# THE LOCAL CHOICE PROGRAM

## Procedures for determining Adverse Experience Adjustment (AEA)

Sections 1VAC55-20-160 D and 1VAC55-20-300 of the Virginia Administrative Code, the regulations under which The Local Choice (TLC) program operates, provide for a potential Adverse Experience Adjustment to withdrawing employers. This adjustment requires any withdrawing employer to contribute their pro rata share of any operating loss experienced during prior plan years. Although the regulations permit a multi-year review of profits and losses, it is the policy of the Department to confine any applicable Adverse Experience Adjustment to the experience of the last plan year during which the employer was a member. The following illustrations have been prepared to assist our members in understanding how an Adverse Experience Adjustment would be calculated.

The basis for determining any Adverse Experience Adjustment will be (1) the amount of the program's loss for the most recent plan year, (2) the experience of the employer, and (3) the proportion of the employer's enrollment to the enrollment for the entire category. Employers are divided into three categories.

1. Employers with 1 to 49 enrollees (Pooled)
2. Employers with 50 to 299 enrollees (Blended)
3. Employers with over 299 enrollees (Experience Rated)

A statement of income and expenses is prepared for each category based upon its experience. (The third category is comprised of experience rated employers. Each group is responsible for their own claims, whether or not the entire category of experience rated employers sustains a loss.)

### EMPLOYERS WITH FEWER THAN 300 ENROLLEES (CATEGORIES 1 & 2)

The first step in the adjustment process is to determine the total number of contract units (C/Us) for each category for the past plan year. A contract unit is determined by the following factors applied to the type of membership times the number of month's participation for each enrollee: an employee only contract has one C/U; an employee plus one contract has 1.85 C/Us; a family contract has 2.7 C/Us. Therefore, the number of contracts by each membership type is accumulated, and the total contract units for that category is computed based on the stated factors as follows:

| Type of Membership | Total Contracts | C/U Factor | Total C/Us |
|---|---|---|---|
| Employee only X 12= | 4,500 | 1.0 | 4,500 |
| Employee + One X 12= | 2,200 | 1.85 | 4,070 |
| Family X 12= | 3,300 | 2.7 | 8,910 |
| Total | 10,000 | | 17,480 |

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## Procedures for determining Adverse Experience Adjustment- Continued

The next step is to determine the total number of contract units for the withdrawing employer during the plan year using the same method illustrated above. The withdrawing employer's pro rata share of the contract units is then applied to the category's loss to determine the adverse experience adjustment for the withdrawing employer. The following example illustrates an adverse experience calculation for employers in categories 1 and 2.

**EXAMPLE *:**

ASSUMPTIONS: Loss for the category is $1,000,000. Total category contract units equal 17,480. The terminating employer had 1,878 C/Us during the review year.

1. Employer's C/Us divided by category's C/Us equals employer's pro rata share.
2. Employer's share times the category's loss equals the employer's Adverse Experience Adjustment.

**CALCULATIONS**: 1,878 / 17,480 = 10.74% X $1,000,000 = $107,437

In the example, the employer would have an Adverse Experience Adjustment of $107,437 at the time of termination. The terminating employer would be notified of this amount within 6 months of termination, and the employer would be required to pay the adjustment in up to 12 equal installments beginning 30 days after the notification by the Department.

It is possible that one category could experience a loss, subjecting employers in that category to an Adverse Experience Adjustment, while another category could operate at a surplus and require no Adverse Experience Adjustment to a terminating group.

## EMPLOYERS WITH OVER 299 ENROLLEES (CATEGORY 3)

The maximum Adverse Experience Adjustment which would be due from each terminating employer in this category would be that employer's loss during the immediate past plan year based upon the employer's plan(s) expenses and its pro rata share of the program overhead. Prior years' performance during which the employer was experience rated would be taken into consideration, if favorable to the employer, but the Adverse Experience Adjustment would never exceed the last plan year's loss.

An employer in this category withdrawing at the end of a year in which they did not have a loss would not be assessed an Adverse Experience Adjustment. Another employer that withdrew with a $100,000 loss during the last plan year would be subject to a maximum Adverse Experience Adjustment of the $100,000 loss paid in equal installments over a 12-month period. An illustration follows:

* Examples are for illustration only and have no bearing on the actual experience of a pool/category or individual group.

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## Procedures for determining Adverse Experience Adjustment – Continued

**SAMPLE ILLUSTRATION ***

**ANY CATEGORY 3 EMPLOYER**
THE LOCAL CHOICE HEALTH CARE PROGRAM
Operating Statement
July 1, 2010 through June 30, 2011

| | |
|---|---|
| INCOME | $1,519,543 |
| EXPENSES: | |
| Incurred Claims | $1,417,129 |
| Contractor Administration | 128,107 |
| Pooled Capitation (Rx, Dental and MISA) | 55,290 |
| Program Overhead | 19,017 |
| Total Expenses | $1,619,543 |
| GAIN OR (LOSS) | ($100,000) |

If this employer had withdrawn on June 30, 2011, the maximum Adverse Experience Adjustment would have been the operating loss of $100,000. However, prior year's accumulated gains could be applied to reduce any current year loss.

Likewise, if an employer withdraws from the program and the review analysis reflects a gain for the immediate past plan year, there would be no Adverse Experience Adjustment, even if their accumulated experience was a loss.

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