A Game-Changer for High Insurance Prices?

Reinsurance Presents an Option to Aid a Troubled Market

APRIL 2018

COLORADO HEALTH INSTITUTE

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Terms to Know

Attachment point: The amount of a customer's annual claims that will trigger payments by the reinsurance fund. For example, if a customer has $150,000 in medical expenses and the attachment point is $100,000, the reinsurance fund will cover $50,000, minus any co-insurance. (See below.)

Co-insurance rate: The percentage of claims expenses above the attachment point that the reinsurance fund agrees to pay. For example, a reinsurance fund might cover 75 percent of claims above the attachment point. The original insurance company would pay the remaining 25 percent.

Reinsurance cap: The maximum amount of a customer's annual claims that the reinsurance fund will help pay. The original insurance company would be responsible for the rest.

Claims impact: The overall reduction of insurance company expenses in the individual market that a reinsurance fund would bring about. The size of the claims impact depends on the attachment point, the co-insurance rate and the reinsurance cap. The larger the claims impact, the greater the price reduction in customers' premiums.

Self-insured or ERISA plans: Health plans provided by a company that takes on the financial risk of providing health care benefits to its workers. Most large employers opt for these plans, which are not subject to state regulations or fees. These plans are regulated under the U.S. Employee Retirement Income Security Act (ERISA). They cover approximately two-thirds of employer-sponsored insurance enrollments in Colorado.

Fully insured group plans: Traditional employer-sponsored insurance plans in which an insurance carrier provides coverage and bears the financial risk. These plans cover approximately one-third of employer-sponsored insurance enrollments in Colorado.

Individual or non-group market: Customers who buy health coverage directly from the insurance company rather than using an employer plan. A reinsurance fund would apply only to this market. About 250,000 Coloradans are insured through the individual market, according to a study by Milliman, an actuarial consulting firm.*

* The 2017 Colorado Health Access Survey projects that about 400,000 Coloradans are covered in the individual market. The size of the market is difficult to measure because of how quickly customers come and go.

State lawmakers, who have searched for years for ways to control the skyrocketing costs of insurance premiums in rural Colorado, are considering an idea that is gaining national momentum — reinsurance.

Reinsurance is basically insurance for insurance carriers. The state-run program would cover some of the costs of the most expensive health care consumers on the individual market, reducing insurers' expenses and lowering premiums that state regulators allow them to charge customers.

Early estimates suggest that reinsurance could reduce premiums by about 20 percent in the individual market, where people who are self-employed or don't have insurance through an employer or public program buy coverage.

Individual market customers who would benefit the most are the ones who have suffered the most from recent price increases — those who do not qualify for federal tax credits under the Affordable Care Act (ACA).

About half of the funding for reinsurance would come from fees on insurance policies, resulting in higher prices for many other consumers. The remaining funding would result from lower premiums, which would save the federal government money it spends on ACA subsidies for eligible consumers. The savings would then be passed on to the reinsurance program.

Prior to the ACA, many states — including Colorado — operated high-risk pools to cover the most expensive customers who could not get coverage because of pre-existing health conditions. But the pools were expensive for both the state and customers, and they covered only a portion of the neediest patients.

High-risk pools were phased out because the ACA required insurance companies to offer coverage to everyone, no matter their health status. But now the high-risk population is back in the spotlight because their disproportionate share of health spending is contributing to rising premium prices for the entire individual market.

Average monthly premiums on the individual market have risen by nearly 80 percent since 2014 and even more in rural Colorado. While the increases have been devastating for some families, insurance companies are not doing well in the individual market, either. State reports show many carriers selling insurance in the individual market lost money from 2014 to 2016, despite their steep annual price increases.[1]

Colorado legislators are debating whether a reinsurance program could slow these annual price hikes while ensuring that struggling insurers continue to offer policies. A bill to create a reinsurance program, House Bill 1392, was introduced April 13, 2018.

