To: Steven Ostlund, David Ball, Members of the PPACA Actuarial Subgroup of the AHWG
From: Judy Dugan for Consumer Watchdog

August 4, 2010

Re: IRD064, tax deductions from premiums

Consumer Watchdog agrees in full with the comment by NAIC Consumer Representative Tim Jost that the only federal income taxes that may be deducted from premium revenue in calculating the medical loss ratio are the taxes assessed on the premium revenue. In particular, we agree that deduction of other federal tax, such as on investment income, would be grossly unfair to policyholders, and that such deduction is nowhere envisioned or permitted under Section 2718 of the Patient Protection and Affordable Care Act.

As Jost's comment of July 27 stated:

> "Investment income is nowhere included in the MLR formula. It is apparently kept by the insurer in addition to the 15 or 20 percent of their premium revenue permitted by the MLR formula for administrative expenses and profit. To allow insurers to additionally subtract taxes on this income would effectively be allowing them to get these funds twice—once as income not counted in the [premium revenue] denominator and a second time by subtracting the amount from the denominator. This would be inequitable and contrary to the intent of Congress of allowing enrollees 80 or 85 percent of premium revenues for claims and quality improvement expenses."

To allow deduction of any tax not attributable to premium revenue would be a direct subsidy of overhead and profit.

Consumer Watchdog also asks that the subgroup seek to estimate the effect of the federal tax deduction the final MLR. While the number would obviously not be fixed across the industry or from year to year, it is surely possible to say retrospectively what the effect would have been in recent previous years, for five or six major insurers.

If one of the aims of the minimum MLR is to promote greater efficiency by insurers, we need to know going in whether the law will have any effect at all once taxes are deducted from premiums, insurer quality improvements are added to medical costs, changes are made in how reserves and reinsurance are accounted for in the MLR, and so on.

You are doing difficult work with a law that demands substantial changes in how medical care is defined and is often not clear in its intention. But is also far from clear that consumers will benefit once the subtractions to income and additions to medical care costs are fully calculated. You are the people best equipped to make these calculations, and Consumer Watchdog hopes you will consider them part of the NAIC's task.