The Council for Affordable Health Insurance's

Issues & Answers

Solutions for Today's Health Policy Challenges

No. 138 February 2007

What Everyone Should Know About Reinsurance

There have been several recent proposals for the federal government to become a national health reinsurer. The most prominent proponent was former presidential candidate Sen. John Kerry (D-Mass.), but former Republican Majority Leader Bill Frist (Tenn.), among others, later voiced support for the idea.

In addition, several states have considered state-based health reinsurance pools. For example, when Massachusetts passed its recent health care reform legislation, it included a provision for a state reinsurance pool. However, Governor Mitt Romney (R) vetoed the provision.

Proponents claim that requiring the government to take up the reinsurance function would lower premiums because insurers and employers would cost-shift the most expensive patients to the government. But there is no free lunch. The money for the high-dollar claims would have to come from somewhere — i.e., taxpayers.

Proposals for the government to become the national reinsurer have found some traction in large part because so little is known about the important role played by private sector reinsurers.

What is reinsurance? Reinsurance is insurance for insurance companies. It protects a primary insurer from catastrophic losses and allows insurers to better predict and manage their risk. For example, property and casualty insurers often use reinsurance to protect themselves from natural disasters such as hurricanes that can lead to a large number of catastrophic claims. Health insurers often use reinsurance to protect against major medical expenses that can arise from, for example, a premature baby or someone needing an organ transplant.

How does health reinsurance work? There is a large and thriving private sector market for health reinsurance, especially in the individual market and among small and medium-sized insurers.

Insurers cede (i.e., transfer) specific risks to one or more reinsurers for a premium, which agree to pay their share of any losses incurred by the ceding insurer(s).

There are two basic types of health reinsurance:

- The traditional and most common type is called "excess reinsurance," in which an insurer "lays off" risk on each covered individual above an annual "attachment point" (i.e., the dollar point where the reinsurer begins to pick up most or all of the costs) — usually between $100,000 and $500,000, but it can be even higher. In other words, reinsurers are far removed from the primary insurance function. Federal legislative proposals typically envision this type of reinsurance, though with much lower attachment points.
- The second type of reinsurance is "quota share reinsurance," whereby a reinsurer shares proportionally in each dollar of risk an insurer accepts. For example, an insurer and reinsurer might split half of each premium dollar and any subsequent claims. This type of reinsurance enables an insurer to sell a greater volume of business and utilize the size and surplus of the reinsurer.

Because reinsurers bear the most expensive claims, they have a financial interest in ensuring patients with severe medical conditions get appropriate and timely care. As a result, reinsurers are heavily involved with chronic and catastrophic medical case management. They work in conjunction with insurers, physicians and providers to promote quality health care.

Who buys reinsurance? The largest insurance companies and employers usually do not buy reinsurance because their reserves are large enough to take care of almost any catastrophic expense. The primary reinsurance purchasers are small and medium-sized insurers and employers that self-insure, but want to limit their high-end exposure.

Reinsurers also buy reinsurance, ceding some of the reinsured risk to other reinsurers to create a widespread network of companies bearing a small portion of the risk of any catastrophic event.

Do insured individuals know their policies are reinsured? No. Health reinsurance operates in the background and doesn't interact directly with insured patients.

What is reinsurance's "value-added"? Reinsurers provide access to chronic and catastrophic medical case management programs to track high-risk patients to ensure they are getting timely and appropriate care. Best-practice medicine for chronic and catastrophic medical conditions is always evolving, and reinsurers have programs to stay on top of changes, accelerate care, seek appropriate alternative levels of care and promote the avoidance of costly medical complications. Those efforts have helped insurers save millions of dollars while delivering quality heath care.

Is the reinsurance system facing problems? Lawmakers sometimes call for the federal government to intervene if a company or industry is facing financial problems or regulatory issues. However, no reinsurance company has defaulted on its claims. And there is no evidence that any of the reinsurers are facing liquidity problems.

What would happen if the government became the reinsurer? Proponents of a national reinsurance system boast that health insurance premiums would be reduced for individuals and small employers (the ones most likely to use reinsurance). It is important to understand that bypassing private sector reinsurance doesn't save money. Reinsurance premiums would be paid to the federal government instead of private companies or government expenses would come from some other source, such as tax revenues or an assessment on health care providers.

The low attachment points recommended by some simply mean that the government would be acting more like a primary insurer than a reinsurer. And that reinsurance coverage would come with numerous strings attached. For example, the government would only accept high-cost patients if they had "qualified" coverage (i.e., the insurance plan would have to meet certain government guidelines and specified coverages). In other words, the government would dictate what a health insurance policy had to cover below the deductible before picking up the costs above the deductible.

Such restrictions would undermine the innovative health insurance products currently being designed both by new health plans, third-party administrators and traditional insurers. The government likes uniformity, not diversity and competition, because it makes regulation simpler.

Would national reinsurance make health insurance more accessible? In most states, insurers selling to individuals are able to underwrite policies, rejecting some or charging more for those applicants with serious pre-existing medical conditions. However, 34 states have created state-based high risk pools to provide coverage to those uninsurable people.

Underwriting is crucial for insurers to price and manage risk. However, some believe that insurers shouldn't be allowed to turn down applicants, regardless of their medical condition (guaranteed issue). They prefer that everyone should be charged the same price (community rating). They argue that with a government reinsurer, health insurers would drop their opposition to guaranteed issue and community rating because the government would pick up the high-cost cases.

Substantial progress has already been made in making insurance more available to those people who were traditionally uninsurable. Creating a viable safety net is a much more cost-effective way to provide health insurance than a government-owned and controlled reinsurance program.

Some of the changes required would also undermine the role of insurers as risk managers and reward inefficient insurers. If the government picks up most of the costs above a low attachment point, insurers' incentives to control patients' costs would be greatly reduced which would eliminate expected premium savings.

How can government make health insurance more affordable? Proponents of national reinsurance claim their plan would make health insurance more affordable. But there are other and better ways to achieve that goal. For example, recent Health Savings Account (HSA) legislation will give more people access to less-expensive consumer driven policies. In addition:

- Providing tax credits for lower-income workers would help defray the cost of coverage.
- Increasing federal funding for state high risk pools would provide an effective safety net for uninsurable people. .
- Giving people the opportunity to buy policies available and being sold in other states would expand access and options for lower-cost policies.

Prepared by Merrill Matthews, Executive Director, The Council for Affordable Health Insurance, and Robert Anderson, Vice President, Re-Solutions Intermediaries

Council for Affordable Health Insurance
127 S. Peyton Street, Suite 210
Alexandria, VA 22314
Phone: 703/836-6200 Fax: 703/836-6550
Email: mail@cahi.org www.cahi.org