AMERICAN ACADEMY of ACTUARIES

Medical Reinsurance

Considerations and Design Options for a Government-Sponsored Reinsurance Program

Policy-makers are considering offering government-provided reinsurance to health plans as part of an overall solution to address some of the problems in the health insurance system. The 2005 American Academy of Actuaries[1] issue brief, *Medical Reinsurance: Considerations for Designing a Government-Sponsored Reinsurance Program*, provides a primer on the current commercial medical reinsurance market and it outlines some of the issues policy-makers should consider when designing and implementing a government-sponsored medical reinsurance program.[2] This backgrounder provides further insight on the various considerations and design options that would need to be addressed when developing such a program.[3]

Current State of the Reinsurance Market

Many health plans and self-funded employer plans are large enough to manage effectively their own catastrophic risk, and therefore usually choose not to purchase commercial reinsurance. As a result, the current reinsurance market is fairly small compared with the health insurance market as a whole. Nevertheless, reinsurers have significant amounts of available capital and large enough risk pools to handle claim variability.

Under "true" reinsurance, risk protection is purchased by insurers for very large (catastrophic) claims. Insurers can almost always purchase reinsurance with annual limits of up to $5 million, and with limits up to $10 million sometimes available.

Under "stop-loss" insurance, insurance is purchased by self-funded employers to cover the risk of large claims. Attachment points (per claim deductible) range from $10,000 to $500,000, with most falling between $25,000 and $250,000. Self-funded employers can almost always purchase stop loss with annual limits of up to $5 million. Higher limits are available, but are not always easy to obtain.

Issues for Consideration

Many issues need to be considered when designing a government reinsurance program. How these issues are addressed could affect how the program is implemented as well as its ultimate costs.[3]

1. *Would participation in the reinsurance program be voluntary or mandatory?*

A program could be voluntary or mandatory. If the program was made voluntary, it would need to be determined what level the decision would be made on. There are several choices:

- Insurer level—Under this option, insurers who opt to participate in the reinsurance program would be required to do so for all of their health plans, not just select groups.

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[1] The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. The Academy is nonpartisan and assists the public policy process through the presentation of clear, objective analysis, and serves as the public information organization for the profession. The Academy regularly prepares testimony for Congress, provides information to federal officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also supports the development and enforcement of actuarial standards of conduct, qualification and practice and the Code of Professional Conduct for all actuaries practicing in the United States.

[2] The issue brief, *Medical Reinsurance: Considerations for Designing a Government-Sponsored Reinsurance Program,* is available on the Academy website (www.actuary.org/pdf/health/reinsurance_jan05.pdf).

[3] This document is not meant to provide a comprehensive listing of all issues and options that could be considered when designing a government-sponsored medical reinsurance program. Rather, it highlights some areas for consideration and provides examples of the options available to address various issues.

- Employer group level—Under this option, insurers could determine to enroll employer group plans on a case-by-case basis, enrolling some groups, but not others.

- Individual employee level—Under this option, insurers could determine to enroll particular employees (and any dependents) on a case-by-case basis, enrolling some employees, but not others.

- Individual insured level—Under this option, insurers could determine to enroll particular insureds on a case-by-case basis. This differs from the employee level above, because the insurer could choose to reinsure only a dependent, but not the employee.

If participation in the program was mandatory, it could apply to:

- All health plans

- All self-insured health plans

- All health plans, excluding those that are self-insured

- All health plans with less than some fixed number of members

- Some other subset of health plans

2. *What issues should be taken into account for a reinsurance program at the state level, the federal level, or for a program that has both state and federal elements?*

Issues that would need to be considered include the interplay of state regulations and ERISA with the reinsurance program, how current state high-risk pools and other state reinsurance programs would be impacted, issues unique to multi-state employers, and the desirability of uniform benefits and procedures.

3. *Will the attachment point be increased over time, and if so how?*

The cost of a reinsurance program would increase at a rate faster than underlying medical trend due to the leveraging effect of a fixed attachment point. That is, costs of the program would increase not only because underlying medical costs would increase, but also because more claims would exceed the attachment point. Over time, this leveraging effect would increase the costs of the program substantially, and therefore, the costs to the government in a government-sponsored program would also increase. Options to mitigate this effect include increasing the attachment point annually by the increase in the Medical Consumer Price Index, the increase in health spending, or some other measure of health cost increases.

4. *How would moral hazard[4] be minimized?*

If reimbursement is based on actual amounts paid by insurers and self-funded plans, the payers probably would alter certain behaviors (e.g. provider contracts, cost-saving measures) as they will no longer be responsible for the catastrophic costs associated with individuals or groups covered by reinsurance. Options to mitigate this effect (known as moral hazard), to varying degrees, include:

- Reimbursing payers based on government-defined nominal costs per service (e.g. Medicare fee for service payable amount)

- Requiring a coinsurance amount from payers, thereby keeping a portion of the catastrophic claims as the payers' responsibility

- Reimbursing payers based on a risk adjuster or other predictive model, similar to the CMS-HCC (Hierarchical Condition Category) model

[4] Moral hazard is the tendency of individuals to change their behavior due to the existence of insurance.

- Requiring payers to have in place cost-containment measures, such as disease management, in order to participate in the pool.

5. *Addressing geographic cost factors, such as Medicare geographic cost factors.*

If a reinsurance program is created on a federal level, geographic cost differentials may result in different "subsidies" for different geographic areas of the country. Because health care costs are high in some parts of the country (due to both cost per unit differences and utilization differences), a fixed attachment point could result in insurers in low-cost areas subsidizing insurers in high-cost areas. Ways to mitigate this potential problem include:

- Adjusting the "national-average" attachment point based on Medicare geographic cost factors

- To the extent that the program is financed by assessing participating insurers, calculating the assessment on a statewide or regional basis, rather than across the entire federal program.

6. *How should the accumulation period be defined?*

Most reinsurance arrangements are based on one year's claims, but it must be determined how this is defined. Options include:

- Reimbursing payers on a “paid-claims” basis, that is, based on all claims paid by the insurer during the year

- Reimbursing payers on an “incurred-claims” basis, that is, all claims for services received by the insured (and thus incurred by the payer) during the year.

7. *What types of services are eligible for reimbursement?*

Different insurance plans will have different benefit packages, covering different services. In addition, some benefit packages will be more generous than others. As a result, it is important to define what services are eligible for reimbursement under the reinsurance program. Options include:

- Medicare/CMS reimbursement policy

- Reimbursement based on the underlying insurance plan.

8. *Other considerations:*

- How would the reinsurance program be administered? Through a government agency? Through the states? Through private reinsurers? Through a partnership or combination of public and private entities?

- Would premiums from insurers and self-funded plans be required for participation in the reinsurance program? If so, how should these premiums be determined?

Designing a reinsurance program that attempts to reduce health care premiums, decrease the number of uninsured, and promote premium stability is a worthwhile goal. Though it does not reduce overall health costs by itself, a properly designed reinsurance program that addresses the issues as described above could help meet these goals.

The American Academy of Actuaries would be glad to examine further the issues that should be considered when designing a government reinsurance program, along with various options that are available under each issue, and their pros and cons. For more information on these issues please contact Holly Kwiatkowski, Academy senior health policy analyst (*Kwiatkowski@actuary.org*, 202-223-8196) or Cori Uccello, Academy senior health fellow (*Uccello@actuary.org*, 202-223-8196).