



Reinsurance in Kansas: Background, Policy Issues and Recommendations

Presentation to a Joint Session of the
House Insurance and Financial Institutions and
Senate Financial Institutions and Insurance
Committees

February 14, 2008

Robert St. Peter, Ron Liebman,
Gina Maree, Sarah Carkhuff Fizell
Kansas Health Institute



Reinsurance is a Relevant Policy Issue in Kansas

- Many small businesses struggle to provide health insurance to their employees
- High costs and an inability to accurately forecast future costs discourage many small employers from offering insurance
- Several states are exploring options to assist small businesses in offering affordable health insurance to their employees



Reinsurance is a Relevant Policy Issue in Kansas

- One-fourth (29%) of Kansas workers are employed by small businesses (i.e., less than 50 employees)
- The average cost of family coverage for small businesses was \$9,237 per family per year in 2005
- One-third (36%) of uninsured adults in Kansas work for businesses with less than 25 employees



Reinsurance is a Relevant Policy Issue in Kansas

- Reinsurance has the potential to increase the number of small businesses which offer insurance to their employees by:
 - Reducing the cost of health insurance for some small businesses
 - Making health insurance costs more predictable
 - Reducing the risk of adverse selection
 - Protecting solvency of insurers that offer policies to small businesses



Overview of Reinsurance

- What is reinsurance
- Different types of reinsurance
- What are other states doing
- Modeling reinsurance in Kansas
- Considerations for policy makers



What is Reinsurance

- Reinsurance is a mechanism that stabilizes the cost of insurance by spreading risk across a larger group of people
- Reinsurance is especially important in the small group market where unexpected medical expenses can cause a significant increase in premiums paid by small businesses
- Reinsurance is one innovative approach that has shown success in helping small businesses provide insurance to their employees



A Simplified Example of How Reinsurance Works

- Acme has purchased insurance in a small group market that uses reinsurance
- Acme offers health insurance to its 23 employees
- One previously healthy employee experiences \$75,000 of medical expenses in a single year
- Reinsurance limits the loss to Acme's insurance company to only \$5,000 for that individual
- The remaining \$70,000 of costs are paid by a reinsurance carrier
- Acme's insurance company is able to offer them (and other small businesses) lower premiums for next year because their losses were less this year



Types of Reinsurance

- Two main types of reinsurance
- Insurer identifies individuals with high medical costs before or after they occur:
 - Prospective reinsurance (before)
 - Retrospective reinsurance (after)



Prospective Reinsurance

- The primary insurer identifies group members who are likely to have high medical costs (known as “ceding”)
- The primary insurer pays a premium to the reinsurance carrier to cover only those group members
- Reinsurance carriers set premiums high enough to discourage the primary insurer from shifting too many group members to the reinsurance plan



Retrospective Reinsurance

- Primary insurers do not have to identify in advance group members likely to incur high medical costs
- All group members are reinsured
- Reinsurance carrier covers medical costs above a certain pre-determined level for any one individual

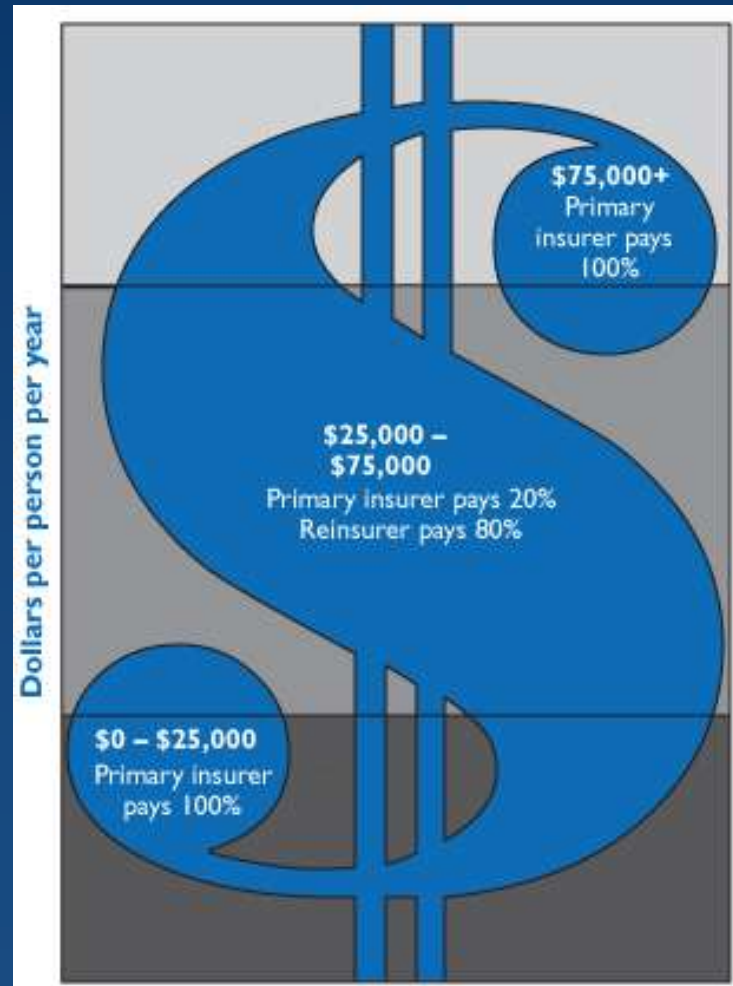


Common Characteristics of Both Types of Reinsurance

- Reinsurance carriers may limit coverage to certain diagnoses or conditions
- Costs for potentially high cost group members are shared between primary insurance and reinsurance carriers:
 - Agreed upon “threshold” of medical costs for any one individual triggers cost sharing
 - The reinsurance carrier pays all or some of the medical costs above a certain amount
 - May have upper limit on amount reinsured



