# Transitional reinsurance at 100% coinsurance: What it means for 2014 and beyond

**Daniel J. Perlman**, ASA, MAAA
**Doug Norris**, PhD, FSA, MAAA
**Hans K. Leida**, PhD, FSA, MAAA

On June 17, the Centers for Medicare and Medicaid Services (CMS) announced that the 2014 transitional reinsurance program would have a coinsurance rate of 100%, rather than the originally stated 80%.[1] This announcement implements earlier guidance that the original 80% coinsurance would be adjusted up or down, as needed, to either increase payments if additional funds are available or to prorate payments downward if actual funds are inadequate.

This change has implications for the final 2014 financial results of issuers of individual and small group market plans that comply with the Patient Protection and Affordable Care Act (ACA), both directly, because of the additional funding, and indirectly, because of its impact on the risk corridor and minimum medical loss ratio (MLR) programs. What we do not yet know is the total dollars CMS now expects to pay under the new parameters and how much surplus might still remain to carry forward for 2015 payments under the program. Carriers can expect to learn these additional pieces of information at a later date, because we will be able to see reinsurance recoveries on each issuer's MLR filing for calendar year 2014 and can aggregate these results across the industry.

## Background on transitional reinsurance[2]

The transitional reinsurance program was established under Section 1341 of the ACA. It is to be effective for three years (2014 to 2016), and the law targeted collection of $12 billion for 2014, $8 billion for 2015, and $5 billion for 2016 (in addition to a small amount of administrative expenses associated with the program). A portion of the collections in each year were allocated to the Treasury, rather than to the reinsurance program. Almost all commercially insured individual, small group, and large group lives in the country, as well as self-funded plans, are assessed an annual fee to pay for this program. However, only claim costs from non-grandfathered, non-transitional individual market plans are eligible for reimbursement.

In earlier guidance, CMS announced that if collections for 2014 were to fall short of the targeted $12 billion, payments to the reinsurance recovery program would take priority over any contributions to the Treasury.[3] Based on contributions received to date and estimates of final payments due later this year, CMS estimates that $9.7 billion will be collected for the 2014 plan year;[4] this means that while the funds collected will be less than anticipated, for the most part the Treasury will absorb the deficiency and the reinsurance pool will be nearly as large as the expected $10 billion originally targeted to fund reinsurance recoveries. CMS has also stated that any surplus reinsurance collections would be rolled forward and made available to make reinsurance payments the next year.[5]

In early 2014, CMS lowered the 2014 attachment point from the originally proposed $60,000 to $45,000.[6] The same guidance also stated that the coinsurance rate that was initially set at 80% could go up as high as 100% if excess funds were available, or it could go down if too little was collected relative to valid reimbursement requests.[7] Last week's announcement implies that the requests for reimbursement, which were submitted in May, are low enough that the $9.7 billion in collections would enable payment at 100% coinsurance without exhausting these funds.

The table in Figure 1 summarizes information known (and unknown) as of now about the transitional reinsurance program for all three years.

1 CMS (June 17, 2015). Transitional Reinsurance Program: Pro Rata Adjustment to the National Coinsurance Rate for the 2014 Benefit Year. Retrieved June 20, 2015, from https://www.cms.gov/CCIIO/Programs-and-Initiatives/Premium-Stabilization-Programs/The-Transitional-Reinsurance-Program/Downloads/RI-Payments-National-Proration-Memo-With-Numbers-6-17-15.pdf.

2 More background information on the transitional reinsurance program can be found in the briefing paper "Update on Canceled Plans: Will Changes to 2014 Reinsurance and Risk Corridor Programs Provide Financial Relief?" here: http://us.milliman.com/uploadedFiles/insight/2014/update-canceled-plans.pdf.

3 79 FR 30258 (May 27, 2014). See http://www.gpo.gov/fdsys/pkg/FR-2014-05-27/pdf/2014-11657.pdf.

4 CMS (April 14, 2015). The Transitional Reinsurance Program's Contribution Collections for the 2015 Benefit Year. Retrieved June 20, 2015, from http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/Reinsurance-Contributions-Total-Amount-Collected-final-.pdf.

5 79 FR 13777 (March 11, 2014). See http://www.gpo.gov/fdsys/pkg/FR-2014-05-27/pdf/2014-11657.pdf.

6 79 FR 13779 (March 11, 2014). See http://www.gpo.gov/fdsys/pkg/FR-2014-03-11/pdf/2014-05052.pdf.

7 79 FR 13777 (March 11, 2014). See http://www.gpo.gov/fdsys/pkg/FR-2014-05-27/pdf/2014-11657.pdf.

