in force. Approximately 70% of the subscribers purchased "single" coverage. Approximately 61% of the subscribers were male and the average attained age of a subscriber was 42. On average, MEGA provided insurance coverage to 1.6 members per certificate. MEGA insures fewer members per subscriber than the other Rhode Island small employer carriers.

Exhibit 2:

MEGA utilizes a "menu" approach to marketing its products. MEGA markets a hospital/surgical product and then allows applicants for health plans to add additional benefits to the hospital/surgical plan as riders. For this reason we have referred to the hospital/surgical benefit in this report as the core benefit. The average premium for single coverage, including any riders that may be purchased on an optional basis, is \$228.

**The MEGA Life and Health Insurance Company**  
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The average PMPM premium is \$198. This amount is considerably less than the average PMPM premium for BCBSRI, which is approximately \$248.

It was noted in the report that the loss ratio for MEGA health plans has been in the range of 35%, indicating a high level of out-of-pocket expense for MEGA subscribers.

Exhibits 3, 4 & 5:

MEGA's association business has a very high termination rate. Approximately 80% of the certificates active as of December 31, 2005 were issued in the 2003, 2004, or 2005. MEGA issued 599 association certificates in 2005 and 313 of these certificates (over 50%) were terminated by December 31, 2005.

Exhibit 6 indicates the reason for termination, as coded by MEGA. It appears that the most common reason for subscribers to terminate their MEGA coverage is that the subscriber obtains replacement coverage through an employer. This suggests that many individuals purchase a MEGA health plan as temporary coverage in between employment.

Exhibit 6:

MEGA obtains information regarding the health status of an applicant for insurance coverage and any dependents that are listed on the application. Based on MEGA's evaluation of each individual's health status, MEGA may decline coverage, offer coverage with an exclusion for certain conditions, or apply a percentage rating to the premium calculated from the rate manual. Of the certificates that were active on December 31, 2005 approximately 85% were issued without a rating and approximately 11% were issued with a rating of more than 22% or an exclusion for certain conditions.

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It is noted in the body of the report that MEGA's methodology of rating for health status is not permitted by Chapter 27-50.

Exhibit 7:

Exhibit 7 indicates that approximately 80% of MEGA health plans sold to Rhode Island residents consist of a Basic Hospital/Surgical benefit plan. The next most common plan, with 14% of the total, is a catastrophic plan which can be purchased with a tax advantaged health savings account.



**The MEGA Life and Health Insurance Company  
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**Appendix 5**

**Correspondence Related to OHIC Findings Regarding MEGA  
Association Business.**

**Appendix 5A:** May 5, 2006 letter from DeWeese Consulting, Inc. to Ms. Susan Johnson

**Appendix 5B:** June 26, 2006 memorandum from Denise Randall and James L. Young of Health Markets to John A Cogan, Esq., Office of the Health Insurance Commissioner and Charles DeWeese, Market Conduct Examiner (without attachments).

**Appendix 5C:** July 21, 2006 letter from Mr. Cogan to Mr. Young

May 5, 2006

Ms. Susan Johnson  
Director of Regulatory Affairs  
The MEGA Life and Health Insurance Company  
9151 Boulevard 26  
North Richland Hills, TX 76182

Dear Ms. Johnson:

After reviewing the material you have sent to us, we have shared pertinent information with the Rhode Island Office of Health Insurance Commissioner ("OHIC"). Based on that information, The OHIC has come to the following conclusions:

- The plans offered to members of your Association Group business segment are health benefit plans as defined in R.I.G.L. § 27-50-3(t).
- Self-employed individuals who purchase Association Group business from you constitute small employers, as defined in R.I.G.L. § 27-50-3(kk).
- R.I.G.L. §§ 27-50-1, *et seq.* and Regulation 82 apply to The MEGA Life and Health Insurance Company's association group and small employer business in Rhode Island, as described in R.I.G.L. § 27-50-4 and Reg.82-3(A), (B) and (C).

Consequently, the Office of the Health Insurance Commissioner has instructed us to collect the relevant information as contained in the data request sent to you on March 31, 2006 with regard to both the business you have identified as small employer group business and the business you have identified as association group business, to the extent that business covers self-employed individuals in Rhode Island.

It is our belief that this review can be conducted remotely, if you can provide us copies of the relevant documents either electronically or by mail and make available appropriate staff for teleconference. However, if that is not feasible, we will schedule a visit to the locations where the relevant documents and staff are available and conduct our examination there.

A response should be prepared by May 19, 2006. Your response should include any responses to data requests contained in the request of March 31, 2006 that are available by then. It should also include a schedule of when remaining documentation will be available, and your advice as to whether it would be more efficient for the examination staff to travel to your place of business.

