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A Review of PEHP's Reinsurance Practices

The Public Employees' Health Program (PEHP) has improved its reinsurance practices as recommended in *A Performance Audit of PEHP's Business Practices*, released in January 2011 (Report 2011-01). PEHP now manages the reinsurance program on a prospective basis and rates are determined independently, specific stop-loss coverage levels are now actuarially determined, and all but one of the medical risk pools currently has a positive balance. In any given year it is possible some risk pools will have higher reinsurance claims than premium, but over time each pool should have a positive balance.

Reinsurance helps to limit the loss that PEHP's risk pools could experience, such as an unusually high medical claim.

Reinsurance helps to limit the loss that PEHP's risk pools could experience in certain circumstances, such as unusually high medical claims or a disaster. For medical coverage, reinsurance is used to cover individual claims above a certain dollar amount, which is called specific stop-loss coverage. When a claim exceeds the specific stop-loss coverage level, reinsurance is used to pay the claim.

Reinsurance Risk Pools Are Now Managed on a Prospective Basis

Prospectively quoting reinsurance rates follows industry best practices.

A portion of the premium that PEHP collects from employers goes toward reinsurance costs. Prior to 2012, PEHP managed the reinsurance risk pools on a retrospective basis; the program did not quote actual reinsurance costs at the beginning of a plan year. Quoting costs at the beginning of a plan year helps risk pools manage their budgets and follow industry best practices. Now each risk pool's reinsurance rates are developed based on individual risk pool experience and quoted at the beginning of a plan year. The state's reinsurance rate is $9.05 per member per month. The reinsurance rate includes the expected cost of reinsurance claims, the external reinsurance cost, and a reinsurance reserve amount. In the past, each risk pool was charged the same reinsurance rate.

Specific Stop-Loss Coverage Levels Are Now Actuarially Determined

Specific stop-loss coverage levels are now based on the size and the risk tolerance of the individual risk pools.

PEHP's specific stop-loss coverage levels are now based on the size and the risk tolerance of the individual risk pools. PEHP has obtained guidance from an actuary firm and, as of July 1, 2012, each of PEHP's risk pool's levels has been adjusted to fall within the recommended range. Figure 1 below shows the adjustments made to specific stop-loss coverage levels.

Figure 1 Specific Stop-Loss Coverage Levels. Jordan and Canyons school districts were already operating on a prospective basis prior to July 2012.

Medical Risk Pool	Specific Level Prior to July 2012	Specific Level After July 2012
State of Utah	$ 75,000	$ 250,000
Local Government Risk Pool (LGRP)	75,000	100,000
Utah School Boards Assoc. (USBA)	75,000	150,000
Salt Lake City	75,000	100,000
Jordan*	225,000	225,000
Canyons*	225,000	225,000

**Jordan and Canyons school districts have a specific level of $225,000 and a $200,000 aggregating deductible.*

A large risk pool, such as the state, should likely have a higher reinsurance specific level than a smaller risk pool.

The figure shows that prior to July 1, 2012, all medical risk pools, regardless of their size, had the same specific level. A large risk pool, such as the state, should likely have a higher specific stop-loss coverage level than a smaller risk pool. Now that the levels for the individual risk pools follow actuarial guidance, the specific level for the state's medical risk pool has increased by $175,000. With the higher specific level, the state's reinsurance premium rate is based on the risk pool's experience.

Most Risk Pools Have a Positive Balance for the Current Fiscal Year

Figure 2 below shows the medical pools that participate in PEHP's reinsurance program. PEHP provided us the premiums collected and the reinsurance claims from July 1, 2012, the time that PEHP began operating on a prospective reinsurance basis, to December 31, 2012. We did not validate the reinsurance data for each medical risk pool.

Figure 2 Reinsurance Funding from July 2012 Through December 2012. The reinsurance premium rates have been actuarially determined to cover the reinsurance claims for each individual risk pool.