Three Takeaways

- Reinsurance is a state-run fund that would help to cover high-cost claims to reduce insurance company expenses and drive down premiums. It would most likely lower costs for the relatively small number of people who buy their insurance on the individual market. These people have borne the brunt of rapid price increases. However, it would result in price increases for a much larger group.
- Reinsurance would be paid for by repurposing federal tax credits under the Affordable Care Act — at no extra cost to the government — plus fees on a broad base of Colorado insurance policies.
- The few states to try this approach have demonstrated some promising early results, although states have limited experience with such programs and critical questions should be discussed before moving forward.

Reinsurance in 30 Seconds

Reinsurance is a way to cut insurance companies' costs by paying some of the medical bills of their most expensive customers in the individual market. In return, the companies would reduce the premiums they charge customers. The program would be paid for by federal subsidies as well as fees on a broad group of health insurance policies.

Recently, Alaska, Minnesota and Oregon have turned to reinsurance programs — which, like high-risk pools, attempt to solve the problem of how to cover people with the most expensive health needs. The Colorado Division of Insurance (DOI) commissioned a study by the actuarial consulting firm Milliman that showed premiums could decrease by nearly a fifth under a well-funded reinsurance program.

The DOI has the responsibility of approving the premiums that insurance carriers can charge for their individual market policies, based on the companies' projected revenue and expenses. With a reinsurance program, expenses would drop, so DOI regulators would mandate lower prices.

The reinsurance fund would be run by the state, and it would be paid for by federal dollars from the ACA plus fees on perhaps 1 million or more Coloradans with private insurance coverage, most of whom are not on the individual marketplace. The federal government would need to approve an ACA waiver for Colorado to launch the program.

The bigger the reinsurance fund, the better it would work to drive down health insurance premiums. Legislators are considering a large fund of more than $300 million a year.

It's all about evening out the pain of Colorado insurance customers and the carriers that provide their coverage. Fees on a large group of customers would help pay for significant relief for a smaller number of people in the individual market who have suffered the most from high premiums in the past five years.

This paper gives a basic overview of how a Colorado reinsurance program could work, examines who would and would not benefit from reinsurance, and poses critical questions for policymakers to consider.

How Could a Reinsurance Program Work in Colorado?

A reinsurance program can be designed in many ways.

Colorado's Division of Insurance convened a stakeholder group in June 2017 to examine options for the state.[7] It hired Milliman to conduct an actuarial study examining health insurance data to estimate the costs and impacts of a reinsurance program.[8]

Fees on insurance plans, plus federal funds secured through an ACA waiver, would fund Colorado's

Will Colorado Be the Fourth State to Try This?

Alaska, Minnesota and Oregon launched reinsurance programs in January after receiving federal approval last year, becoming the first states to operate state-run programs.

These states are facing some of the same challenges plaguing Colorado's individual insurance market. For example, premiums rose 70 percent in Minnesota in 2017. They climbed 29 percent in Alaska, where only one insurance carrier offers individual market plans, and rates rose 20 percent in Oregon.[5]