FIGURE 1: SUMMARY OF TRANSITIONAL REINSURANCE PROGRAM (AS OF JUNE 18, 2015)

| PARAMETER | 2014 | 2015 | 2016 |
|---|---|---|---|
| Target reinsurance pool size | $10 billion | $6 billion | $4 billion |
| Target Treasury collection | $2 billion | $2 billion | $1 billion |
| Per capita fee on commercial market | $63 | $44 | $27 |
| Attachment point | $45,000 | $45,000 | $90,000 |
| Coinsurance: Proposed in Federal Register | 80% | 50% | 50% |
| Coinsurance: Final | 100% | ? | ? |
| Claim cap | $250,000 | $250,000 | $250,000 |
| Actual collections | $9.7 billion | ? | ? |
| Actual payouts | ? | ? | ? |
| Actual Treasury share | $0 | ? | ? |

## What this means: Closing the books on the 2014 plan year

For issuers of ACA-compliant plans in the individual market, the increased coinsurance has a fairly obvious direct positive impact on 2014 financial performance: more will be collected than many issuers likely assumed when preparing annual statements for 2014. Any issuer that had computed its transitional reinsurance recovery accruals at year-end 2014 based upon the originally announced coinsurance parameter will now receive an additional 25% (because 100% / 80% = 1.25) given the change in coinsurance. The impact of this change will vary significantly by insurer, but could be material in relation to overall individual ACA market claim costs for many insurers. It may not be uncommon to see reductions in net paid claims of 2% to 4% as a result of this change. Note that some issuers may have already assumed a coinsurance rate of greater than 80% when setting accruals for 2014.

Changes in the reinsurance recoveries will also have indirect effects on the risk corridor and MLR programs. In particular, transitional reinsurance recoveries are a direct input into the formula for computing risk corridor transfers. Any additional money collected through reinsurance can decrease the calculated receivable, or increase the calculated payable, under risk corridors. This in theory offsets some of the gain that plans will realize under the coinsurance increase, but it is far from a complete offset for several reasons:

- The risk corridor formula does not share all risk. For example, in a narrow window around the target amount, nothing is shared (so extra reinsurance receipts are a pure gain to carriers in this window). Even in the extreme, only 80% of gains and losses are shared, so some of the additional reinsurance recoveries will remain with the carrier even in this window.
- CMS has previously announced (and Congress has passed legislation to this effect) that the risk corridor program will be administered in a budget-neutral fashion. For a more detailed discussion of budget neutrality in risk corridors, please see the briefing paper "Risk Corridors Episode IV: No New Hope."[8] This implies that amounts receivable under risk corridors may not be collectible in full.[9] In other words, one dollar an issuer is owed of reinsurance is likely worth more than one dollar an issuer is owed of risk corridors, because the reinsurance money will be paid while the risk corridor money may not be paid. Additionally, because reinsurance receipts affect the risk corridors calculation, having more money available for reinsurance reduces the likelihood and magnitude of a risk corridor program shortfall, meaning that any remaining risk corridor receivables are more likely to be more collectible than if reinsurance were only paid at 80% coinsurance.

  Of course, the Department of Health and Human Services (HHS) has said repeatedly that it anticipates that risk corridors collections will be "sufficient to pay for all risk corridors payments", at least over the three year life of the program, and that the program is unlikely to fall short on payments to issuers.[10] If HHS is correct, then the budget-neutral nature of the program will not carry adverse financial consequences for issuers.
- The MLR rules only affect carriers with loss ratios below the federal minimum (80% in the individual market). As long as the additional reinsurance funds (potentially partly offset by risk corridors) do not push MLR below this threshold, there is no offset that is due to MLR rebates. And if the coinsurance change does cause MLR to dip below 80%, it is offset only to the extent needed to increase the MLR to 80%.

8 Norris, D., Perlman, D., & Leida, H.K. (December 2014). Risk Corridors Episode IV: No New Hope. Milliman Healthcare Reform Briefing Paper. Retrieved June 20, 2015, from http://www.milliman.com/uploadedFiles/insight/2014/risk-corridors-no-new-hope.pdf.

9 Earlier CMS guidance (https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/Downloads/faq-risk-corridors-04-11-2014.pdf, retrieved June 22, 2015) has stated that any risk corridor collections for 2015 will first be used to fund any shortfall from risk corridors in 2014 before being applied to 2015 risk corridor payments. If this process is used, then risk corridor receivables are more likely to be collectible for the 2014 plan year than for 2015 or 2016.