Medical Risk Pools	Reinsurance Premiums	Reinsurance Claims	Difference
State of Utah	$ 4,065,133	$ (895,119)	$ 3,170,014
LGRP	2,915,658	(1,471,701)	1,443,957
USBA	867,010	(271,237)	595,773
Salt Lake City	1,333,747	(271,420)	1,062,327
Jordan	236,087	(553,493)	(317,406)
Canyons*	99,700	(23,979)	75,721
Total	**$ 9,517,335**	**$ (3,486,949)**	**$ 6,030,386**

**Canyons School District is no longer with PEHP as of December 31, 2012.*

The fiscal year is only half over, but preliminary results show that each of the risk pools has a positive underwriting balance, except for Jordan School District. The state's medical risk pool has a balance of $3.2 million.

When each risk pool has a positive balance, one risk pool does not rely on other risk pools to cover its reinsurance claims.

When each risk pool has a positive balance, one pool does not rely on other risk pools to cover its reinsurance claims, and each risk pool operates independently. However, this figure shows only half of the current plan year. The current plan year's experience for each of the risk pools will be used to determine the premium rates in future plan years.

Individual Risk Pools Can Rely on Reinsurance Reserves from the Aggregate Reinsurance Risk Pool if Needed. All employer groups that participate in PEHP's reinsurance risk pool can access the reinsurance reserves. If reinsurance claims exceed the premiums collected for an individual pool, then PEHP can rely on the reinsurance reserves to cover those claims. The total reserves for the reinsurance risk pool are $19 million as of June 30, 2012. This reserve amount was within PEHP's consulting actuary firm's target ranges for that year. The reinsurance reserves of $19 million are built from all the participating risk pools' excess premium over time. The excess premiums shown in Figure 2, and later in Figure 3, are for specific periods of time, and do not represent the total reserves in the reinsurance risk pool.

When we completed the *In-Depth Follow-Up Audit of PEHP's Business Practices* (Report 2012-05), PEHP reported looking into buying external reinsurance when claims exceeded the specific level for the state's medical risk pool. However, PEHP learned that external reinsurers charge a 30 percent premium on reinsurance rates. As a result, obtaining external reinsurance at the specific coverage level would be more expensive for the state's medical risk pool than pooling with PEHP's other participating medical risk pools in PEHP's reinsurance.

The State's Reinsurance Risk Pool Was One of Two Risk Pools Where Claims Exceeded Premiums in the Previous Two Fiscal Years. In Figure 3 below, PEHP provided us the reinsurance pool funding for the period of July 1, 2010 through June 30, 2012.

Figure 3 Reinsurance Funding from July 2010 to June 2012. This figure shows that the state's reinsurance premiums did not cover claims for the two-year period.

Medical Risk Pools	Reinsurance Premiums	Reinsurance Claims	Difference
State of Utah	$ 49,181,513	$ (50,070,355)	$ (888,842)
Salt Lake County*	5,266,669	(5,269,369)	(2,700)
LGRP	11,888,251	(8,427,513)	3,460,738
USBA	5,111,590	(5,073,035)	38,555
Salt Lake City	5,167,026	(3,956,127)	1,210,899
Jordan**	983,063	(393,033)	590,030
Canyons**	710,445	(191,550)	518,895
Total	**$ 78,308,557**	**$ (73,380,982)**	**$ 4,927,575**

**Salt Lake County is no longer with PEHP as of March 31, 2012.*
***Jordan and Canyons school districts were already operating on a prospective basis.*

Since the state's risk pool was underfunded from 2010-12, the reinsurance reserves were used to cover those costs.

This figure shows that the reinsurance claims for the state's medical risk pool exceeded premiums by $889,000 for those two years. Salt Lake County is no longer with PEHP, but also had a premium shortfall. As a result, the reinsurance pool reserves were used to cover the state's and Salt Lake County's claims.

Recommendation

1. We recommend that PEHP continue to review reinsurance premium rates each year, and try to maintain an overall positive balance for each risk pool.