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INSIGHTS FROM THE BDO INSURANCE PRACTICE

FINANCIAL IMPACTS OF COVID-19 ON HEALTH INSURERS

By Ugo Okpewho

Health insurers are navigating unprecedented challenges brought on by the coronavirus pandemic, and they can expect to feel the long-lasting financial impacts as a result. In the pre-pandemic world, insurers chose which markets to enter. Their membership was generally stable enough to allow them to set appropriate reserve levels and anticipate incoming premiums with reasonable accuracy. COVID-19 has fundamentally disrupted this landscape and forced insurers to think creatively in order to reduce their financial exposure. In this insight we discuss the main financial risks that insurers are facing and strategies to mitigate loss.

5 FINANCIAL RISKS FACING HEALTH INSURERS

Following are financial risks that health insurers will need to evaluate in their own organization now, and as they begin to project 2021 premium rates:

1. Pressures on claim reserves

Enrollment is typically stable from period to period, and any minimal fluctuations typically have minimal effect on net cash flow. However, COVID-19 has created a misalignment of claims paid and premiums collected. The number of insureds has rapidly declined due to surging unemployment, adversely affecting premium collection. This can put a strain on the insurer's reserve balances to finance their claim payments.

Additionally, some members may be delaying care while their health is deteriorating—so it's plausible that those claims will eventually emerge at higher levels than originally estimated.

All these factors point to how critical it is for insurers to manage their reserve levels and ensure that current redundant reserves aren't released prematurely.

2. Pressures on the premium deficiency reserves

A premium deficiency reserve (PDR) is required when there is a probable loss on premiums in force yet to be earned as of the measurement period. It is recognized when the unearned premium reserve is insufficient to cover future expected expenses. It would have been difficult for an actuary to prepare a PDR to account for the costs associated with COVID-19 due to the unprecedented nature of the event.

3. Uncertainty around premium collectability

Early predictions of the revenue impact of COVID-19 on health insurers were that individuals and employers might delay premium payments to conserve cash. Additionally, it was thought that the uptick in layoffs would lead to decreased demand for health insurance, which negatively impacts premium volume and in turn, income for insurers. Recent health carrier actions have been aimed at providing relief to customers due to treatment disruptions related to COVID-19. That relief has come in the form of premium credits and refunds, cost sharing waivers and extended premium payment windows of 31 to 60 days.

4. Difficulty in premium rate calculation for 2021

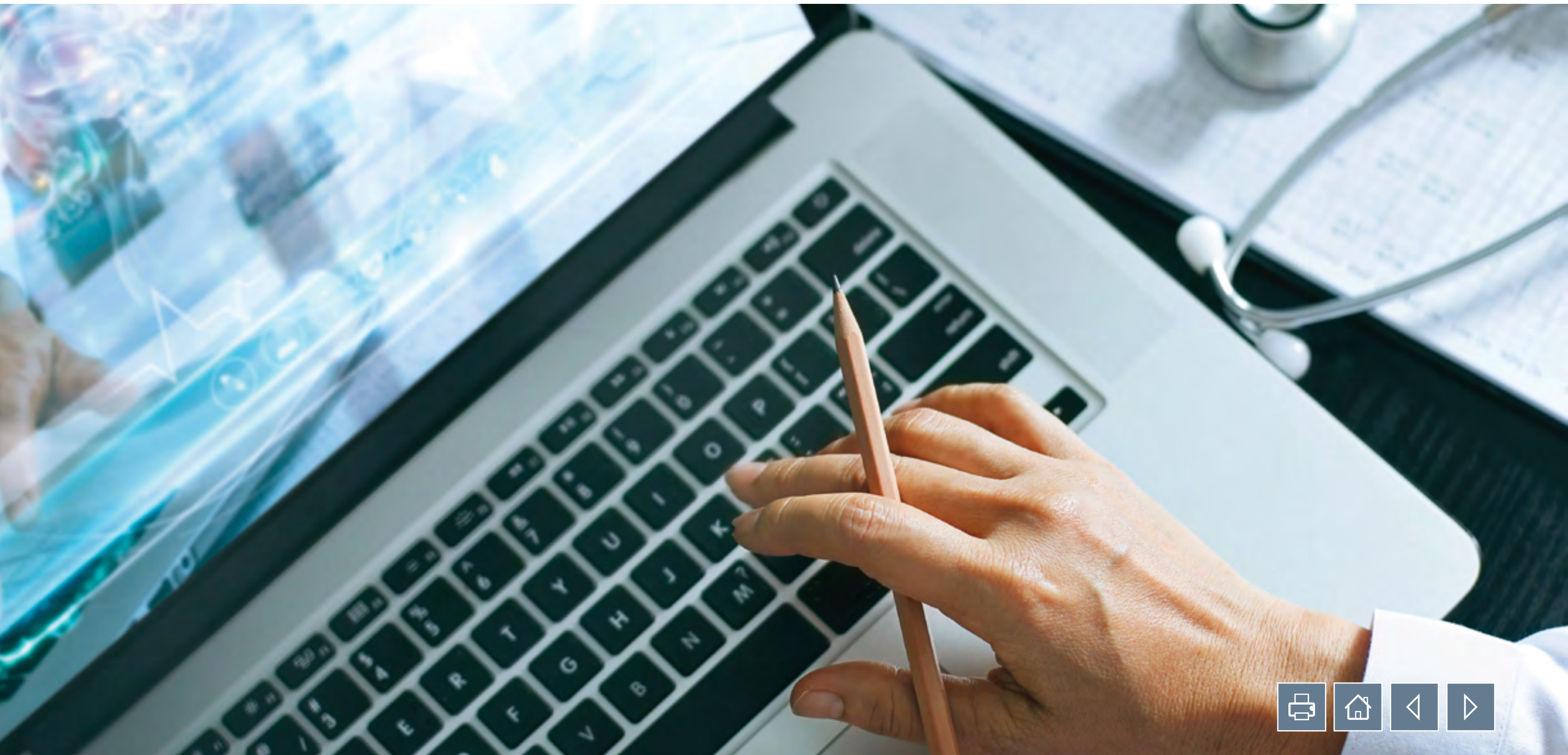
In rate development, actuaries must project medical cost and utilization levels, mix and intensity of services, and composition of risk pools—all of which can vary by geographic area and from one health plan to another. To date, the effects of COVID-19 have varied significantly by region—both in acuity and duration.

