Economy, 9/11 tragedy send reinsurance market reeling

Deterioration of the equity and financial markets, coupled with the catastrophic events of last September 11, have sent the reinsurance market into a tailspin, according to industry sources. The good news is that renewal rates for managed care reinsurance were virtually unaffected for health plans and provider organizations with good claims histories. The bad news is that the fallout in property and casualty (P&C), medical and malpractice, and other types of reinsurance may yet lead to a hardening market this year.

In its annual Review/Preview of the life and health insurance industry, released in January, Oldwick, NJ-based A.M. Best noted that “the immediate financial impact of September 11 was manageable, but the longer-term impact of the tragedy is less clear and will not be easily separated from the effects of the prolonged economic downturn.” The venerable insurance rating and information company predicts that the collision of catastrophe and recession will have long-term implications for insurers’ investment portfolios, mental health and disability claims, and reinsurance.

‘Concentration risk’

Reinsurers were “taken to school” over the past few years, and the terrorist acts of 9/11 introduced “concentration risk -- a type of risk that wasn’t supposed to happen,” says Charles Crispin, president in the Stuart, FL, office of Evergreen Re, a managed care insurance brokerage and consulting firm. The enormous loss of life and property, coupled with mounting worker’s compensation claims, is causing reinsurers to reevaluate whether they can spread their own risk enough to continue to underwrite reinsurance policies.

For instance, one reinsurer initially estimated its World Trade Center losses at $50 million, but recently revised its losses to more than $500 million, Crispin says.

“Some organizations that have traditionally underwritten multiple lines of reinsurance are getting out of the managed care marketplace, and that will affect capacity,” he explains.

During the past year, the insurance industry entered a hard market cycle where losses were substantially greater than predicted, adds David Wynstra, division president of Gallagher Healthcare Insurance Services in San Francisco. The September 11 attacks crystallized the situation. Ultimately, all major players in the health care industry -- physicians, hospitals, health plans, integrated systems, and vendors such as disease management firms -- could be affected by the impact on reinsurers, Wynstra says.

“The insurance industry is very attuned to what happens in the financial marketplace because of the need for underwriting profit or break-even and investment gains,” he points out. “The collapse of many of the financial markets over the past six months coupled with the horrendous losses associated with 9/11 have had a major effect on the ability of insurers to take risks and on the pricing of these arrangements.

“The particular impact on managed care reinsurance remains to be seen,” Wynstra concedes. “We’ll know more as past losses are filed as reinsurance claims.”

Pricing pressure ‘across the board’

Naturally, the biggest concern of health plans and capitated provider organizations is the impact on pricing. In the professional liability arena, Wynstra is seeing cost increases manifested two
ways. “The first is flat-out premium increases of 25% to 65%,” he says. “The second is higher deductibles and lower limits. In the past, the industry has been responsive to relatively low deductibles for professional liability -- generally $10,000 to $30,000. Almost universally, those deductibles now are being increased to $50,000 to $100,000. The scope of that change requires organizations purchasing coverage to do a careful internal analysis of their needs.”

“There is pressure on pricing across the board,” Crispin agrees, “but organizations that can document their claims experience and provide information back to reinsurers are in a better position to negotiate more comprehensive policies at satisfactory rates.”

Traditional P&C lines have encountered the greatest impact in the wake of 9/11, with premium increases of 50% to 100% coupled with dramatic reductions in coverage, Crispin adds. These price hikes are wreaking havoc on the predictability of capitated providers because the cost side of their business is affected.

“The cost of physical plant coverage in health care, even with greater limitations, has probably increased about 200% since 9/11,” he explains. The enormity of such an increase can’t easily be recouped by capitated groups that are paid a fixed PMPM rate that was probably set the previous year.

Moreover, “the number of insurers that are willing to consider a reinsurance proposal for a small capitated population -- less than 10,000 lives - - is dwindling,” Crispin adds. “Most don’t want to offer any coverage, or they want to exclude major lines such as Medicare risk because they don’t want the exposure associated with members who are older, have chronic health needs, and are more expensive to manage.”

