COMPLETE ACTUARIAL SOLUTIONS COMPANY

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Healthcare Reform: A Year Later

Will it stay or will it go? Time will tell, but for now, it is prudent to consider opportunities in the changing world of healthcare. We know your organization is working hard on the checklist of items to be completed by the imposed deadlines. However, some provisions of the bill will have more far reaching effects that make it important to evaluate long-term strategies and consider changes in light of the financial impact of the new law. Some of these items that may be of interest are summarized here.

Taxes and Fees

Although there are expected to be some savings, the bill will require additional revenue, some of which will come from additional fees and taxes. For example:

- The Medicare Part D subsidy being received by many employers for retiree prescription drug costs will be taxed in the future. There are opportunities to take advantage of the expanding Medicare Rx plan by integrating your Rx plan with Medicare (similar to current integration of the physician and hospital coverages) or offering an employer-customized Part D plan directly to your retirees.
- The excise tax on high cost (“Cadillac”) healthcare plans may impact an employer’s retiree medical plan in the future, requiring immediate financial recognition due to accounting rules, even if the current plan cost is far below the thresholds. Health plan costs are likely to catch up to the thresholds because the increase to the thresholds is limited by the Consumer Price Index (CPI) whereas the health plan cost trends have historically been much greater than the CPI. The need for immediate measurement and recognition of this impact has been overlooked by some employers.
- For highly-paid employees, the Medicare tax will not only increase but will also apply to personal unearned income.
- There will be annual fees charged to the pharmaceutical and health insurance sectors.

Medicare’s Reimbursement Structure is Changing

Collaboration, consolidation, and quality measures will impact reimbursement amounts under the new law. Since Medicare represents a significant portion of revenue for most providers, changes in the Medicare reimbursement structure will reverberate throughout the system as providers react and realign to maximize potential revenue. The following are some examples of how the new structure encourages more cooperation between providers, payers, and the pharmaceutical industry, as well as renewed focus on quality of care:

- ACOs (groups of providers responsible for the overall care of a patient) can share in any cost savings they achieve for Medicare through the coordination of care.

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Healthcare Reform: A Year Later (continued)

- Bundling payments to providers will require cooperation and, along with an increase in primary care physician reimbursements, may further the trend toward a greater number of hospital-employed physicians for their mutual benefit (as well as stronger primary care/specialty physician coordination). In addition, Medicare will no longer be contracting with new physician-owned hospitals.
- Penalties related to preventable hospital readmissions, hospital-acquired conditions, and poor quality metrics should provide further incentives to focus on quality of care. In addition, a newly implemented hospital value-based purchasing program will base reimbursements on quality measures. These quality metrics will be made publicly available on the Internet.
- Increased cooperation and communication, along with increased focus on quality of care, should result in fewer medical professional liability claims.

Unintended Consequences on Workers' Compensation (WC)

Although WC is not directly addressed by the health reform legislation, expanding coverage and changes in the way health care is delivered and financed is certain to have some effect on medical costs under WC. For example:

- Currently, there may be some incentive for employees without healthcare insurance to try to get medical coverage by filing a WC claim. With the expansion of healthcare coverage under the new law, this incentive should be reduced.
- The emphasis on preventative services and primary care may reduce complications for chronic conditions, thus lowering WC claim severity.
- The reduction in Medicare reimbursement rates will also reduce WC medical fee schedules that are based on these rates. This will lower the medical benefit component of WC costs.
- The focus on quality measures and management of medical services will extend to the care of WC patients.
- Increased fees and taxes may get passed on in the form of higher WC insurance premiums.

Overall, there will be new required benefits, more available coverage, changing sources of federal funding, increased financial pressure on healthcare providers, and increased regulation. The new rules will potentially change how providers do business, employers provide coverage, and individuals choose from amid the various options. Are you ready?