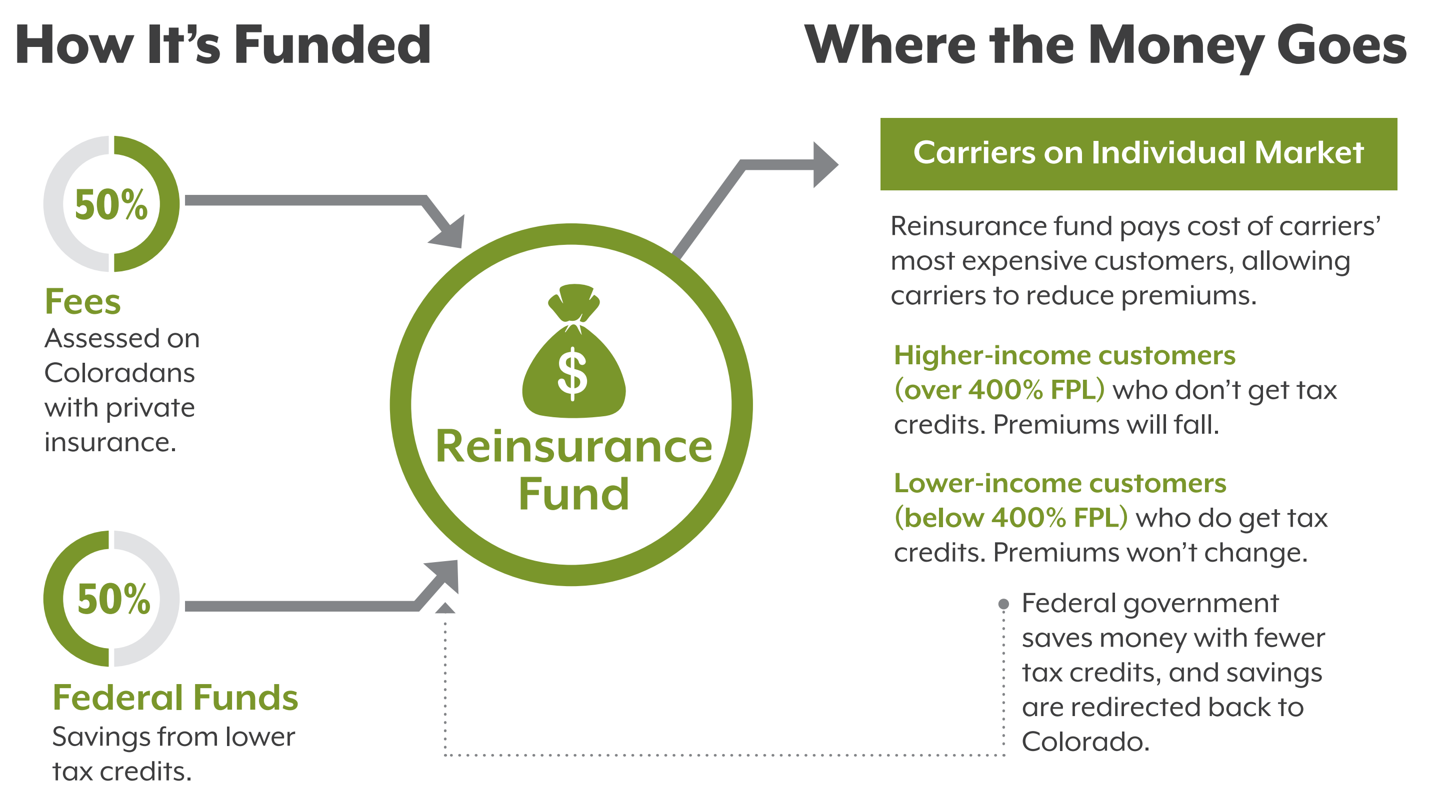
It's too soon to know how well the new reinsurance programs will improve affordability in the long-term and whether these programs are financially sustainable.

However, the short-term impacts are promising, if mixed. Premiums in Alaska dropped 22.5 percent in 2018 compared with 2017 based on the projected impact of the reinsurance fund. Premiums dropped 15.1 percent in Minnesota. Oregon's premiums, however, rose about the same as the average national increase.[6]

Additional states are heading down the reinsurance path. Wisconsin and Maryland recently passed legislation for reinsurance programs that would begin in 2019. Both states will be submitting waiver applications to the federal government in the next few months.

FIGURE 1. How a Reinsurance Program Works

What is Reinsurance? State-run fund covering some high-cost claims, designed to lower insurer expenses and drive down premiums.



reinsurance system. (See Figure 1.) The reinsurance fund would make payments to insurance carriers to cover individual claims above a certain amount, called the attachment point.

Higher-income residents who do not get ACA subsidies would see a reduction in their monthly premiums, according to Milliman. But lower-income residents who receive subsidies would see little change in how much they pay for their insurance. ACA subsidies vary based on premium costs, which insulates customers from large price swings.

This paper looks at two sets of questions, based on the Milliman study:

- How could a reinsurance program improve affordability on the individual market? How much could it reduce premiums?
- How could it be funded?

