

CRISIS = RISK AND OPPORTUNITY - IN ANY LANGUAGE

By Kathy Kunigiel and Sandra L Berkowitz, RN, JD,
Willis Managed Care Practice

In Japan, the word for crisis combines the characters for *risk* and *opportunity*. In the U.S. the crisis in health care cost and access has led to the passage of the Patient Protection Affordability and Privacy Act (PPACA) in 2010, with implementation milestones occurring from 2010 to 2017 and beyond.

Each step along the PPACA path presents both risk and opportunity. Therefore, we use this lens in our 2011 MCO E&O Market Update to focus on post-reform changes in the health insurance company (MCO) industry from the standpoint of the E&O buyer. We then turn to Willis' view of the MCO E&O market response over the past and coming 12 months, and finally, we conclude with renewal strategies for a marketplace that is still pliable, but firming.

CRISIS: HEALTH INSURERS' RESPONSE

Reform is creating risk and opportunity for every player in every health care segment – but the first beachhead has focused on health insurers. Matt Dolan, President of E&O carrier IronShore, describes the chasm between insurers and providers in a recent brief, *Evolving Healthcare Landscape Requires Insurance Solutions Not Just Insurance Products*:

“...the purported goal of reform is to achieve a highly coordinated system of providers, supported by an electronic backbone (EMR), who are compensated on outcomes-based quality and service, while providing significantly broader access. Today's reality and tomorrow's blueprint could not be further apart.”¹



We see health insurers and managed care entities, such as pharmaceutical benefits managers (PBMs), more broadly, confronting a litany of challenges:

■ **RISK MANAGEMENT, NOT RISK AVOIDANCE:** No lifetime benefits limitations by 2012; no pre-existing condition underwriting by 2014.

■ **INSURER BRAND NEUTRALITY:** Health Insurance Exchanges will restructure the individual and small group marketplace in 2014 to “standardize” plan design choices, directing consumer focus to price.

- **DIVERSIFICATION:** MCOs are beginning to shift into complementary, non-insurance strategies that promise more return on capital and more value in controlling health care costs; said another way – into areas beyond current core competencies.
- **CONSOLIDATION:** As reform’s high costs drive Blue plans into intrafamilial joint ventures that circumvent regulatory opposition to conversion and weak plans of every stripe into the hands of the strong, anti-trust risk increases. Nowhere is this better illustrated than in the PBM world, where #1 Express Scripts has announced its acquisition of #3 Medco, leaving retail pharmacies fearful of price negotiations with no leverage.
- **REGULATION:** The quickening pace of subpoena service on MCOs signals an enforcement environment searching for transparency and ways to lower health care costs, including stepped-up efforts to reduce fraud and abuse, increased scrutiny of filings seeking more than a 10% rate increase, medical loss ratio caps on administrative expense – not to mention dueling federal and state agendas over the regulation of ACOs.
- **TECHNOLOGY:** Patient networking sites, use of social media to enhance patient access to patient-centric medical home providers, electronic health records and e-prescribing are all capital intensive opportunities for health insurers to provide “glue” in support of patient-centric accountable delivery models. But they also expose the MCO, its members and providers to privacy breaches, with financial and reputational consequences.

Well capitalized health plans are responding quickly, as evidenced by the following transactions which have occurred over the past 18 months:

- Aetna purchased Medicity Inc., a health information search engine.
- Humana purchased Concentra, creating vertical integration with the addition of clinics, urgent care centers and wellness centers that will evolve into medical homes to manage chronic diseases in their membership.
- Highmark purchased West Penn Allegheny Health System, an ailing five-hospital system in its back yard.
- Independence Blue Cross and BCBS Michigan announced plans to jointly own not-for-profit multistate Medicaid plan AmeriHealth Mercy and offer equity positions in it to other Blue plans interested in growing their managed Medicaid footprint.
- WellPoint recently purchased CareMore physicians, with an eye to operating clinics that serve Medicare Advantage beneficiaries.
- All MCOs are branching into wellness programs that blur the lines between managed care and medical services – and resurrect the question of whether nurse care managers must be licensed in every state in which plan members reside.

