



Reinsurance: High Cost Claims

AHIA Position Paper

June 2006

Background

AHIA engaged KPMG to work with the AHIA Reinsurance Steering Group to develop an industry agreed system of reinsurance for Private Health Insurance. The Steering group consisted of AHIA and HIRMAA members.

The industry agreed AHIA model was presented to the Minister for Health in a joint letter from AHIA & HIRMAA on 18 October 2004.

The Department engaged Ernst & Young to develop a reinsurance solution. Ernst and Young held an industry consultation forum 19 December 2005.

Prior to the Ernst & Young meeting HIRMAA pushed for the incorporation of some form modification to the AHIA model to account for high cost claims that would not be covered under the AHIA model. At the meeting industry agreed to incorporate a high cost component to forward the AHIA model.

The AHIA model presented to the Minister noted that if true reinsurance is left outside the claims equalisation scheme, then:

- It could be addressed by an industry reinsurance scheme that runs along side the claims equalisation scheme, or
- It could be left as a voluntary arrangement that funds should be able to undertake if they deem it appropriate from a risk management viewpoint.

Whilst it appears unlikely (particularly in the short term) that the DHA will support health funds effecting reinsurance arrangements with reinsurance companies, it may be possible for health funds to reinsure with registered health funds, or to establish some form of reinsurance pool between funds.

Industry was informed via Departmental circular (PHI 27/06) that the AHIA model would be introduced from April 2007 with a modification to include a mechanism to incorporate high cost claims into the reinsurance pool. On 24 May 2006 the Department wrote to individual funds to notify that Ernst & Young would consult and report back to the Department with a suggested solution to the high cost claims pool.

The AHIA called a meeting of the Finance and Accounting Committee to develop an industry position that could be put to Ernst & Young, the Department and the Minister. At this meeting on the 27 April 2006 the HIRMAA representative along with AHIA members agreed that there was no need to have a high cost claims pool.

The AHIA Position

- 1) AHIA does not believe a high cost claims pool is required or necessary.
- 2) AHIA stands by its original agreed position on reinsurance. That is, legislative change should be made that enables health funds to obtain external reinsurance and be available to those funds that wish to pursue such a service to protect their members if deemed necessary.
- 3) Industry understands that the initial Departmental objections to external reinsurance centred on concerns of the 30% rebate being passed onto general insurers. If this is the case industry should be allowed to reinsure itself internally for high cost claims where deemed appropriate by individual funds. So small funds could enter into arrangements with larger funds, or alternatively smaller funds could pool together to share necessary risk.
- 4) If change must be made to incorporate a modification for high cost claims then any such system should be based on the following principles:

a) Any high cost claims solution must operate independently from the agreed AHIA/KPMG model

Industry has agreed on the AHIA/KPMG model and as such this should remain independent to any high costs solution to ensure industry harmony on the overarching reinsurance methodology. The AHIA believes the high cost claims pool must operate separately from the age based claims equalisation pool.

b) Health fund participation in the high cost claims pool must be voluntary.

The impact of the incidence of high cost claims will vary depending upon the size of the fund. Large funds will not be concerned at the number of high cost claims as the number of these claims will be reasonably predictable and will not represent a significant financial impact on the fund. Smaller funds may find that the number of high costs claims can vary due to their smaller size and may potentially have a significant financial impact. This will happen only where the expected number of high cost claims is small and a few high cost claims would represent a significant proportion of cash flow in any particular quarter.

The AHIA therefore believes that any high cost claims pool should not be compulsory. Each fund would assess its risk tolerance by determining the likelihood and financial impact of various levels of high cost claims.

Some smaller funds may conclude that there is the potential for variability in the level of high cost claims experienced which would have an adverse financial impact. These funds may benefit from pooling their high cost claims and may elect to participate in a voluntary pooling arrangement.

The pool must be voluntary to minimise administration costs and keep the arrangements as simple as possible. The highest volume of high cost claims are incurred by large health funds. Forcing participation would incur administration, compliance and audit costs. The AHIA believe that a voluntary high cost claims pool can operate on a viable basis for the benefit of those funds who believe they would benefit from smoothing the impact of high cost claims over time.

- c) **Only funds with a membership less than 60,000 can be eligible to participate in the pool.** Not all health funds need to participate in the pool (as outlined above in (b)). It is important however that even under a voluntary scheme that large funds do not take advantage of the scheme and impose unnecessary burden on smaller funds.

For this reason, to be eligible to participate in the high cost claims pool health funds must have 60,000 or less persons covered by some form of hospital cover.

The objective of the high cost claims pool would be to smooth the incidence of these claims over time. Over time it is expected that the high cost claims pool would not change the claims experience of any individual fund, but simply replace a potentially unpredictable claims experience with a more predictable one. This illustrates why there is no reason for larger funds to participate.

- d) **An independent high cost claims pool must only include those high costs that are not currently compensated within the current AHIA model (i.e. less than age 55).** The AHIA model equalises benefits across health funds for all health fund members over the age of 55 that represent the vast majority of industry high claims. If a high cost claims pool included all members who claimed then funds would be compensated twice. Therefore the high cost claims pool must only include claims for persons under the age of 55.

- e) **Rules must ensure the high cost claims pool cannot be “gamed”**

Such rules should include but not limited to:

- (i) Health fund must make an election to participate in the pool prior to the commencement of each quarter in which the claims are made. The notice period for a fund to nominate to be included in the high cost claims pool should be 28 days prior to the commencement of a quarter.
- (ii) Funds that participate should participate for a minimum period of 12 months to alleviate seasonal factors, but could elect to subsequently withdraw from the pool.
- (iii) Claims to be based on a individual episode rather than at a member level to ensure consistency with current PHIAC reporting
- (iv) Acknowledgement of date of service of the claim to ensure that claims are lodged in the appropriate quarter.

- f) **Claims greater than \$75,000 to be eligible for the high cost claims pool.**

The AHIA proposes that the high cost claims pool only apply to those claims where the total hospital, medical and prostheses benefits paid for an individual hospital claim exceeds \$75,000.

The level of \$75,000 has been chosen by considering the objective of minimising the potential for adverse financial impact of high cost claims on small funds while avoiding the inclusion of higher volume medium sized claims. A number of small funds would expect to have fewer than one or two of these claims per year and a higher number of these claims could cause significant financial impact. Larger funds will expect to have dozens or hundreds of these claims each year and their impact would be much more predictable.

Most of these claims in fact occur at the older ages where the main pool will smooth out the claim. It is really only relevant for ages below age 55 where the incidence of high cost claims is quite small.

Funds with eligible claims would provide details of the individual claims involved to PHIAC to enable reinsurance settlements to be determined and would become subject to the annual audit process.

g) Provision for the secondary pool to be revised in 12 months by industry.

To ensure continued industry harmony the independent high claims pool should be open for review by industry in 12 months.

Keeping the high cost claims pool separate from the age based claims equalisation pool will enable it to be separately monitored to ensure that it is meeting its objectives.

**AUSTRALIAN HEALTH INSURANCE ASSOCIATION
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