The following are some links with more information on the new law:

Summary of the Acts

Timeline for changes

White house blog on Health Care Reform

Complete Patient Protection and Affordable Care Act

Complete Health Care and Education Reconciliation Act

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Ask the Actuary: Loss Trend

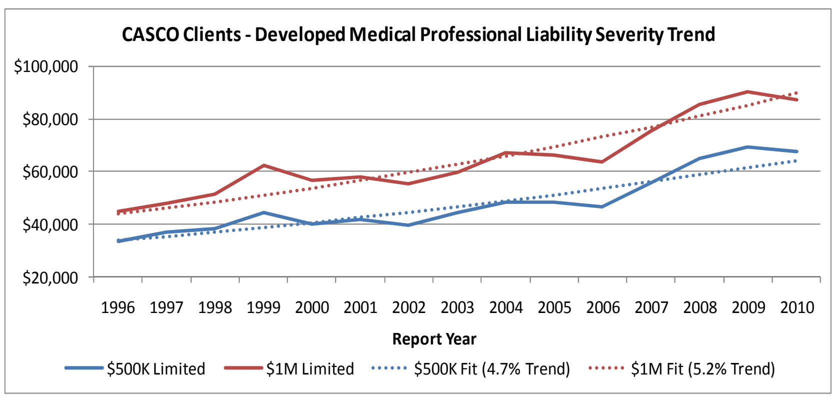
Actuarial analysis involves the use of historical data to project future losses. The historical experience must be adjusted to reflect any anticipated changes through the application of loss trend factors.

Q: What are the components of loss trend?

Actuarial projections rely on frequency, severity, and exposure trend assumptions. Frequency trend accounts for any anticipated change in the number of claims occurring over time. Severity trend anticipates changes in the cost per claim (including inflation). Exposure trend captures the impact a changing exposure base (growing or shrinking operations) is expected to have on losses.

Q: What are reasonable trend assumptions?

Selection of trend assumptions should consider past experience as well as reasonable future expectations. Frequency trend is often assumed to be flat (0% change) in the absence of specific legal or risk profile changes. Selected severity trend assumptions are generally larger for higher retention levels and for lines of coverage that are more affected by inflationary forces. Below is a graph of developed historical severity for CASCO medical professional liability clients.



Severity trend for layers excess of a deductible can be highly leveraged. This is especially true in cases where the deductible remains fixed for a long period. The example below shows how severity trend for an excess layer can be much higher than the overall trend.

Assumed severity trends of 4.7% for losses limited at $500k and 5.2% for losses limited at $1M result in a severity trend of 7.2% for losses between $500k and $1M in this example.

Trend Example

(1) 2010 $500k limited severity	$ 67,800
(2) 2010 $1M limited severity	$ 87,300
(3) 2010 severity in $500K to $1M layer = (2)-(1)	$ 19,500
(4) 2011 $500k limited severity assuming **4.7%** trend	$ 71,000
(5) 2011 $1M limited severity assuming **5.2%** trend	$ 91,900
(6) 2011 severity in $500k to $1M layer = (5)-(4)	$ 20,900
(7) Resulting $500k to $1M layer trend = (6)/(3) - 1	**7.2%**