The new exposures created by these vertical and horizontal integrations present hurdles for both the MCOs and their E&O carriers. MCO E&O markets have a comfort level with the direct medical malpractice exposure, and most carriers (Travelers excepted) are willing to incorporate this exposure into the MCO E&O program if the client so chooses. The same does not hold true for technology-provider exposures, which are different from those exposures generated by privacy and network security breaches. Technology providers

perform operations, such as information technology consulting, data base design, information system outsourcing, data storage and cloud computing. Most E&O underwriters, with the exception of Chartis, do not have the expertise in this line of coverage and will not incorporate these exposures into the MCO E&O program.

ARE MCO E&O (AND MEDICAL MALPRACTICE) MARKETS WITH CAPITAL "BOUNCING ALONG ON THE BOTTOM" OR MANAGING CAPITAL?

In late 2010 through mid 2011 we thought we'd see premium decreases slow down and limits/retentions stay steady. Surprisingly, only the latter has been true, based on Willis' 2010-11 MCO E&O benchmarking survey:

- An overall 10% reduction in premium was recognized by *smaller to mid-size non-government regional plans* (including the Blues) with fewer than 5,000,000 enrollees. This reduction suggests that the E&O marketplace views these accounts as their sweet spot: these plans give meaning to "health care is local" and are not likely to be engulfed in systemic litigation risk. In order to retain this business incumbent markets reduced premiums in response to competition. This is especially true for the Blues excess layers, which are being aggressively quoted by BCS.
- *Government plans* with up to 1,300,000 enrollees saw a 5% premium reduction. We suspect this reduction is less than non-government plans because of increased scrutiny (think False Claims) and shrinking reimbursement rates – a formula markets may see as amounting to more claim activity.
- *Large plans* with more than 5,000,000 enrollees enjoyed surprisingly large premium reductions up to 7% (compared to flat renewals last year), driven by a combination of program restructuring and the presence of competition at the broker or market level.
- *Small entities* (IPAs, DMs) with fewer than 100,000 members may have seen larger reductions due to IronShore's restructuring of their minimum premium levels – which occurred a few years ago but is a work in progress that keeps pricing competitive even for small risks.

Health care reform and technology drove E&O underwriters to review their approach to, and coverage terms for, Managed Care E&O. One MCO E&O carrier, AWAC, began to look at its overall book of business from a capital management perspective; it trimmed its

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pre-claim and non-member privacy protection within its MCO E&O policies (bolstering its free-standing cyber product) and walked away from existing business it viewed as underpriced. In contrast, Ace and IronShore seem fairly satisfied with their significantly smaller books. Based on the very small \$250M universe of MCO E&O premium, combined with rapid consolidation in the segment, these two carriers seem happy to grow or not grow – so long as they are profitable. One Beacon’s hunger stands in contrast to their counterparts’ reluctance. In the words of One Beacon’s lead underwriter, “If you think of your line as ‘business as usual’, you let business run off. But if you see uncertainty then there’s hope.”

What keeps these markets in the game when their capital might generate better return on investment elsewhere?

- The promise of new premium from MCO diversification strategies, including direct medical service delivery, the sale of information and back-room services
- The hope that ACOs will sooner or later need insurance solutions
- The insights that flow from underwriting the strategic position MCOs play in the health care landscape
- No paid losses of any substance...still (good news)
- The ability to collect premium once losses are paid (even better)

ACCOUNTABLE CARE ORGANIZATIONS - WHAT WILL THEY BE?

The steep projected start-up expenses (>\$5M) may quell the robust ACO development originally forecast, but MCOs continue to ambivalently regard Accountable Care Organizations as both threats (that the ACO will absorb the “I”, so the Health Insurer [the “I”] itself disappears) and as opportunities to partner in new direct delivery models in order to increase the accessibility and quality of care – and manage costs. Willis is pushing for market solutions that integrate the ACOs’ MCO E&O, privacy, regulatory, stop loss and medical services exposures; but the dust simply hasn’t settled. While Ace sees ACOs as primarily medical malpractice driven, One Beacon sees them as PHO E&O revisited. IronShore and AWAC have holistic ACO insurance programs in their funnels. Other markets are shying away from ACOs because of the dueling federal and state agendas which

continue to obscure – depending on whether the ACO serves a managed Medicaid, Medicare Advantage or commercial population – how these integrated delivery systems will be regulated. One thing seems clear: while CMS is front and center on the ACO’s management of *medical cost risk vs performance (quality outcomes) risk*, state regulators are ominously silent with respect to whether ACOs that direct-contract with employers are “engaged in the business of insurance” and so need an insurance license (captive business plan expansion?). For that matter, what demonstration of financial responsibility is expected for protection of consumers from any ACO liabilities? Payers (i.e., parties contracting with ACOs) should be thinking about ACOs’ evidencing of minimum limits, including D&O, E&O, cyber and social media, regulatory and medical malpractice – risks that will need addressing long before the ACO requires stop loss protection.

