Make the trend your friend

After years mostly characterised by low interest rates in advanced economies, easy access to capital and loose monetary policy, the world is waking up to inflation. For health insurance, setting expectations about claims evolution does not only involve assessing medical inflation, but more broadly understanding medical trend, say LINK Insurance's Messrs Jihad Ghanem, Jens Sonnenschein and Imad Hamoush.


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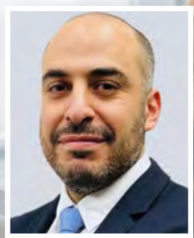
Mr Imad Hamoush

Medical trend is the impact resulting from combining the evolution of unitary costs of health services and the frequency of use of these services. It can therefore be affected both by inflation or by a change in the rate of recourse to particular medical services.

In the former case, unit costs can be propelled by various drivers.

Such drivers can be the emergence of new, more performing medical techniques, methodologies and technologies.

Unit cost increase can also result from general inflation, as economy, law, regulation and monetary policy evolve over time affecting cost of materials, equipment, medicine, practitioner fees, facility management and commercial yield targets.

Changes on the provider scene also affect unit costs such as when multiple providers consolidate or when patient choice and preference for providers change. This is even more marked when the insurer changes TPA or when patients get to change their TPA selection resulting in a different level of claims optimisation or scrutiny.

To address these challenges, providers might need to improve their services and adjust pricing strategies.

Third-party administrators (TPAs) categorise providers into tiers based on cost efficiency and quality. Changes in patient preferences can lead TPAs to re-tier providers, affecting demand for the providers' services and potentially leading to renegotiated contracts and tariffs. This re-tiering and tariff adjustment can impact healthcare costs and utilisation patterns, potentially increasing costs for patients or insurers but also fostering greater competition and altering medical trends.

Besides unit cost changes, medical trend is also driven by changes in the frequency of use related to medical services. This can be the result of various factors such as increased patient awareness related to the health insurance benefits or increased health-consciousness which might for instance encourage insured members to perform medical tests more frequently.

A compounding effect is also created when premiums increase year on year for individual policies, creating a drive for the client to justify his increased investment and get more value out of it by making a more extensive use of the policy's benefits.

Finally, fraud and abuse have a massive impact on frequency, especially when they happens with the complicity of the provider or practitioner.

Make the trend your friend

It is extremely important to identify which drivers of the trend are at work in a given portfolio. There a two main reasons for this.

First, it has a major impact on the overall expected cost of claims, and pinpointing its magnitude gives insurers a better visibility on their portfolio's future performance.

For insurers writing a large part of their business in health, accurately forecasting trend has major implications on balance sheet and performance indicators, reserving, capital adequacy, rating and policy pricing. For reinsurers writing XoL health reinsurance programmes, an increasing medical trend pushes the increased claims burden on the reinsurance cession for insureds whose claims hover around or above the XoL priority, resulting in a modified balance between premiums and recoveries.

Secondly, understanding which drivers of unit cost or frequency are behind a particular medical trend would allow insurers to better design products, better model their claims forecasts, improve performance, take pre-emptive corrective measures related to the particular drivers at cause and better negotiate rate increases with clients and reinsurers.

It is also worth noting that outside the insurance ecosystem, there are important segments of payers in the market such as government, semi-government, military, self-funded corporates, and others for whom understanding medical trend is critical to either plan adequate budgets or consider a shift to insurance solutions.

Where it becomes difficult

Assumptions about general inflation and medical trend vary significantly depending on the source estimating it, its experience and methodologies, the market involved, the portfolio assessed, and other considerations. It is therefore essential to nail the right assumptions which will determine a health portfolio's profitability for both the insurer and his reinsurers.

Let's look at how reinsurer's perspective might vary from the view of their local clients.

First, reinsurers have a global view reflecting the cost evolution they experience globally on various components of the medical service realm such as practitioner fees, medicine costs, surgeries, imaging techniques, etc.

Secondly, reinsurers might factor in their assessment their learnings from other cedants in the same region or market and use credibility factors to blend a mix of the client's portfolio particulars with their experience gleaned with other region or market players. They might also set a trend assumption per TPA, as each TPA might have a different leverage and performance with network providers.

While some of the externalities used above might have relevance for assessing a cedant's portfolio's Medical Trend, it is the weight they are given compared to intrinsic factors which needs to be carefully set so as not to ignore the particular market context, cedant situation or processes and cedant portfolio.

A medical portfolio's specific mix of blue-collar population for example should reflect a different Trend assumption compared to another cedant's portfolio. A particular cedant might have contractually locked in advantageous tariffs with his TPA and providers over a number of years allowing him to better control his Medical Trend compared to competitors and achieving competitive advantage.

Timing assumptions can be another factor of divergence. While GP fees in Jordan for example were expected to increase in 2024, the magnitude but also timing of such increase were unknowns for which reinsurers' overly cautious assumptions diverged from insurers' more informed assessments.

Renewals, the moment of truth

While it is clear that medical trends as earlier highlighted need to be evaluated, decomposed and analysed in a continuous manner all through the year, their use for policy pricing, budgeting and reinsurance planning during treaty renewals remains key.

Although insurers and reinsurers are continuously collaborating to reach a common assessment, the renewal period is a particularly important moment where insurers and reinsurers are often confronted with the difficult task of reaching an agreement over many future assumptions not the least impactful of which is the medical trend assumption underlying treaty renewals.

To address this challenge, three strategies stand out which can be pursued concurrently.

First, relying on the expertise of a credible and experienced reinsurance broker, a precious ally in any successful effort to bridge the assumption and perception gap. Indeed, the reinsurance broker can act as a more neutral contributor on the matter of cost increase and inflation, drawing in on his related experience in the region and in the specific market the cedant operates in. The latter should be able to convey an objective situation to both parties, sharing his exposure to regional and market trends with cedants and exposing reinsurers to local market realities cross-checked with a myriad of other sources (competing insurers, TPAs, regulators, studies, etc) thereby confirming or reinforcing whenever applicable cedant assumptions.

Secondly, where doubts still subsists and positions still diverge, treaty design might offer a solution. For example, designing treaties to include a variable compensation scheme such as a profit commission or sliding scale commissions can help mitigate the impact of reaching irreconcilable viewpoints on claims forecasts.

The third avenue to be explored for overcoming these challenges is operational. This is where best practice comes in handy and depends on the market context and cedant situation. This could depend on the case be the establishment of a strong, credible and recognised internal claims control capability for example or resorting to capitation models or locking in multi-year provider tariffs.

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