


THE HEALTH REINSURANCE

BY CHARLES CRISPIN

The health reinsurance market

is getting tighter—

Enron and Sept. 11 haven't helped.



REINSURANCE MARKETS ARE IN A STATE OF FLUX. In the early 1990s, insurers observed a rapidly expanding managed care market and actively courted business from health care providers and HMOs. Unfortunately, many of these companies were simply too aggressive and accepted risks they didn't fully understand. After several years of losing money, a number of insurers exited the health care reinsurance business.

Several unrelated major events have further exacerbated the reinsurance marketplace. Sept. 11 and the recent implosion of Enron are two of the most obvious.

Another lesser-known event—outside of reinsurance markets, that is—is Unicover. Unicover resulted in multi-billion-dollar losses and the collapse of several insurers. At its peak, Unicover was estimated to have handled nearly 16 percent of the entire U.S. workers' compensation market valued at \$8 billion in premium. In simplest terms, in an environment of increasing risk, risks were underwritten dramatically below historical claims levels. The matter is still going through arbitration and litigation, and one judge has estimated damages could exceed \$2 billion. At least nine major reinsurers are involved.

The events of Sept. 11 caused a new set of challenges. In addition to the emotional impact of "an attack at home," insurers and reinsurers experienced concentration risk, a risk previously not fully addressed in the underwriting process. While direct health care costs related to Sept. 11 and the other events referenced in this article were not staggering, the exposure to reinsurers in traditional property/casualty (P/C) and certain accident & health (A&H) lines created a significant capital crunch and corresponding pricing pressure across all lines.

Almost every insurance company has been affected to some

logical acts, most of these limitations aren't a direct result of recent events but reactions to medical trends during the past several years. Others are the results of a general fear of ongoing and rapid advances in medical technology and treatments.

Examples of limitations affecting these risks include limitations on daily eligible charges whether in inpatient or outpatient settings; exclusion of services "in lieu of hospitalization," a definition that in and of itself needs clarification, given the magnificent advances in treatment outside of acute inpatient settings; exclusions of durable medical equipment (DME)—po-

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degree; published reports indicate that Odyssey Re took a gross underwriting loss of \$187.5 million related to Sept. 11 and Enron; PartnerRe Ltd. took a \$47.3 million pre-tax charge related to Enron and a \$400 million pre-tax hit related to Sept. 11; Chubb wrote off \$420 million after taxes for claims from Sept. 11; and Swiss Re announced significant losses related to Sept. 11, Enron, and tropical storm Allison. In fact, one published report indicated Swiss Re's exposure to Sept. 11 alone at more than \$1 billion. Allianz is reported to have suffered losses of up to \$1.3 billion.

Recent surveys have indicated that many P/C coverage costs have increased up to 300 percent since Sept. 11. On the health care side, while coverage is still readily available, the challenge is dealing with limitations being imposed by reinsurers. Other than riders regarding terrorism-related injuries and mass bio-

tentially devastating for an entity with a high density of members receiving fairly sophisticated cardiac-related care. Additionally, recent trends, such as multiple births and new transplantation procedures, will continue to alter the landscape.

Now more than ever, managed care organizations and plan sponsors must find more effective ways to protect themselves from catastrophic events and major fluctuations in cash flow. In addition, HMOs in many states are subject to the risk-based-capital guidelines of the National Association of Insurance Commissioners. The result of coverage gaps due to setting, charge, or service limitations serves to directly undermine plan predictability and underlying surplus levels. The challenge is finding the best strategy to protect surplus, budgeted medical-loss ratio, and solvency.

Tools for Determining Targets

The goal of the reinsurance portion of the solvency equation is to enhance fiscal predictability by transferring potential catastrophic claims. Achieving the most effective and predictable transfer is the difficult part. Determining the appropriate or optimum level of reinsurance in the context of an organization's underlying situation is the major test, particularly in a hard market.

A surprisingly large number of managed care organizations continue to purchase reinsurance on a commodity basis covering historical patterns of health care utilization. Regrettably, health care utilization has been anything but "historical" in the past five to seven years. The rampant migration of services to home health and other outpatient settings, not to mention powerful pharmaceuticals and biologics that are continually being introduced, emphasize the need for more sophisticated approaches to analysis and purchase.

Underscoring the "historical" purchase problem is the fact that standard "inpatient coverage" could mean very different things from one reinsurer to another. Certain insurers would cover any and all expenses in an inpatient setting. Others would exclude all DME. Still others would exclude all blood and synthetic blood or factor products in the setting, etc.

Given this backdrop, the problems of purchasing coverage based on gross premium expense alone could result not only in tremendous dissatisfaction on the part of covered managed care organizations but also in real threats to medical-loss ratios and available surplus.

There are several methods for determining the proper mix of reinsurance and retention. The use of analytical models can help managed care organizations and plan sponsors understand the optimal balance between reinsurance and capital.

Executives charged with protecting budgeted medical-loss ratio and the surplus position of their organizations face a significant challenge simply navigating through daily operations. Combined with medical costs advancing in the range of 10 percent annually, pharmaceutical cost increases of 15 percent to 20 percent for the foreseeable future, increases in inpatient utilization and intensity, and potentially explosive home health and other outpatient expenses, reinsurance decision-making must evolve.

As Dorothy said to Toto, "We're not in Kansas anymore." ●

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1/2
Pinnacle
Page 33