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LEGISLATIVE MEMO

Insurance Commissioner Proposal Would Weaken Insurance Carriers by Lowering their Financial Reserves

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Introduction

By law, health insurance carriers must retain a certain amount of money, or capital, above and beyond the company's fixed liabilities. These reserves are an indicator of a company's ability to pay claims and reflect the carrier's financial stability.

Background

Insurance regulation began in the late 1800s largely to guarantee insurer solvency. People who buy health insurance policies need to be sure that when it is time to file a claim the insuring company is, first, still in business and, second, has enough money on hand to pay the claim. Requiring companies to maintain a certain level of financial reserve achieves both goals.

Insurance regulation and reserve requirements are also a way to combat fraud. Reserve requirements insure con-men don't sell people insurance policies and then disappear. For that reason responsible insurance companies gladly cooperate with the Insurance Commissioner's office in maintaining reasonable reserves to serve consumers and pay expected claims.

The basic service insurance companies provide the public is to reduce risk. From an accounting standpoint, these risks are determined by the company's available assets, the number of annual claims, how much a company's investments earn and other business factors. Taken together, these four points define a company's risk-based capital.

Pending Legislation

State Insurance Commissioner Mike Kreidler has proposed a bill (HB 1301 and SB 5247) to limit the amount of money non-profit health insurance carriers can hold in reserve. The non-profit companies are local and are the three largest carriers in the state – Premera, Regence and Group Health. The bill states that companies would need to return to policy holders any amount of money in excess of the legally prescribed reserve amount. The rationale of the insurance commissioner is that this act would supposedly decrease the cost of health care for individuals and small group employers.

HB 1301 and SB 5247 would actually contradict existing Washington state law. RCW 48.43.305 states that "an excess of capital over the amount produced by the risk-based capital

requirements [in law] is desirable in the business of insurance." RCW 48.43.335 further states that risk-based capital reports "are intended solely for use by the [insurance] commissioner in monitoring the solvency of carriers … and shall not be used by the commissioner for ratemaking … nor used by the commissioner to calculate or derive … premium levels." In other words, the law says that beyond holding adequate reserves, the Insurance Commissioner has no authority to tell private companies how to run their businesses.

Policy Analysis

The health insurance industry is based on assuming risks. No one can predict future health care catastrophes. The larger a company's reserves, the stronger the company is and the more likely it will be able to protect its clients in the face of a medical claim or disaster. Forcing insurance companies to be less financially stable will not bend the cost curve of health care down, but will put clients in jeopardy of personal financial harm.

Health insurance reserves are extremely fragile. Deterioration of the stock and bond markets could quickly lower a health insurance company's reserves by 15–20%. A natural disaster or mass emergency could lower its reserves by 20–25% in one day.

The very real uncertainty for reserves in the next few years is the impact of the new federal health care reform law, the Patient Protection and Affordable Care Act (PPACA). Health insurance premiums increased on average this past year by 9% nationally. This reflects the cost of adding young adults to existing policies and the anticipation of the cost of the individual mandate and community rating as the PPACA takes effect.

The new federal law will unquestionably increase taxes on insurance companies by billions of dollars, will force health insurance carriers to provide plans with more benefits, will set pricing of plans, will require more onerous medical-loss ratios (80% for individuals and small groups) and will cause an increase in enrollment without price flexibility. All of these requirements of PPACA taken together could lower a carrier's reserves by 30%.

Non-profit health insurance carriers do not have access to capital markets as for-profit companies do. Consequently, reserves are the only source of money these carriers have for paying claims and for paying business expenses that non-profits incur. Forcing carriers to reduce their reserves would weaken their financial standing.

The Insurance Commissioner's proposal to lower non-profit insurance carriers' reserves through state legislation would place all policy holders at risk for financial catastrophe.

Dr. Roger Stark is a retired surgeon and a health care policy analyst with Washington Policy Center, a non-partisan independent policy research organization in Washington state. Nothing here should be construed as an attempt to aid or hinder the passage of any legislation before any legislative body. For more information, visit washingtonpolicy.org.