10 http://www.gpo.gov/fdsys/pkg/FR-2014-11-26/pdf/2014-27858.pdf.

## What this means: Implications for 2015

If, even after the increase in coinsurance, total payouts are less than the $9.7 billion in reinsurance assessments collected, there will be additional funds to roll forward into 2015. These additional funds could help create the same (or similar) outcome for the 2015 plan year by increasing the size of the reinsurance pool by any amount carried forward from 2014. (This could conceivably happen for the 2016 plan year as well, for similar reasons.)

Is there a surplus available to carry forward to 2015, and if so, how big is it? We don't know for sure based on any information provided by CMS. While this information was not included in last week's CMS announcement, it's likely it will become known at a later date because carriers must report their reinsurance payments in their annual MLR forms. Some clues can be found in 2014 annual statement data. Across the industry, we only found approximately $5.9 billion of reinsurance receivables disclosed on annual statements for 2014. There is, of course, potential for some differences between these amounts and what was actually submitted to EDGE servers last month. We also don't have knowledge of the assumptions carriers used to develop their annual statement estimates and are not in a position to audit the reported values for accuracy. Also, we cannot rule out the existence of late filers who may distort the totals. However, even if we were to increase the total filed amount somewhat to account for potentially underreported recoverable amounts, increasing it by a further 25% (to go from an 80% coinsurance to 100% coinsurance) may still leave somewhere between $1 billion and $2 billion unspent.

Even if this calculation is accurate–and there is admittedly a fair bit of uncertainty–that still leaves unanswered what will happen to the 2015 reinsurance parameters. Initially, CMS announced an attachment point of $70,000 for 2015 (with coinsurance at 50% and a cap at $250,000).[11] Later in 2014, CMS announced the intent to lower the attachment point to $45,000,[12] which it finalized in early 2015.[13] Did this lower attachment point already reflect CMS's emerging expectations of the ability to roll over funds from 2014 to 2015? Unfortunately, we do not know this, and even if we did, only time will tell how accurate those expectations are. Additionally, the preliminary 2015 coinsurance rate is 50% (not 80%). It would take a large surplus in 2015 to enable the raising of that year's coinsurance to 100% (as it would mean doubling payouts rather than merely increasing them by 25%).

If there is a surplus from 2014 (which there may well be, based on available data), the bottom line is that there would be more money available to make reinsurance payments for the 2015 plan year. This is good news for issuers of ACA-compliant individual market plans. However, issuers should be cautious about relying on further enrichment in the 2015 program parameters, as (among other concerns) it is possible that the current parameters have already assumed some amount of carryover.

## Other considerations

As described throughout this report, the provisions of the transitional reinsurance program have changed many times, and there is uncertainty as to how they may change in the future. This report represents our best understanding as of the date of this publication; to the extent rules change in the future, the conclusions in this report may no longer hold.

Guidelines issued by the American Academy of Actuaries require actuaries to include their professional qualifications in actuarial communications. The authors of this report are members of the American Academy of Actuaries and meet its qualification standard to perform the analysis and render the actuarial opinion contained herein. The authors of this report are not lawyers, and nothing in this report should be construed as legal advice.

**Daniel J. Perlman**, ASA, MAAA, is an associate actuary with the Denver office of Milliman. Contact him at daniel.perlman@milliman.com.

**Doug Norris**, PhD, FSA, MAAA, is a principal and consulting actuary with the Denver office of Milliman.
Contact him at doug.norris@milliman.com.

**Hans K. Leida**, PhD, FSA, MAAA, is a principal and consulting actuary with the Minneapolis office of Milliman.
Contact him at hans.leida@milliman.com.

11 79 FR 13745 (March 11, 2014). See http://www.gpo.gov/fdsys/pkg/FR-2014-05-27/pdf/2014-11657.pdf.

12 79 FR 30259 (May 27, 2014). See http://www.gpo.gov/fdsys/pkg/FR-2014-05-27/pdf/2014-11657.pdf.

13 80 FR 10752 (February 27, 2015). See http://www.gpo.gov/fdsys/pkg/FR-2015-02-27/pdf/2015-03751.pdf.

The materials in this document represent the opinion of the authors and are not representative of the views of Milliman, Inc. Milliman does not certify the information, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

Copyright © 2015 Milliman, Inc. All Rights Reserved.

**FOR MORE ON MILLIMAN'S HEALTHCARE REFORM PERSPECTIVE**

Visit our reform library at www.milliman.com/hcr
Visit our blog at www.healthcaretownhall.com
Or follow us on Twitter at www.twitter.com/millimanhealth