Health Reinsurance Update

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Health Reinsurance Update

- Reinsurance Market Conditions
- Medical Cost Trends
- Reinsurance Treaty Terms

Reinsurance Market Conditions

*Underwriting Cycle*

- Late 1980s through early 1990s: profitable!
  - Less capacity + reinsurance cost low small & margins high
- Mid 1990s through 2000: ugly losses!
  - Too much capacity → poor pricing & UW → significant losses
- 2001 to today: recovery period
  - Reduced capacity
  - Lower expense levels + increased discipline + increased UW controls
- Recovery period ramifications:
  - Reinsurers more risk averse
  - Reinsurance management expectations for more consistent results
  - Allocable capital for health lines competing with non-health lines
Reinsurance Market Conditions

The Reinsurance Decision

• Reasons for purchasing reinsurance:
  – Risk transfer
  – Reinsurer expertise & services
  – Balance sheet issues (credit on Annual Statement)
  – Arbitrage ("naïve capacity")

• Considerations in selecting a reinsurer:
  – Financial strength
  – Commitment
  – Reputation

Reinsurance Market Conditions

Market Segments

• National carriers and the Blues
• Individual Medical
• Small Group Medical (< 50 EE’s)
• Employer stop loss
• HMO & provider excess
• Niche plans
Reinsurance Market Conditions

Market Segments

National Carriers and The Blues

• Market size: top 10 writers totaled $150 Billion in 2003 (source: AM Best)

• National carriers continuing to grow through acquisition and organic growth

• Recent experience: 2003-2005 has been a profitable period

• Little, if any, reinsurance opportunity
  – Why/not Quota Share?
  – Why/not Excess?

Individual Medical

• Consolidation: fewer and larger players

• 15 million policyholders

• Expanding market due to growing number of self-employed individuals and early retirees
Reinsurance Market Conditions

Market Segments

Small Group Market (Under 50 Employees)
- Some self-funded business migrating back to fully insured
- Impact of HRA & HSA plans
- Typical plan: min $1,000 ded, 80/60 coins., 3-4 tier Rx card
- 2005 renewal increases: 12%-16% average
- High renewal persistency (70%-80% of cases)
- Benefit “buy-downs” at renewal:
  - “Price point” reached ➔ sizable number of groups with average 10% buy-down
  - Helps improve persistency, but does not necessarily lower trend

Employer Stop Loss
- Is the market hardening or softening?
  - Milder conditions today than 5-6 years ago
  - Aggregate turnaround
- Average renewal rate increases vary widely
- High renewal persistency (70%-80% of cases)
- Smarter claims management
  - Improved identification of potential high dollar claims
  - Laser, rate-up, or decline during underwriting
Reinsurance Market Conditions

Market Segments

HMO & Provider Excess

• Smaller market today due to significant consolidation among HMOs and providers’ move away from capitation

• Greater reinsurance scrutiny of claims experience, coverage terms, provider contracts, etc.

• Typical cover
  – Comprehensive coverage has given way to more limited coverage
  – Higher reinsurance deductibles
  – Inpatient average daily maximums & more defined fee schedules

Niche Plans

• Effort to meet varied market needs:
  – Previously uninsured
  – Take pressure off of Medicaid and state high-risk pools
  – Voluntary/worksite options underneath high-deductible plans

• Mini-med

• Low-limit comprehensive

• Gap plans
Medical Cost Trends

Historical Macroeconomic Cost Trends

Annual Change in Per Capita National Health Expenditures (NHE) vs. Consumer Price Index – Medical Care (CPI-MC) for All Urban Consumers ('82-'84 Base)

NHE Per Capita vs. Out-of-Pocket (OOP) Expense as % of Total NHE

Medical Cost Trends
Aging of the Population

Demographic Realities: Today

Medical Cost Trends
Aging of the Population

Demographic Realities: Tomorrow
Medical Cost Trends

First Dollar Cost Trends

GRL July 2005 Trend Recommendations

- PPO Medical (w/o Rx) = 12.2%
- Prescription Drug = 14.9%
- PPO Medical & Rx = 12.6%

Leveraged Cost Trends - Illustration

- 2005
  Ground-up claim = $100,000
  Specific deductible = $50,000
  Claim in excess of deductible = $50,000
  1st dollar trend = 12.6%

- 2006
  Ground-up claim = $112,600 ($100,000 * 1.126)
  Specific deductible = $50,000
  Claim in excess of deductible = $62,600

  Trend on excess portion of claim = 25.2% ($62,600 / $50,000 – 1)
Medical Cost Trends
**Leveraged Cost Trends**

- Illustrative example using GRL models and database comprised of both fully insured and self-funded claims.
  - 12.6% first dollar trend assumed (medical and Rx combined)
  - Composite employee and dependent claims
  - Leveraged trend by deductible and pricing component:

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Medical Cost Trends
**Cost Drivers**

- Underlying inflation
- Aging of population
- New technologies and treatments
- Professional liability costs
- Regulations and mandates
- Consumer behavior
**Reinsurance Treaty Terms**

**Evaluating Opportunities**

- Underwriting “beyond the manual”
- Running the numbers
- Quality of the business and the business partner(s)
- Pricing and underwriting considerations
- Environmental factors
- Major contract provisions
- Challenges

**Reinsurance Treaty Terms**

**Important Success Factors**

- Alignment of financial interests ("skin in the game")
- Disciplined underwriting
- Sound pricing
- Reasonable expenses
- Good claims management
- Supportive distribution channels
Reinsurance Treaty Terms

Major Provisions

• Scope & limits
  – What business is/not covered
  – Must effectively deal with “what if” scenarios
• Underwriting guidelines
• Confidentiality
• Arbitration
• Extra-contractual obligations
• Commencement and termination

Health Reinsurance Update

Questions? Comments?

Thank You!