Page 2.

If you disagree with the determination that the business referred to above is subject to the Rhode Island small employer law, your attorneys may present their legal analysis based on applicable Rhode Island law, including R.I.G.L. §§ 27-50-1, *et seq.*, directly to John A. Cogan, Esq., Executive Assistant for Policy and Program Review, Office of the Health Insurance Commissioner, 233 Richmond Street, Providence, RI 02903.

Sincerely,

Charles C. DeWeese, FSA, MAAA

Market Conduct Examiner

under contract with

Rhode Island Department of Business Regulation and Office of the Health Insurance Commissioner

Cc: John Cogan, Executive Assistant for Policy & Program Review [Office of the Health Insurance Commissioner]

Christopher F. Koller, Health Insurance Commissioner

# Memo

To: John Cogan, Esq., Executive Assistant for Policy and Program Review  
Charles DeWeese, Market Conduct Examiner  
Rhode Island Office of Health Insurance Commissioner

From: Denise Randall, Associate Counsel   
James L. Young, Vice President & Deputy General Counsel 

Date: June 26, 2006

Re: 2005 Small Employer Health Insurance Targeted Market Conduct Exam  
Compliance with R.I.G.L. §§ 27-50-1, *et seq.* and Regulation 82

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The purpose of this memorandum is to set forth The MEGA Life and Health Insurance Company's ("MEGA") position regarding the applicability of R.I.G.L. § 27-50-1, *et seq.* and Reg. 82 to MEGA's association group business.

## **Department Position**

In a May 5, 2006 letter, Mr. DeWeese stated that the Rhode Island Office of Health Insurance Commissioner ("OHIC") had concluded as follows:

- The plans offered to members of MEGA's association group business segment are health benefit plans as defined in R.I.G.L. § 27-50-3(t).
- Self-employed individuals who purchase association group business from MEGA constitute small employers, as defined in R.I.G.L. § 27-50-3(kk).
- R.I.G.L. §§ 27-50-1, *et seq.* and Regulation 82 apply to MEGA's association group and small employer business in Rhode Island, as described in R.I.G.L. § 27-50-4 and Reg. 82-3(A), (B) and (C).

## **Summary Response**

MEGA believes that it has acted with good faith and in a reasonable and appropriate manner to comply with the Rhode Island small employer statute and regulations and that the Rhode Island small employer statute and regulations do not apply to its association group business.



To: John Cogan, Esq.  
Charles DeWeese  
Rhode Island Office of Health Insurance Commissioner  
Page: 2  
Date: June 26, 2006

### **Applicability of Small Employer Statute**

Applicability of the small employer statute is determined by R.I.G.L. § 27-50-4(a), which provides that the statute applies to any *health benefit plan* that provides coverage to the employees of a *small employer* in Rhode Island if any of the following conditions are met:

1. any portion of premium is paid by the small employer;
2. an eligible employee or dependent is reimbursed by or on behalf of the employer for any portion of the premium;
3. the employer or any of the eligible employees or dependents takes certain tax deductions for the health benefit plan; or
4. the health benefit plan is marketed to individual employees through an employer.

R.I.G.L. § 27-50-3(t) defines a *health benefit plan* to include “any hospital or medical policy or certificate.” The association group plans sold by MEGA to members of its association group business segment provide “hospital or medical” coverage and, thus, meet the definition of health benefit plan as defined in the statute.

R.I.G.L. § 27-50-3(kk) defines a *small employer* to include a *self-employed individual*. While self-employed individuals may have purchased MEGA health benefit plans as individual association members, the fact that a health benefit plan provides coverage to a self-employed individual is not, by itself, determinative of whether such coverage is subject to the small employer statute. As noted above, a health benefit plan providing coverage to the employees of a small employer must also meet at least one additional requirement in order to subject such coverage to the provisions of the small employer statute. The question then becomes whether any of the conditions enumerated in R.I.G.L. § 27-50-4(a) are met, triggering applicability of the small employer statute.

Rhode Island small employer regulations place the burden of determining whether a health benefit plan is subject to the small employer statute on the carrier. Regulation 27-82-010(F)(2) requires that carriers elicit from applicants information regarding whether any portion of the premium will be paid by a small employer and whether either a small employer or an individual intends to claim any tax deduction for the premium. MEGA requires agents to use an eligibility form that documents information regarding the items listed in the regulation, a copy of which is attached as Exhibit 1. This form must accompany any application submitted for a MEGA health benefit plan. The top portion of the form is intended to address both state small group employer statutes and the federal requirements of the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”). While this form does not contain the exact text from the Rhode Island small employer regulation, it does closely match that text and captures the essential elements listed in the regulation (i.e., employer contribution to, and tax deductions for, premiums).