Reinsurance Illustrated





Reinsurance Works by Spreading Costs

- Reinsurance spreads the cost of unexpected medical claims of small businesses to larger groups of people
- The cost can be spread to:
 - Small group market only
 - Large group market only
 - Both small and large group markets
 - Entire insurance market (ie, individuals)
 - All tax payers



Financing the Cost of Reinsurance

- “Private model” – insurers pay cost via premiums or assessments
 - May limit cost to specific segments of the insurance market (i.e., small or large group)
 - Cost passed on to businesses and individuals through higher premiums
- “Public model” – state pays all or some portion of the cost as a subsidy to the small group insurance market
 - Cost passed on to taxpayers through use of state general fund, tobacco taxes, etc.



Limitations of Reinsurance

- Reinsurance IS a strategy for preventing large fluctuations in insurance premiums for small businesses
- Reinsurance is NOT a strategy for reducing overall health care costs
- Assumes that stabilization of costs paid by primary insurers is actually passed on to small business through lower premiums
- Administrative costs associated with reinsurance programs



Reinsurance Initiatives in Other States

- New York – Healthy New York
- Arizona – Healthcare Group of Arizona
- New Mexico – Health Insurance Alliance
- Idaho – Small Employer Health Reinsurance Program
- Connecticut – Small Employer Health Reinsurance Pool



Healthy New York (HNY)

- Retrospective reinsurance plan launched in 2001
- Designed to benefit small employers, sole proprietors and low-income individuals
- Benefit package more limited
- Some pre-existing condition and “crowd out” rules apply
- Originally, 90% of claims were paid between \$30K - \$100K
 - Premiums 50% lower than individual market



Healthy New York (Cont.)

- HNY restructured so that all claims between \$5K - \$75K were reinsured
- Additional 17% reduction in premiums:
 - Premiums 40% below small group HMO
 - Premiums 65% below individual market
- In 2005, total cost estimated at \$61.7 million for 107,000 enrollees
 - Funded through tobacco taxes and MSA
- As of Dec. 1, 2006 there were 131,000 enrollees in the program



Healthcare Group of Arizona (HCG)

- Retrospective reinsurance program created in 2000
- Designed to benefit small employers, self-employed and political subdivisions
- Primary insurer pays first \$50k in costs, HCG pays \$50-100k, costs over \$100k paid by commercial reinsurance
- State provided initial subsidy of \$8m
- As of 2006, program funded through premium payments from participating small businesses and other entities
- As of January 2008, 24,000 enrollees in medical program



New Mexico Health Insurance Alliance (HIA)

- Retrospective reinsurance plan (1994)
- Designed to benefit small employers and sole proprietors
- Claims that exceed 75% of premium revenues are reinsured
- Funded through assessments on all participating insurers. If losses exceed this amount, all insurers in state assessed
- NM insurance carriers paid about \$4.5 million in 2003 to cover reinsurance losses
- In 2004, enrollment was 4,000



Idaho Small Employer Health Reinsurance Program (ID-SEHRP)

- Hybrid reinsurance plan (characteristics of both public and private, and prospective and retrospective models) created in 1994
- Designed to benefit small employers
- Primary insurers are given 60 days from issuance of policy to reinsure the entire group or only certain individuals
- Primary insurers responsible for the first \$13K of claims, and 10% of claims above that amount, up to variable thresholds



Idaho Small Employer Health Reinsurance Program (Cont.)

- Funded through premiums and assessments on all insurers in the state
- In 2003, program cost \$538,062
- As of April 2004, 44 small group plans in program



Connecticut Small Employer Health Reinsurance Pool (CT-SEHRP)

- Prospective reinsurance program established in 1990
 - Identified by the National Association of Insurance Commissioners as a model program
- Designed to benefit small employers and self-employed
- Within 60 days of issuance, primary insurer has option to reinsure
- Reinsurer pays all claims above \$5K
- Funded by premiums from participating carriers and an assessment on all carriers
- 3,100 individuals enrolled in Oct. 2004



Modeling Reinsurance in Kansas

- Interest by KID in how reinsurance could be structured and implemented in Kansas
- KID used grant from HRSA to engage actuarial firm, Pool Administrators, Inc., to:
 - Use Kansas-specific data
 - Conduct analysis of potential reinsurance program designs
 - Recommend a design for Kansas
- UMHMF and KID asked KHI to summarize technical report for policy audience



PAI Recommendations

- Full retrospective reinsurance model
 - Analyzed three other options as well
- Eligible employers have 50 and fewer employees
- Primary insurer pays
 - First \$5,000 in claims
 - 10% of all claims between \$5,000 - \$75,000
 - All claims above \$75,000
- Limiting reinsurance coverage to \$75,000 encourages primary insurers to manage the costs of their groups more efficiently



PAI Recommendations (Cont.)