Market Focus

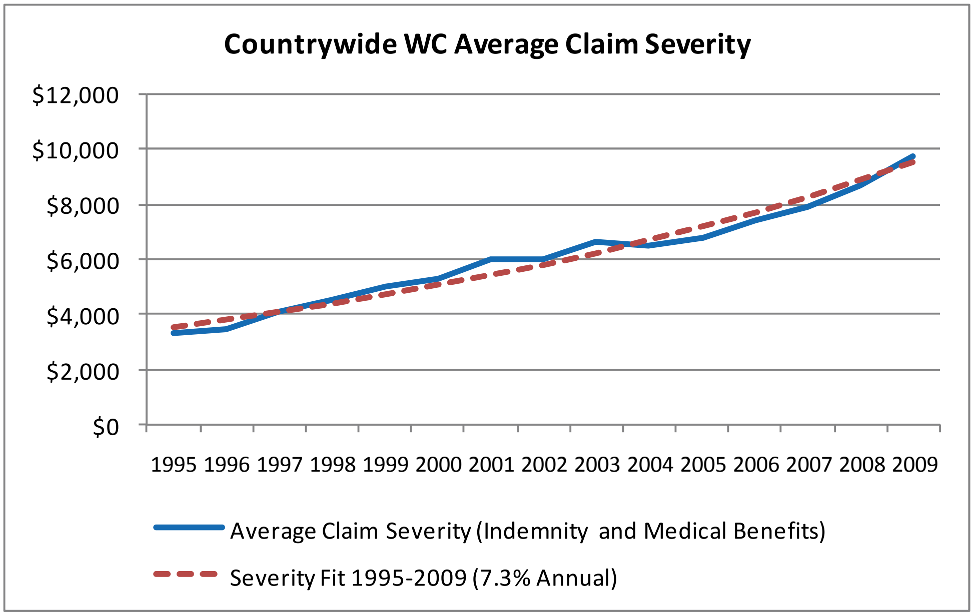
In this issue, we look at industry wide workers' compensation data.

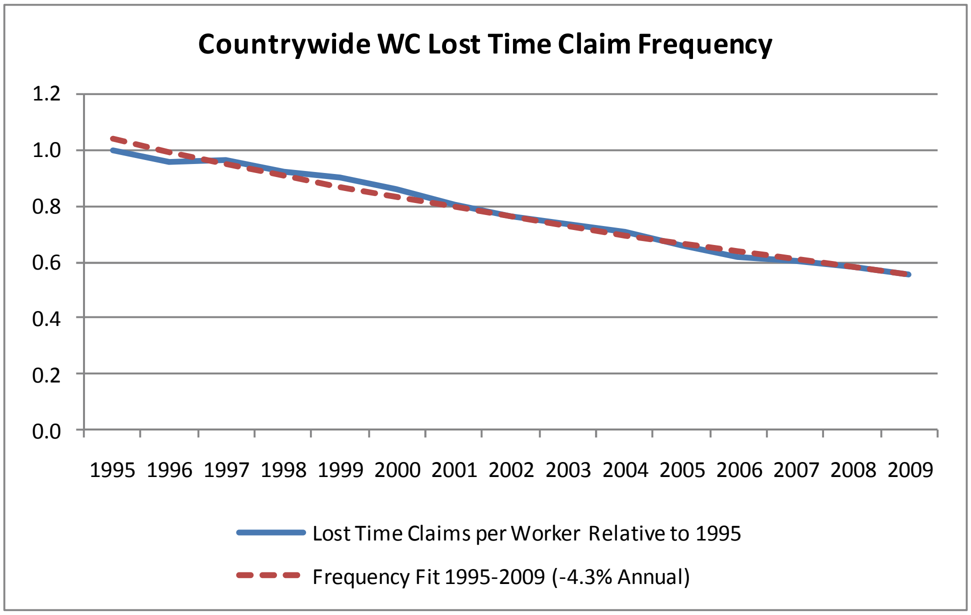
Claim severity has been increasing at a rate of about 7% to 8% annually since 1995. Indemnity benefits outpaced wage inflation and medical benefits outpaced medical CPI during this period.

Lost time claim frequency has been declining since the early nineties due to factors such as the shift away from manufacturing jobs in the U.S. workforce, technological advances, increased emphasis on safety and loss control, and an aging workforce (older workers have fewer accidents on average).