How Much Could Reinsurance Improve Affordability?

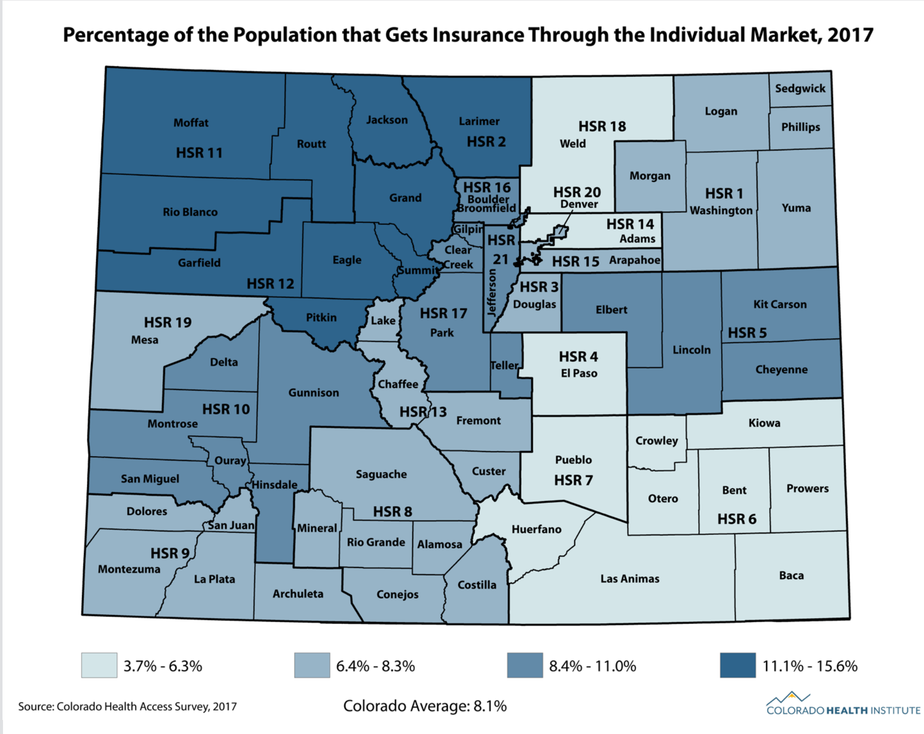
Two groups of Colorado customers stand to benefit from a reinsurance program, according to the Milliman study:[9]

- **Higher-income people earning above 400 percent of the federal poverty level (FPL), ineligible for ACA tax credits.** This group, expected to number about 124,000 in 2019, would see annual premiums decline by as much as 19 percent if Colorado opted for a program designed identically to the Milliman study. Price reductions would vary if the state made changes to the claims impact, attachment point and other variables.
- **Lower-income people earning between 139 percent FPL and 400 percent FPL, eligible for ACA tax credits.** This group of about 102,000

What is the Individual Market?

Nearly 250,000 Coloradans purchase their health insurance on the individual market, according to a recent actuarial study.[2] Most do so because they don't qualify for public insurance programs like Medicare or Medicaid or don't have access to coverage through their job.

The individual market is more important in rural Colorado. Nearly twice the proportion of the population in northwestern Colorado uses the individual market compared with the state average.[3]



About 40 percent of the people on the individual market receive federal tax credits because their income is less than 400 percent of the federal poverty level — an annual income of about $100,000 for a family of four and about $49,000 for a single person. The tax credits cover about 80 percent of the total premium, on average.[4]

But the other 60 percent of customers in the individual market — those earning more than four times the federal poverty level — don't get federal tax credits and pay the full cost of their insurance.

Some customers in the individual market have high health needs and are relatively expensive to cover. As premiums increase to cover their costs, healthy people are more likely than sick people to drop their coverage. This leaves a higher concentration of people with high health costs in the market. Carriers need to increase their premiums even more, causing yet more healthy people to drop out of the market. The phenomenon is a vicious cycle that some people refer to as a death spiral.