Even when they are willing to underwrite managed care risk, reinsurers are scrutinizing capitation contracts and shunning those with inadequate reimbursement or imprecise terms. Some capitated providers have more exposure than others simply due to the vagaries of their covered population. Provider organizations that accept risk without evaluating the sufficiency of their PMPM rates or limiting their exposure “might not be able to get reinsurance coverage,” Crispin says.

“The art of preparing information to forward to reinsurers for a request for proposals has increased considerably,” he points out. “In any environment - - but particularly in this environment -- if you leave reinsurers with questions, they will increase the numbers.”

Coverage limitations more prevalent

MCOs have different utilization patterns for the inpatient services that are most likely to trigger a reinsurance claim, for instance. Some of these differences occur due to random variation, but others are affected by contracting skill, sophistication of referral patterns, member demographics, and line of business. Before issuing stop-loss coverage, reinsurance firms often evaluate an organization’s inpatient utilization to determine how well providers are performing against local or regional trends, Crispin says.

“It’s important to model current utilization trends in the reinsurance decision-making process,” he emphasizes. “A lot of organizations are making decisions based on data that are two to three years old and don’t reflect current health care utilization.”

The threat of bioterrorism in the United States also has created a new dynamic for reinsurance coverage that requires the full attention of health plans and capitated providers. For instance, standard wording in reinsurance contracts excludes incidents related to “acts of war, declared or undeclared,” Crispin points out. With that exclusion in mind, both health plans and provider groups must define their financial exposure for treating plan members who may be victimized by bioterrorism -- whether an outside aggressor claims responsibility or not. On a widespread basis, bioterrorism could have a devastating impact not only on the well-being of U.S. citizens but on the financial resources of provider groups, hospitals, the HMO industry, and even the global reinsurance market.

On the other hand, capitated providers that don’t understand their policies also may be paying for coverage they don’t have.

“We’re seeing some fairly significant limitations in coverage -- some that are apparent and some that are not,” Crispin says. “There are a lot of gray areas appearing in contract language.”

For instance, home health might be listed as an eligible service, but the reinsurer may insert language requiring a prior hospitalization for a predetermined period of time. That type of limitation would exclude the usage of home health to treat a hemophiliac with clotting factors during a major bleed -- a service that might cost $15,000 or more, Crispin points out. Home health reinsurance with major exclusions -- requiring a prior inpatient stay, limiting reimbursement to $500 per day, or excluding services such as blood factors, DME, organ acquisition, donor services, or outpatient chemotherapy -- is “phantom” coverage, he insists.
Availability no problem -- so far

So far, availability of managed care reinsurance has not been an issue, but concerns about the strength of the reinsurance industry abound. Some of the major reinsurers that deal with health plans and health care providers -- Zurich American, Chubb Group of Insurance Companies, and AIG National Insurance Company, for instance -- could see their ratings affected, sources say. At press time, AIG and Chubb both were rated A++ by Warren, NJ-based A.M. Best Company, while Zurich American had been downgraded to A+.

“Rating dips occur regardless of other circumstances for a variety of reasons,” Wynstra says. “More fundamental to the problems we will see in the future is capacity -- the ability of the marketplace to respond to the needs of the customer base with acceptable amounts of insurance based on what people perceive their needs to be.

“We’ve seen an erosion in this market in the past two years,” he adds. “I don’t know if it will continue, but 40% of the companies that wrote managed care reinsurance two years ago are no longer in that business.”

“Availability is relatively good right now, but I’m concerned about flight from the category,” Crispin agrees. “There has been very poor underwriting in this category of reinsurance because managed care organizations have not understood their own claims experience.”

For example, providers rarely conduct an analysis to determine the most cost-effective combination of reinsurance and risk retention, which is affected by variables such as utilization history, expected premium margin, cost of capital, line of business, membership, reinsurance coverage and limitations, deductible, and expected net cost. By understanding these components thoroughly and tweaking coverage levels, provider groups can craft appropriate reinsurance coverage at an affordable price, Crispin says.