To: John Cogan, Esq.  
Charles DeWeese  
Rhode Island Office of Health Insurance Commissioner  
Page: 3  
Date: June 26, 2006

MEGA has also adopted certain internal rules to further assist in determining applicability of the small employer statute. MEGA prohibits submission of a business check with applications for coverage sold to individual association members and also prohibits list billing or common billing for such coverage. Either of these practices would indicate possible employer contribution to coverage which could trigger applicability of the Rhode Island small employer statutes. MEGA has also instructed agents that solicitation is prohibited at a place of business which, as stated in R.I.G.L. § 27-50-4(a)(4), could subject coverage to the Rhode Island small employer statute.

Agents are provided information on the above requirements through memoranda as well as through a mandatory training course which each agent must complete. Copies of the memoranda, dated July 26, 2003 and November 15, 2004, regarding Rhode Island requirements are attached to this memorandum as Exhibits 2 and 3. A copy of relevant portions of the agent training material in use during the exam period is attached as Exhibit 4. Please note that the training material in use during the exam period incorrectly states that employees may be solicited at a place of business; however, the July 2003 and November 2004 memoranda referenced above did tell agents of the prohibition. Training materials have been updated to include the correct information. A copy of these revised training materials is attached as Exhibit 5.

#### **Provision of Small Employer Coverage**

While the small employer statute allows self-employed individuals to purchase coverage subject to the statute, nothing in the statute requires that the small employer market be the exclusive means of obtaining coverage for self-employed individuals. R.I.G.L. § 27-50-7(b) requires that small employer carriers market to small employers all health benefit plans actively marketed to small employers in Rhode Island including *at least* the Standard and Economy plans. MEGA requires its agents to market to small employers, including self-employed individuals, all plans MEGA has available in the small employer market, namely the Standard and Economy Plans. Other coverages offered by MEGA are designed to be provided to individual association members and not small employers. Applicants who qualify themselves as individuals not subject to the small employer statute are allowed to apply for MEGA coverage as an individual association member. When an applicant is identified as being within the scope of the small employer statute, agents are required to offer such applicant the Standard and Economy Plans. A copy of a memorandum sent to the field force, dated January 25, 2005, setting forth this requirement is attached as Exhibit 6.

As noted above, MEGA has adopted certain forms and internal rules to determine whether an applicant is eligible for coverage subject to the small employer statutes. Applicants who identify themselves as self-employed individuals but who wish to apply as an individual association member are required to complete, in addition to the eligibility form discussed above, a rejection form indicating that they have been given the opportunity to apply for MEGA's available small employer plans and have elected not to obtain coverage under those plans. Each such applicant is required to

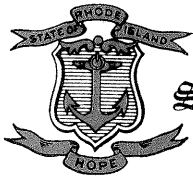
To: John Cogan, Esq.  
Charles DeWeese  
Rhode Island Office of Health Insurance Commissioner  
Page: 4  
Date: June 26, 2006

complete and return this form along with the application. A copy of this rejection form is attached as Exhibit 7.

### **Conclusion**

Systematic implementation and use of the above forms, internal rules, and training is proof of MEGA's good faith intention to comply with Rhode Island's small employer statute and regulations. MEGA believes that implementation of these forms, rules, and training is a reasonable and appropriate response to the requirements of the Rhode Island small employer statute and regulations. The Company believes that any deviations from its rules are isolated. We note that both Mr. DeWeese and OHIC previously have suggested that they have information regarding the activities of some MEGA agents which may be in violation of the Rhode Island small employer statute. If the examiner or OHIC can provide additional specific information regarding these allegations, MEGA will investigate the allegations and determine whether retraining or disciplinary action is warranted.

In light of the foregoing, MEGA believes that the Rhode Island small employer statute and regulations do not apply to its association group business in Rhode Island.