MARKET FORECAST: WHAT'S AHEAD?

The MCO E&O market continues to stabilize, with rates expected to further flatten in 2012. No new lead domestic capacity has entered the marketplace and ACE, Allied World, Chartis, IronShore, OneBeacon and Travelers continue to be the only carriers writing MCO E&O (with BCS writing Blue plans only). Chartis has re-organized and continues to have interest in this line but will only entertain accounts with good loss history. Chubb (remember Chubb?) indicates interest in reentry into the segment as an excess player.

In response to MCO client needs driven by increased regulation, carriers have begun to



expand product offerings. IronShore introduced a standby capital fraud and abuse option for MCOs after participating in Willis New York's "Government at the Door" roundtable earlier this year. OneBeacon gets credit for pioneering limited subpoena defense coverage, in response to client demand, with Ace and Allied World also stepping up to the plate. We live in interesting times: Willis continues to work with domestic and Bermuda markets to produce solutions offering an explicit grant of false claim coverage to MCOs, integrated ACO coverage solutions, and increased coverage certainty in class actions alleging breach of contract wrongful acts.

For the year ahead, the MCO E&O markets will accommodate buyers' new product needs only if these markets are pushed to perform (IronShore and One Beacon excepted). In the words of Ace's lead managed care underwriter, "E&O and medical malpractice markets have plenty of capital; we are all bouncing along on the bottom." Until health care reform breaks some eggs and generates new litigation activity (e.g., medical loss ratio calculation whistleblower actions, challenges to ACO bonus payment distribution, or allegations that an MCO did not properly evaluate the financials of a now-insolvent IPA) and a justification for more premium, we agree.

PREPARING NOW

We update last year's advice on how to position your organization for potential market changes:

- 1 BUDGET** for flat premiums in 2011 and 2012 if no relevant changes in exposure have occurred.
- 2 BUDGET** increases for exposure changes, including increased members, acquisitions and new business activities.
- 3 NEGOTIATE** terms now:
 - Clarification of carriers' care management definition so that chronic disease programs are not caught up in the medical services exclusion
 - Confirmation of how an acquisition of direct care providers would dovetail with your MCO E&O coverage
 - Related claim scope narrowing, if indicated
 - Pre-claim cyber coverage for notice and monitoring expenses
 - Subpoena defense coverage
- 4 CONSIDER** purchasing a separate network security and privacy policy if not already purchased. Dovetail the cyber with the MCO E&O so that the "other insurance" exclusion is not triggered.
- 5 INITIATE** – before the first subpoena arrives – C-Suite conversation regarding your organization's appetite for affirmative False Claims and Regulatory Risk protection.
- 6 CONTINUE** to scrutinize carrier balance sheets and understand how much each takes net or reinsurance.

INSURER AM BEST MCO E&O CAPACITY 2011

INSURER	RATING	CAPACITY
ACE	A+, XV	\$15M
Allied World Assurance Company	A, XV	\$25M
BCS (Blues Owned)	A-, VIII	\$40M
Chartis Executive Liability	A, XV	\$25M
IronShore	A-, XIII	\$25M
Lexington (Chartis Healthcare)	A, XV	\$25M
OneBeacon Professional Partners	A, XI	\$25M
Travelers	A+, XV	\$20M

In addition to the domestic markets listed above, other carriers that may participate on a capacity basis include ACE Bermuda, AIG Cat, AIG Europe, Alterra, Arch, Argo Re, Endurance, Hannover Re, IronStarr, Lloyd's, Starr, Swiss Re and XL. Hartford provides excess capacity for Blues plans; Travelers, through MGU Chatham Agency, provides lead and excess capacity to both for-profit and nonprofit plans.

CONTACTS

Sandy Berkowitz

Managed Care Practice Co-Leader

215 498 6594

sandy.berkowitz@willis.com

Kathy Kunigiel

Managed Care Placement Specialist

860 756 7375

kathy.kunigiel@willis.com

Frank Castro

Managed Care Practice Co-Leader

213 607 6304

frank.castro@willis.com

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¹ http://www.ironshore.com/pdfs/onPoint_vol1_iss4.pdf