In terms of their claims experience, “usually the problem is not the claims that an organization knows about but the losses that it doesn’t yet know about or the losses that could occur based on policy limitations and restrictions,” Crispin says. “Trends are getting worse in reporting not just actual claims but also potential claims to managed care reinsurers, so reinsurers are penalizing organizations that can’t document their claims experience.”

Capitated health care organizations also become their own worst enemies when they don’t keep reinsurers abreast of potential claims at the point where losses could be contained. Sophisticated reinsurers often have relationships with DM companies, PBM’s, organ transplant networks and other vendors who can affect downstream losses by intervening early in a potentially catastrophic case.

Recent renewals ‘no problem’

Despite these warnings from industry experts, several provider organizations tell CMR that recent reinsurance renewals were surprisingly simple. Lexington, KY-based Bluegrass Family Health saw its premium cost rise just one cent PMPM when its contract with Miami-based Risk Based Solutions came up for renewal.

“I was expecting a huge increase, but it never materialized,” says Rick Schultz, director of operations for the 160,000 member health plan. “That’s where having a good [claims] experience pays off.”

Bluegrass put the contract out for bid, Schultz says, and most responding companies came in 10 cents to 15 cents PMPM higher than Risk Based Solutions, a reinsurance manager and underwriter that specializes in managed care. That scenario is typical in the current market, where pricing and coverage restrictions are all over the map, Crispin says.

“If you go to five reinsurers with a request for proposals, you might get one or two responses giving you what you asked and the rest with significant variations or limitations,” he says. “The only way to make good decisions on the best reinsurance coverage is to conduct a reinsurance analysis that examines all the factors that contribute to the price and structure of a policy.”

No rate increase for GA health system

Samuel D. Bishop, ARM, vice president of compliance and insurance services at Marietta, GA-based Wellstar Health System, reports that his five-hospital system north of Atlanta also renewed its managed care reinsurance policy in December 2001 “at essentially the same rates” as the previous year. Despite the organization’s size, with 300 physicians in four suburban counties and $750 million in annual revenues, Wellstar has a relatively small capitated population of just 23,000 covered lives. Its reinsurance, purchased through Evergreen Re, is written on a PMPM basis with an attachment point of $35,000.

Nevertheless, Bishop is still reeling from the impact of 9/11 on his P&C coverage, which was renewed in November 2001 at triple the premium and reduced capacity even after increasing the deductible from $5,000 to $250,000.

“No one anticipated the catastrophic loss that could occur from one event,” Bishop says. “Even though we’re in a highly protected risk environment, we still have more than $850 million of property that insurers now realize could be vulnerable.”
Some companies have incurred major financial losses in the past six months, and they are much more serious about underwriting."

Though major price hikes in managed care reinsurance are not expected this year, the reinsurance market will remain convoluted for several years to come, sources predict. In this environment, it’s essential for risk-bearing organizations to understand their potential exposure and coverage needs, including statutory insolvency for HMOs and medical malpractice for physician groups. Organizations that negotiate financial risk also need to evaluate the obligations between MCOs and provider groups because these change with each wave of contracting, Wynstra says.

"This is not the time to cut back on coverage," he cautions. "We suggest strongly that the situation is not going to improve soon. Organizations should purchase the highest level of reinsurance that they can because of the potential that coverage will be unavailable in the future. They should work with industry professionals to evaluate the financial condition of the insurers and reinsurers they deal with, and they should seek a knowledgeable evaluation of the players and market.

"The compelling factors in purchasing reinsurance are how much business a company does, its revenue level, and its exposure," Wynstra adds. "Many companies that are public have a different attitude toward risk than those that are private. It’s a question that we can’t address globally. We’re able to tell companies what they need, but it’s considerably more expensive now, and the terms are not nearly as favorable as they were a year ago."

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