As a result, COVID-19 has injected tremendous uncertainty into the 2021 rate development process as health insurers grapple with unknown scenarios including:

- The deferred or avoided care not related to COVID-19 has reduced healthcare utilization for the first half of 2020. How many missed services will return in 2021, and how many will be eliminated outright?
- What are the long-term effects of COVID-19 on those who contracted it?
- Will there be an arrival of another COVID-19 wave, and if so, when?
- Prescription drug spending does not appear to have been affected by COVID-19 as of now. Will this change if there are new drug therapies and/or a vaccine becomes available?

5. Uncertainty in treatment and testing costs

The experience thus far in 2020 has provided insurers with information on the cost of COVID-19 treatments. However, there is still uncertainty regarding COVID-19 related costs per case for 2021 due to the possibility of new treatment therapies, antibody tests, the availability of a vaccine, and the overall severity mix should the virus persist. The cost of testing is also uncertain and could be significant if insurers are required to cover it for free due to public health and occupational safety reasons. This scenario goes beyond the diagnostic testing for individuals typically covered in a health plan and would be a factor in increasing health insurance premiums in 2021.



6 STRATEGIES FOR HEALTH INSURERS TO MITIGATE FINANCIAL RISKS DURING COVID-19

To mitigate some of the financial risks detailed above, insurers should consider the following strategies:

1. Avoid terminating employer groups due to non-payment

While insurers may have a policy of terminating delinquencies, they may want to accommodate longer premium payment cycles for groups that have good credit to avoid further disruptions to enrollment cycles. Well-capitalized insurers may even explore temporary financing for self-funded employer claim expenses.

2. Run multiple scenarios in calculating premium rates for 2021 pricing

When developing 2021 premium rates, insurers should run multiple scenarios with different assumptions, such as:

- If a new COVID-19 infection wave occurs in 2020/2021
- The degree of deferred/avoided services by members
- The amount of testing (including antibody testing)
- The cost and availability of a vaccine

Greater degrees of uncertainty could lead to more conservative assumptions and risk margins. Under the Affordable Care Act (ACA), many states allow insurers participating in the small group market to file updated rates on a quarterly basis—giving more flexibility to adjust rates based on market conditions compared to forecasting rates on a typical annual time frame.

3. Consider projecting MLR rebates in 2021 rates

Medical Loss Ratio (MLR) rebates are issued back to members if the proportion of medical claims to premiums charged fall below a certain level—80% and 85% for the individual and small group markets respectively. 2019 saw significant MLR rebates in the individual market, and, judging by how low claims have been to date, a larger refund is plausible for 2020.

Insurers may consider projected MLR rebates when setting their 2021 premiums by reducing their levels of conservatism in the rate filing process to reduce the possibility of owing rebates for 2021.

4. Quickly identify underlying chronic conditions of new population

Due to the rising level of unemployment, individuals are losing their employer-sponsored coverage and enrolling in either Medicaid or one of the ACA individual exchanges. Because of this churn in the individual, employer and Medicaid populations, insurers may quickly need to onboard a large influx of new members. Insurers will need to quickly utilize their analytical capabilities to understand this churn and identify underlying chronic conditions among new members in order to avoid future unexpected expenditures.

5. Spread risk by promoting diversity in membership mix

How diverse insurers' membership mix regarding line of business and geography could have an impact on profitability with respect to COVID-19 testing and treatment. So far, COVID has disproportionately impacted Medicare-aged members, particularly in the urban areas of the country. It has also shifted people who lost their employer-sponsored coverage to the ACA exchanges and Medicaid plans. Diversity in terms of age, line of business and geography could spread an insurer's risk to avoid paying out on a disproportionate amount of COVID cases.

6. Support risk mitigation assistance programs from the federal government

The federal government can help mitigate some of the financial uncertainties brought on by the pandemic for the insurance industry by implementing one of more of the following solutions. To date, these recommendations have not been implemented, so it is prudent for the insurance industry to support lobbying efforts to inspire action on these fronts.

- **Create a COVID-19 high-cost risk pool.** In this scenario, all insurers pay a set per member per month (PMPM) into a risk pool to cover the costs of potential catastrophic losses that cannot be predicted using historical trends. Losses above an attachment point for each member will be reimbursed to the insurer.
- **Develop a temporary unfunded (or government funded) pool.** As of writing, President Trump has not signed a stimulus package for the health insurance industry. An unfunded pool would be for a specified period—for example during 2020 and 2021—and would keep insurers from collapsing while providing relief for the most vulnerable of its membership.
- **Institute risk corridors.** In this scenario, the Centers for Medicaid & Medicaid Services (CMS) set a target MLR, and will share in gains and losses with the insurer depending on whether the MLR is below (gains) or above (losses) the target.

With COVID-19 cases continuing to surge across the country, there is no definitive assessment on how this unprecedented event will ultimately impact health insurers' bottom lines. It is prudent for health insurance executives to consider all the scenarios that could play out in the foreseeable future—both negative and positive—and employ some of the financial strategies outlined above to forecast premium rates for 2021 as best they are able.

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