Organizational Form and Regulatory Compliance: Evidence from Medical Loss Ratio Regulation

Lynn M. Hua
Georgia State University, Robinson College of Business

Can firms comply with a binding regulation without changing the underlying behavior the regulation is intended to influence? Economic theories of regulation typically emphasize incentives, but firms facing the same incentives may respond differently if organizational structure alters the set of available compliance strategies. This paper studies this idea in the context of the Affordable Care Act's medical loss ratio (MLR) provision, which requires individual market insurers to spend at least 80 percent of premium revenue on medical claims and quality improvement activities or provide rebates to enrollees.

Since implementation of the MLR provision, insurers have largely converged to the 80 percent threshold and distributed billions of dollars in rebates to consumers. Existing work finds that insurers below the threshold increased medical spending following implementation but does not examine whether organizational form affects how firms achieve compliance.

I focus on vertically integrated insurers that own or are affiliated with the providers to whom they pay medical claims. For traditional insurers, increasing the MLR requires negotiating higher payment rates with independent providers, expanding utilization, or both. These responses impose real economic costs and should scale with the size of the insurer's compliance gap. Vertically integrated insurers face a different set of opportunities because payments to affiliated providers are internal transactions. If transfer pricing is a way for some firms to comply with regulation, integrated insurers may be able to increase reported claims spending without the corresponding changes in care delivered. This organizational difference generates a testable prediction: traditional insurers should exhibit a strong response relative to the compliance gap, while vertically integrated insurers should not.

Using NAIC regulatory filings from 2001–2024, I implement a triple-differences design that exploits variation in insurers' pre-regulation distance below the 80 percent threshold. The design compares changes in MLRs after implementation across insurers facing different levels of regulatory pressure while allowing responses to vary by integration status.

The main results are that vertically integrated and traditional insurers respond differently to the same regulation. Consistent with prior work, traditional insurers close approximately 71 percent of their pre-regulation compliance gap. In contrast, vertically integrated insurers display a response approximately 90 percent smaller and largely independent of the size of their compliance gap. Regardless of how far below the threshold they begin, vertically integrated insurers increase their MLRs by roughly the same amount.

Several findings are consistent with transfer pricing as an important mechanism rather than efficiency gains or care coordination. First, vertically integrated insurers with larger future compliance gaps reported systematically lower claims before the ACA, when there was no regulatory incentive to maintain high MLRs. Second, decomposition of the MLR numerator shows that the differential response is concentrated in the claims channel rather than quality improvement or administrative expense categories. Third, event study estimates show that the gap between integrated and traditional insurers persists and widens over time rather than converging.

The paper contributes to three literatures. First, it extends work on insurer responses to MLR regulation by showing that organizational form shapes compliance mechanisms. Second, it contributes to a growing literature on transfer pricing and profit shifting within integrated health care organizations. Third, it adds a regulatory arbitrage dimension to the welfare analysis of vertical integration in health care. More broadly, the findings suggest that organizational structure affects both market outcomes and the effectiveness of regulation itself.