Reinsurance is designed to halt this cycle. A well-functioning program would lessen the risk for carriers, lower prices for consumers and attract new and healthier customers into the market — which could over time lower carriers' risk and consumer premiums even more, according to a study commissioned by the DOI.

would most likely have little change in out-of-pocket costs. Reinsurance would reduce their premiums, but tax credits — which are tied to premium levels — would also decline.

People who get their health insurance somewhere other than the individual market would not see benefits. In fact, some would be assessed fees passed along by their insurance companies to fund the reinsurance program.

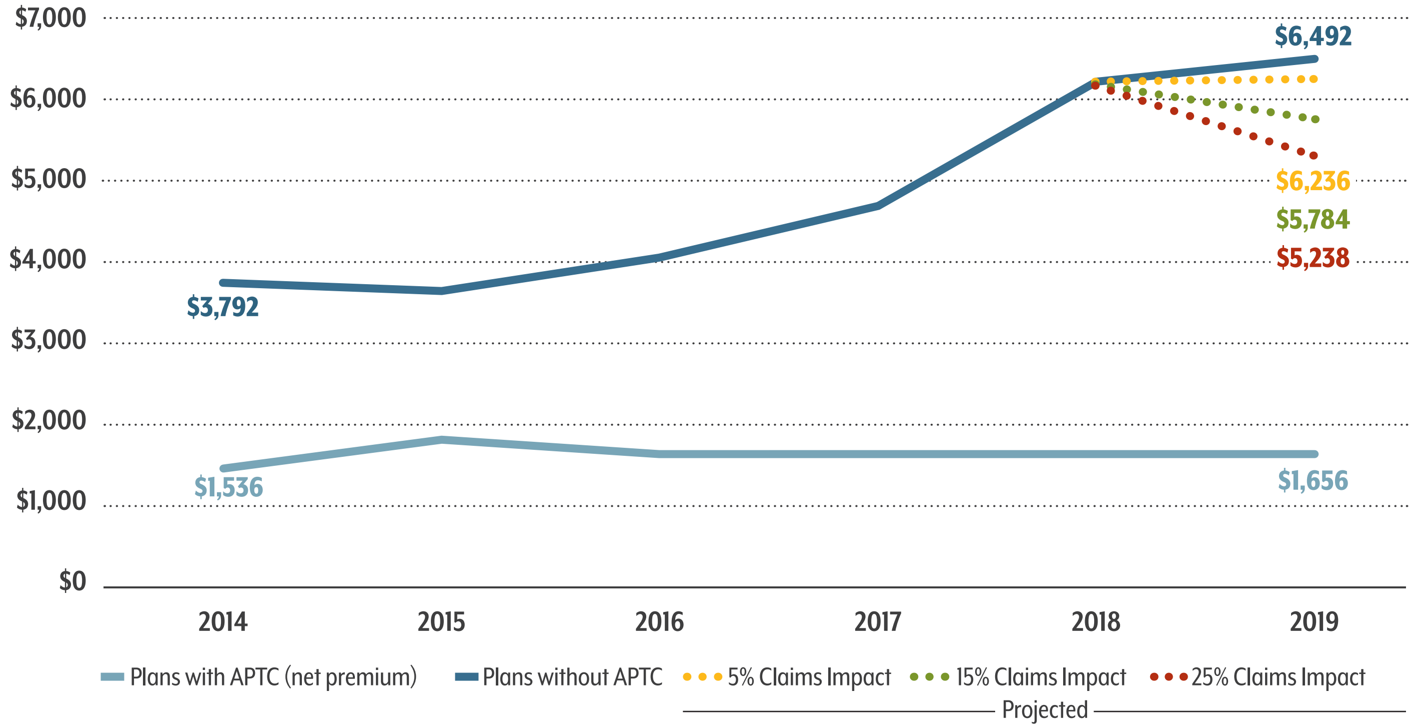
The amount of money in the reinsurance fund will determine the claims impact, which will determine how much premiums can be expected to decline.