- Estimates that 33% of small employer claims, totaling \$107 million per year would be paid through reinsurance under stated assumptions
- Recommends small employers cover one-third, and large employers cover two-thirds, of that \$107 million
- Estimates that 6 – 16% of total premium costs for the small group market would be paid from outside the small group market



PAI Recommendations (Cont.)

- These costs could be paid by large group market or through state subsidy
- Recommended funding through an assessment on all regulated carriers in the small and large group markets in the state
 - Self-insured plans would not contribute
- Some level of state and/or federal subsidization is desirable
 - Potential funding sources not identified



Modification Proposed by PAI

- To further limit risk to primary insurers, add a prospective component to the model
- The primary insurers:
 - Identify potential high-risk individuals
 - Pay an additional premium to the reinsurer
 - Pay none of the costs exceeding \$75,000 for these individuals
- Cost estimates for this approach were not provided



Critical Assumptions in Current PAI Models

- Models based on mandatory participation of small group carriers
 - Current study does not assess feasibility and impact of mandatory participation on market
 - Current study does not model rates of participation for insurance carriers or small employers in voluntary program
- Assumptions in model can significantly affect the findings
 - Average premium cost in Kansas
 - Number of covered lives per premium



Considerations for Future Reinsurance Models

- If program is voluntary, model supply and demand behaviors of small group insurance carriers and small businesses
- Limit participation to different size employers, e.g., fewer than 10 employees
- Effect of “ceding” different high-risk individuals into the reinsurance pool
- Vary cost-sharing structures between primary insurers and reinsurers
- Consider variations in benefit structure
- Estimate administrative costs of program



So What Do We Know About Reinsurance in Kansas

- PAI model helps us understand the potential value and limitations of reinsurance in Kansas
- Assumptions in the models are critical to the outcomes
- More modeling is needed to determine the best approach for Kansas
- Continued use of Kansas-specific data
 - Value of KHIS database for policy analysis



Conclusions

- Reinsurance can be an effective strategy to stabilize premiums for small businesses
- Several states have had success in using different reinsurance models
- Structure and funding of program must be appropriate for state
- Further modeling will be useful



More Information

- ***Lessons from the Kansas Reinsurance Modeling Project***, KHI, January 2008
- ***Modeling of Prospective and Retrospective Reinsurance: Impact on the Small Employer Market***, Pool Administrators Inc., December 2007
- ***Reinsurance and State Health Reform: The Role of Reinsurance as a Public Policy Tool in Kansas***, KHI, April 2007
- **Reports available at**
 - <http://www.khi.org/s/index.cfm?aid=600>

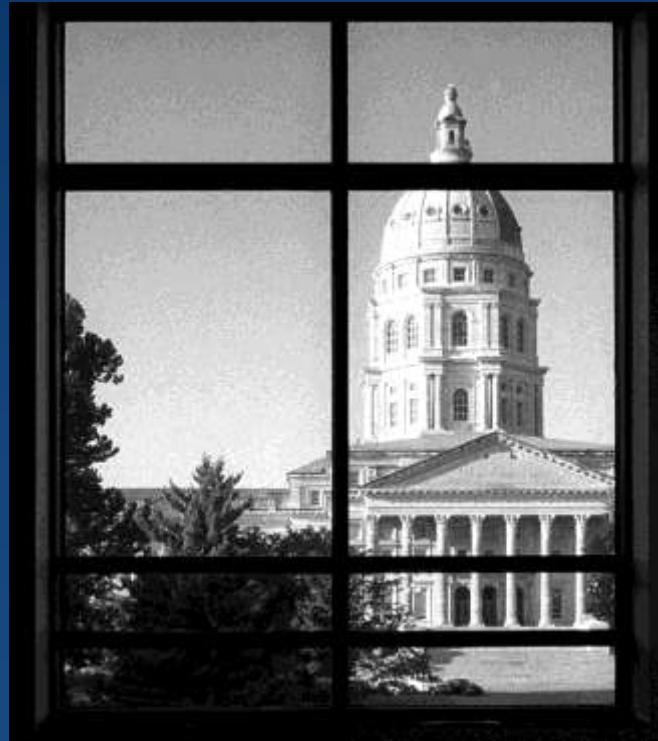


About This Project

- Funded by the United Methodist Health Ministry Fund
- Acknowledge contributions from
 - Karl Ideman and Rick Larose, PAI
 - Steve Schramm
 - Kim Moore
 - Commissioner Praeger and Larry Bruning
 - Barbara Langner
- Original PAI report funded by State Planning Grant from HRSA to KID



Kansas Health Institute



Information for policymakers. Health for Kansans.