State of Rhode Island and Providence Plantations

OFFICE OF THE HEALTH INSURANCE COMMISSIONER

233 Richmond Street, Suite 237

Providence, R.I. 02903 - 4237

Tel: (401) 222-2246

Fax: (401) 222-6098

TTY: 711

July 21, 2006

Mr. James L. Young  
Vice President and Deputy General Counsel  
Health Markets  
9151 Boulevard 26  
North Richland Hills, TX 76180

By EMAIL Only

Re: The MEGA Life and Health Insurance Company 2005 Small Employer Health Insurance Targeted Market Conduct Examination

Mr. Young:

Thank you for your letter and accompanying memorandum dated June 26, 2006 regarding the above-referenced targeted market conduct exam. In your letter and memorandum you provided an explanation as to why you believe The MEGA Life and Health Insurance Company (MEGA) is not subject to Rhode Island's Small Employer Health Insurance Availability Act, set out at R.I. Gen Laws § 27-50-1 *et seq.* (the Act), and the Act's implementing regulations. After a careful review of your letter and memorandum, we have concluded that our original determination on this issue, set out in the May 5, 2006 letter of Charles DeWeese, is correct.

Sincerely,

John Aloysius Cogan Jr.

Executive Assistant for Policy and Program Review

cc: Christopher F. Koller  
Charles DeWeese  
G. Rollin Bartlett  
Elinor Socholitzky  
Denise Randall



## **Exhibits**

## Exhibit 1

Distribution of Certificates by Family Composition 12/31/2005 *					
Family Composition Type	Single	Husband and Wife	Family	Parent and Child	Total
<b>Subscribers</b>	667	111	126	64	968
<b>Members</b>	667	222	477	152	1,518
	Male	Female	Total		
<b>Subscriber Gender</b>	592	376	968		
<b>Average Attained age of the Subscriber</b>	42 years				

\* Association Business only

## Exhibit 2

### Average Premium by Family Composition

Family Composition Type	Single	Husband and Wife	Family	Parent and Child
Core Benefit *	\$ 128	\$ 294	\$ 297	\$ 179
Medical Riders	\$ 100	\$ 211	\$ 265	\$ 166
Total Medical Plan	\$ 228	\$ 505	\$ 561	\$ 345

\* The Core Benefit consists of the Hospital and Surgical benefit. Other benefits are purchased as riders

### Exhibit 3

**MEGA Association Certificates Inforce by Year of Issue  
(Active 12/31/2005)**

<u>Issue Year</u>	<u>Number of Certificates</u>
1986	1
1987	2
1988	2
1990	1
1991	1
1992	3
1993	1
1994	1
1995	4
1996	1
1997	8
1998	3
1999	10
2000	24
2001	29
2002	94
2003	158
2004	199
2005	<u>426</u>
Total	968

## Exhibit 4

### Association Business Termination Activity

#### Active 12/31/2005

	<b>Certificates</b>	<b>%</b>
12/31/2005 Inforce certificates	968	100%
Terminations 1/1/2006-7/31/2006	245	25%
Remaining Inforce 7/31/2006	723	75%

#### 2005 Issued Business

	<b>Certificates</b>	<b>%</b>
Certificates Issued	599	100%
Certificates Terminated by 7/31/2006	313	52%
Remaining Inforce 7/31/2006	286	48%

#### Active 12/31/2004

	<b>Certificates</b>	<b>%</b>
12/31/2004 Actives	959	100%
2005 Terminations of 12/31/2004 Actives	417	43%
Remaining Inforce 12/31/2005	542	57%

## Exhibit 5

### Reason for Termination Association Business Only Rhode Island Issued 2005 Terminations

Reason for Termination	Number of Certificates	% of Total
No reason given	232	39.3%
Rate increase	3	0.5%
UW Decision decline	1	0.2%
UW Decision exclusion	1	0.2%
Claims	10	1.7%
Employee left business	1	0.2%
Covered through spouse	23	3.9%
Can't afford	40	6.8%
More coverage for less premium	93	15.8%
Miscommunication at presentation	2	0.3%
New job with insurance	55	9.3%
Unhappy with coverage	49	8.3%
Just doesn't want	20	3.4%
On Medicare	2	0.3%
Did not receive certificate	2	0.3%
Refund date due to cancellation	<u>56</u>	<u>9.5%</u>
Total Terminations	590	100.0%

## Exhibit 6

### MEGA Rating for Health Status Certificates Active 12/31/2005

<b>Risk Classification*</b>	<b>Subscribers</b>	<b>%</b>
No rating	820	85%
Rating less than 22.2%	39	4%
Rating greater than 22.2% or exclusions	<u>109</u>	<u>11%</u>
Total	968	100%

\* Does not reflect any applications that were declined or not taken

## Exhibit 7

### Distribution of Association Business by Plan Type

12/31/2005 Inforce

Description	Form	Number of Certificates	%
Basic Benefits Plan	25875	775	80%
Catastrophic Plan	25876	133	14%
Premier PPO Plan	25877	16	2%
PPO Plan	PPO 2 895	19	2%
Misc Plans	Other	<u>25</u>	<u>3%</u>
Total		968	100%