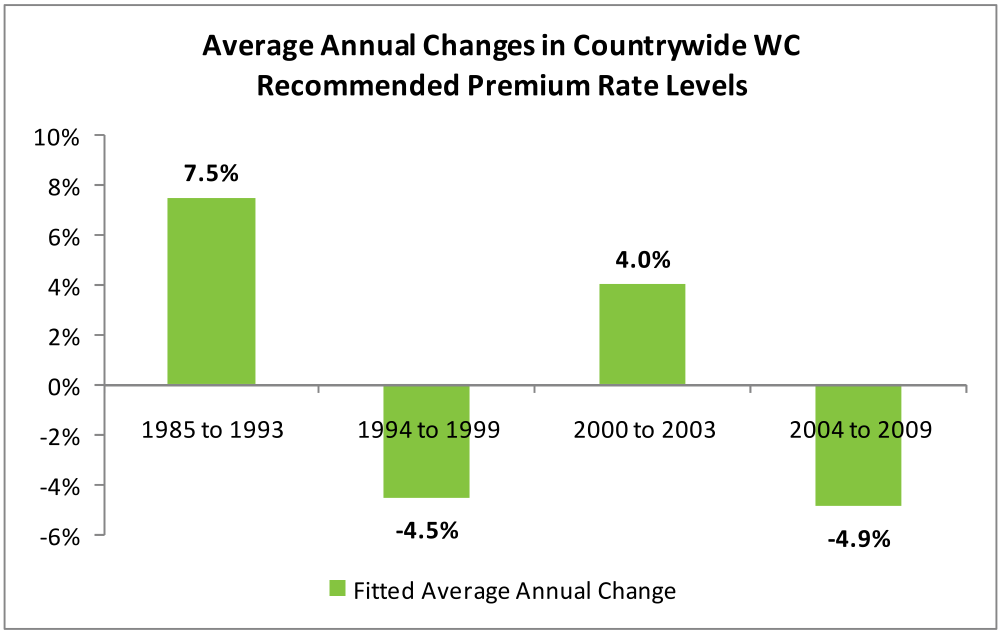
Market Focus: Workers' Compensation

Two important sources of industry data on workers' compensation (WC) loss experience are the National Council on Compensation Insurance (NCCI) and AM Best's Aggregates and Averages. Shown below is information on countrywide WC claim severity and claim frequency for coverage years 1995 through 2009 and average recommended premium rate changes for coverage years 1985 through 2009 based on AM Best data for reporting insurance carriers and NCCI data.





Market Focus: Workers' Compensation (continued)



Note: Recommended rate levels increased every year from 1985 to 1993 and 2000 to 2003 and decreased every year from 1994 to 1999 and 2004 to 2009. These recommended rate level changes are for the overall commercial WC insurance industry (not the self-insured WC industry) and may not be appropriate for any individual state, sector, or company.

Interesting Articles

Increase in Workers' Compensation Temporary Total Disability Payments
After a period of moderation, NCCI is now seeing an increase in the average duration of payments for Temporary Total Disability (TTD) indemnity benefits. This increase coincides with the onset of the recession in late 2007.

Social Media Activity May Mean Updating Your Company's Insurance Coverage
The use of social media may require companies to explore the coverage afforded by their insurance policies.

Issues Affecting Workers' Compensation in 2011
Eleven issues that bear watching.

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About CASCO

We provide ongoing actuarial services to over 100 clients in several areas:

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- Directors' & Officers' Liability
- Workers' Compensation
- Automobile Liability
- Managed Care Errors & Omissions
- Medical Benefits Stop Loss Risk
- Disability Benefits

We help clients with:

- Annual funding/pricing analyses
- Liability and cost projections for accounting and budgeting
- Formal opinions and reports to meet regulatory and audit needs
- Communication with auditors, regulators, and excess insurers
- Other regulatory or administrative problems
- Impact analysis of judicial/law changes affecting program costs
- Strategic risk financing studies
- Retention limit analysis (single and multi-line)
- Internal cost allocation
- Pro-forma projections of program results under varying scenarios
- Cash-flow forecasts to help in setting investment strategy
- Evaluation of insurance products
- Projecting costs for acquisitions and new ventures
- Expert witness testimony
- Benchmarking data on loss costs, trends, retention limits, and more

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