The Milliman study projected that a relatively small reinsurance program, one with a five percent claims impact, would reduce premiums for individual market customers without tax credits by four percent. The study found that a larger program with a 25 percent claims impact would reduce their premiums by 19 percent. (See Table 1.)

Milliman also projected an increase in enrollment due to lower premiums ranging from 2,000 to 17,000, depending on the size of the reinsurance fund. Without the lower premiums, these people would probably be uninsured.

The projected premium reductions would provide welcome financial relief for some. But even if Colorado implemented a large reinsurance program in 2018, premiums might still be higher than those seen in 2017 because of other factors, such as Congress' repeal of the individual mandate and continuing steep increases in prescription drug prices.

Figure 2. Historic and Projected Premiums ($ Per Member Per Year)



How Could a Reinsurance Program be Funded?

Funding for reinsurance depends on a bit of budgetary magic enabled by the ACA. The law offers subsidies paid by the federal government to help consumers afford health insurance.

The federal government in 2017 provided $375 million in federal tax credits to eligible Colorado individual market customers.[10]

Those subsidies rise and fall with the price of insurance premiums. That means when states do something to cut insurance premiums — like reinsurance — the federal government saves money. The ACA allows states to apply to use the federal savings to improve affordability for their residents — in this case a reinsurance program — by asking for a Section 1332 waiver of the ACA.

Those federal tax credits would fund only about half of of Colorado's reinsurance program. The other half would come from fees assessed on insurance companies. The Milliman study modeled annual fees ranging from $18 to $198 for each person covered by a carrier — fees that could be passed along to customers. The amount of the fee would depend on the size of the reinsurance fund and the types of health insurance plans subject to the fee.

TABLE 1. Projected Effects on Prices and Enrollment in the Individual Market Based on Different Reinsurance Programs

Claims Impact Scenario	Change in Average Premium, per person per year		Enrollment Increase
	Percentage	$	
5%	-4%	-$260	2,000
15%	-12%	-$750	8,000
25%	-19%	-$1,260	17,000

Colorado legislators could impose fees on individual market plans, fully insured group plans and stop-loss plans, which are insurance plans bought by self-insured employers as their own form of reinsurance.

However, federal law would likely prevent the state from imposing a fee directly on the self-insured ERISA plans, which cover about two-thirds of Coloradans with job-based insurance.

The per-person fee in HB 1392 would likely be less than $100 per year. The scenario in the Milliman report

TABLE 2. Projected Fees to Run a Reinsurance Program

Health Insurance Plans Subject to Fee	Number of People Subject to the Fee	Fee per person per year		
		Small Reinsurance Fund (5% Claims Impact)	Moderate Reinsurance Fund (15% Claims Impact)	Large Reinsurance Fund (25% Claims Impact)
Fully insured group plans	1.0 million	$37	$111	$198
Fully insured group plans, Individual plans	1.2 million	$30	$88	$157
Fully insured group plans, Individual plans, Stop-loss plans*	2.0 million	$18	$54	$96

* HB 1392 proposes a large reinsurance fund with fees on these three types of plans.

that comes closest to the bill is a large reinsurance fund with fees on fully insured, individual and stop-loss plans (see Table 2). However, the reinsurance program proposed in HB 1392 differs slightly from the scenario that Milliman modeled.

The cost of a reinsurance program depends on the percentage of carrier claims that it will pay. A small reinsurance program that pays five percent of claims would cost $70 million in 2019, while a large program with a 25 percent claims impact would cost $346 million, according to the Milliman report.

The administrative costs to run the program would likely be between $450,000 and $1.2 million a year, according to the Milliman report.[11]

Is Reinsurance a Game-Changer?

It's important to recognize what a reinsurance program could and could not do.

It could provide substantial help to the approximately 124,000 people who buy coverage on the individual market and don't receive federal tax credits. Plus, the premium reductions could make insurance affordable for people who might otherwise decide to go without coverage.

Reinsurance could also help keep more carriers in the market and improve competition and choice for consumers. For most carriers, the individual market is not a profitable line of business,[12] and the possibility of carriers exiting the market is never far away. Reinsurance removes some of the financial risk from carriers, which could help their bottom line.

