

BRIEF

Companies losing out as insurers skirt rebates

[Published May 11, 2021](#)

[Robert Freedman](#)
Editor



Fotolia

Dive Brief:

- Policyholders aren't getting hundreds of millions of dollars in premium rebates each year because health insurers are overestimating claims costs to avoid paying refunds, [an academic study](#) published in the Accounting Review has found.
- The finding could impact companies whose benefits package includes paying all or a portion of their employees' health insurance premiums.
- "The more likely companies were to be forced to issue refunds to policyholders, the more likely those companies were to overestimate forthcoming costs – which would allow them to reduce or avoid paying the refunds," Andrew Van Buskirk,

co-author of the study and an associate professor of accounting at Ohio State University, said.

Dive Insight:

The Affordable Care Act includes a provision requiring insurers that don't spend at least 80% of the premiums they collect on medical claims to rebate the difference between the premiums and the claims to policyholders.

The provision is intended to give insurers an incentive to direct more of their expenditures to benefit policyholders and help lower insurance costs.

To meet the requirement, insurers calculate the percentage of premiums they spend on claims based on a rolling three-year average that mixes actual costs with estimates.

The estimates in the calculation give insurers flexibility in reporting their claim-expense ratio, opening the door to overestimations that enable insurers to keep more of the premiums, the researchers said.

“We estimate that about 14% of insurers engage in strategic overestimation, costing policyholders hundreds of millions of dollars in unpaid rebates,” said Evan Eastman, co-author of the study and an assistant professor of risk management and insurance at Florida State University.

The key variable is what's called the medical loss ratio (MLR), a measure of claims to premiums. The number should be more accurate in the first year of the three-year rolling average, since insurers can include a higher ratio of actual costs to estimates compared to years two and three.

As they replace estimated costs with actual costs, the three-year average should get more accurate over time, but that doesn't always happen.

Instead, the researchers found, insurers' estimates were consistently overstated in situations where more accurate estimates would have triggered higher rebate payments.

“If you create an incentive, companies are going to respond to that incentive,” David Eckles, co-author of the study and a professor of risk management and insurance at the University of Georgia, said. “In this case, that means overestimating costs to avoid paying rebates.”

Regulators could limit misaligned incentives by changing the rules to focus solely on paid costs each year, Eckles said, or by incorporating a clawback provision to account for previously overestimated costs.