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Mau-Mauing the Medical Loss Ratio

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Senator Max Baucus recently admitted that he never read the new health care law. But that hasn't stopped him from trying to re-write it after the fact, in a way that would drive more health plans from the market and give consumers less choice.

The new law reduces choice of health plans by giving government the power to control the Medical Loss Ratio (MLR) — the amount of dollars an insurer spends on medical care divided by the total premiums. Policies that cover large businesses will have to achieve an MLR of 85 percent, while those for small businesses and individuals will have to achieve an MLR of 80 percent. This sounds simple but leaves many issues unresolved.

Calculating he MLR can be quite complicated — especially when the government gets involved. Suppose, for example, an insurer invests in information technology that it gives to patients or providers in its network in order to improve co-ordination of care. Is that a medical cost?

Furthermore, the MLR regulation is deadly for increasingly popular consumer-directed plans. Suppose a traditional policy costs $4,000 and spends $3,400 on patient care, for an MLR of 85.00. With the consumer-directed policy, the patient controls $800 more of the medical spending than with the traditional policy, through a higher deductible, and his premium goes down by $800. In this case the MLR goes down to 81.25 ($2,600/$3,200). There is no real difference, but the new regulation could require insurers to rebate $120 — the amount by which the ratio falls short of the required MLR. (In real life, the consumer-directed plan would have lower total costs than in this simple arithmetical example, because cutting out the middleman and giving more health dollars to patients to control themselves motivates them to get better value for money.)

But Senator Baucus wants to throw yet another wrench into the works. Taxes are not medical care, and they are not under any health plan's control. So, the legislation excludes taxes from total costs used to calculate the MLR. Senator Baucus leads a group of senators who now assert that they meant to pass a bill that exempted some taxes from health plans' MLR calculations, but not corporate income taxes.

If it prevails, Baucus' flawed notion will lead to an even greater reduction of choice of health plans. Suppose two insurers of the same size compete in a region's large-group market. They earn premiums of $1 million each. They each spend $850,000 on medical claims, thereby achieving an MLR of 85 percent. One insurer is for-profit, earning a profit of 4 percent

($40,000), and pays combined federal and state corporate income tax of 45 percent ($18,000). Its MLR automatically shrinks to 83.5 percent and ObamaCare demands a rebate that likely drives the for-profit carrier from the market.

The whole focus on MLRs is a politically seductive waste of time: MLRs are irrelevant because the insured and their employers tend to choose health plans based on other criteria — likely invisible to politicians and bureaucrats. Plans with relatively low MLRs have increased market share in the last few years.

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