But reinsurance is not a game-changer in the broader push to control health care spending. Reinsurance shifts the burden of paying the bills, but it does not tackle the increasing costs of hospital and physician care or prescription drugs. Recent studies show that Colorado spends substantially more on health care than many other states,[13, 14] and as long as this is true, premiums will be high.

Critical Questions to Ask

A Colorado reinsurance program would be an expensive proposition with the promise of substantial benefits to those who have suffered the most from recent price increases.

Some questions for Colorado policymakers to consider:

Will consumers notice a dramatic price reduction from reinsurance? A large reinsurance program could reduce consumer costs by nearly 20 percent, but it's not clear that consumers would notice. If prices jump again in 2019 — possibly from repeal of the ACA's individual mandate and other Trump administration actions that could draw healthier customers out of the individual market — price reductions from a reinsurance program could be swamped. So, even though reinsurance could prevent an even larger price increase, consumers who were expecting a price cut could be in for an unpleasant surprise.

How confident can we be that the projected premium reductions will actually happen? The Milliman projections are based on several

Who Gets What from Reinsurance

Middle-class Individual Market Customers: This group would benefit the most. The ACA offers no financial help for people who earn more than four times the federal poverty level, so they suffered the most under the recent dramatic price increases. They would see the most relief from a reinsurance program.

Subsidized individual market customers: This group would see little change. The ACA offers subsidies to cushion the effects of price hikes. A reinsurance program would use some of those subsidies to lower premium prices, so the result probably would be a wash for this group.

Other health insurance enrollees: Customers of small- and large-group health insurance plans and individual market plans could face fees of $11 to $185 a year, according to an estimate.

Insurance companies: Carriers that sell plans on the individual market would likely come out ahead with more predictable markets. But they may also be assessed fees to help finance the reinsurance program.

assumptions. Will the financial assistance that carriers get from the reinsurance program translate into premium reductions? It's possible that carriers won't be able to reduce premiums as much as projected. Plus, the federal government would determine how much money it would give to Colorado to finance the program if it decides to approve the waiver. This decision would directly impact the size of the program, the level of premium reductions and the overall feasibility.

What are the longer-term impacts of reinsurance on premiums? The Milliman study examined the potential impacts of reinsurance for one year, 2019. Colorado would need a waiver of the ACA that would cover a longer period, possibly five years. Detailed projections for longer-term impacts do not exist.

What is the right balance between fees and the effectiveness of the program? A small program would impose low fees, but it wouldn't provide much help to individual market customers. A larger program would reduce premiums more but would require fees of around $100 a year on policies covering about 2 million Coloradans.

Who will bear the burden of the fees? Will carriers absorb the fees to pay for the reinsurance program? Or will they pass them directly to their consumers? This could influence how palatable the fee assessments will be to consumers — and to lawmakers.

Will the federal government approve a proposal for reinsurance in Colorado? It has approved requests from Alaska, Minnesota and Oregon but not Oklahoma and Iowa. State proposals must meet specific timelines and procedural requirements. This represents a wild card in any efforts to implement reinsurance.[15, 16, 17]

Conclusion

For the past several years, policymakers have tried to address skyrocketing premiums on the individual market. Those efforts have largely failed,[18] and Coloradans saw premiums rise an average of 34 percent in 2018. Policymakers and consumers are anxious to find something that can provide relief.

Reinsurance is an attractive option. It could reduce premiums for an estimated 124,000 Coloradans, and the federal government could repurpose some of its savings from reduced premium tax credits to pay for half the cost of the program. It could also help settle a jittery market, attract more customers who currently pass up coverage because of the cost and perhaps attract more competition among carriers.

But it would be costly. As many as 2 million Coloradans would pay fees to help finance the program. Plus, a reinsurance program won't address the underlying causes of high health care spending in Colorado.

Unanswered questions about the impact of reinsurance remain. And policymakers will confront the thorny issue of weighing benefits for a relatively small number of Coloradans against the costs that would be imposed on many more.

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