Update on canceled plans: Will changes to 2014 reinsurance and risk corridor programs provide financial relief?

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For insurers, the most tantalizing piece of the president's November 14 announcement that certain canceled health insurance policies could be reinstated was a note at the very end of the administration's official letter[1] on the subject. The note suggested that the administration might change one of the key premium stabilization programs—the risk corridor program—in order to "provide additional assistance" to health insurance issuers who might otherwise face losses because of the change in rules.[2]

The letter did not specify exactly what changes might be coming, which made it hard for insurers to judge how much relief they might provide. However, with the release of further proposed rules in late November and early December, more specifics have finally come to light (although, as usual, many questions remain).

Besides potentially major modifications to the risk corridor program, the administration is also proposing significant changes for 2014 to the federal reinsurance program (the second of the "three Rs" premium stabilization mechanisms, with risk adjustment as the third). This added change, if implemented, has the potential to materially improve financial results for insurers in the individual insurance market. Finally, the administration announced that insurance issuers will be given an extra month to set their 2015 premium rates.

All of these changes are clearly designed to stabilize the fledgling reformed markets on and off the exchanges—and in particular to reduce the chances that insurers might exit the exchange markets or increase premium rates dramatically in 2015.

NEW SOURCES OF GUIDANCE

The first piece of new guidance, released on November 21, was pedestrian—it simply provided required language for the notices that insurers are required to send to affected policyholders in order to reissue canceled policies.[3] On December 2, however, the federal government released the proposed 2015 Notice of Benefit and Payment Parameters, a highly anticipated piece of regulation.[4] Besides setting rules for 2015 products, the notice also proposes a number of material changes to parameters that had already been set for 2014. Several of these changes were directly linked to the transitional policy in the regulation, and others may be indirectly related. Of course, because this is a "proposed" rule, final guidance may be significantly different (indeed, the proposed rule requests comments and suggestions on almost every provision discussed in this paper). The comment period for the proposed rule closed on December 26, 2013.

RELATED READING

Risk corridors under the ACA: **http://tinyurl.com/oa73cb9**.
President Obama's transitional policy for canceled plans: **http://tinyurl.com/ksjahug**.

1 Centers for Medicare and Medicaid Services (November 14, 2013). Letter to state insurance commissioners. Retrieved from http://www.cms.gov/CCIIO/Resources/Letters/Downloads/commissioner-letter-11-14-2013.PDF.
2 For a detailed discussion of the original announcement, see Leida, H. (November 19, 2013). President Obama's transitional policy for canceled plans. Milliman Insight. Retrieved from http://us.milliman.com/insight/2013/President-Obamas-transitional-policy-for-canceled-plans/.
3 Required notices: http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/standard-notice-bulletin-11-21-2013.pdf.
FAQ on required notices: http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/standard-notices-faq-11-21-2013.pdf.
4 *Federal Register* (December 2, 2013). Retrieved from http://www.gpo.gov/fdsys/pkg/FR-2013-12-02/pdf/2013-28610.pdf.

FEDERAL REINSURANCE CHANGES FOR 2014

The proposed rule would make two changes to the 2014 federal reinsurance program. This program reimburses insurance issuers for a portion of claim costs for high-cost claimants in the non-grandfathered individual market. It is funded by assessments on all major medical insurance (group and individual) that are intended to amount to $12 billion in 2014, $10 billion of which would be used to fund payments to insurers.

However, it appears that (absent further regulatory changes) exempted policies under the president's transitional policy would not qualify for reinsurance receipts. To the extent that fewer policies are eligible for payments, there is an increased likelihood that the funds collected for 2014 will not all be paid out.

The proposed rule would address this in two ways. First, it proposes to lower the attachment point of the reinsurance program from $60,000 to $45,000, while leaving the coinsurance rate at 80% and the cap at $250,000. This will increase the payments under the program. In particular, the maximum possible payment made for an individual will increase from $152,000 (= 80% × [$250,000 - $60,000]) to $164,000 (= 80% × [$250,000 - $45,000]).

It is difficult to estimate the impact this change might have, given the significant uncertainty in the number and health status of insureds that will be eligible for reinsurance recoveries. However, it is possible to get a sense of the potential magnitude of this change using a simplified model based on the Milliman Health Cost Guidelines™. Based on this model, for an average population in a silver plan, if the reinsurance recoveries were worth a 10% reduction in premium under the old rules, they might be worth a 13% reduction under the new rules.[5] The impact for any particular plan or market will vary, possibly significantly, from this estimate, but it is clear that this is a major increase in the payment rate per individual (although overall payments are still capped at the total collections of approximately $10 billion).

The second change proposed for this program involves what happens if funds are left over. Under prior rules, the funds could be carried over to future years (at least through 2018). The proposed rule would instead make a pro rata increase to payments in order to use up any excess funds, potentially even if this meant that the effective "coinsurance" became greater than 100% (comments are sought on whether this should be allowed). Essentially, this serves to increase funding of the individual market in 2014, perhaps in order to offset some of the potential losses that may be caused by the transitional policy keeping healthier members out of the reformed risk pool for an extra year.

RISK CORRIDORS

The letter introducing the transitional policy suggested that changes to the risk corridor program might be used to protect issuers from some of the potential losses the policy might cause. The proposed rule provides more detail on how this might work, although it still does not say exactly how much relief the administration intends to provide—or how much that might end up costing the federal government.

The risk corridor program seems simple: Insurers share a portion of profits and losses on qualified health plans (both individual and small group) with the federal government.

However, in practice, the program is actually quite complex.[6] In particular, the "profits" and "losses" that get shared may not translate directly into the true bottom line profits or losses for insurers. The changes proposed in the new rule are:

- The profit floor of 3% of after-tax premiums and the ceiling of 20% of after-tax premiums for allowable administrative costs may both be increased.
- The government is considering developing the adjustments to the profit margin floor and administrative cost cap parameters using a "model plan" with:
  - Allowable costs equal to 80% of premium
  - Federal income tax of 35% of pretax profits
  - Other tax liabilities of 7.5% of premium
  - Other administrative costs of 8% of premiums
- The government is considering assuming that allowable costs for exempted policies under the transitional policy are 80% of what the full risk pool's costs would have been.
- It is considering making state-specific adjustments to the parameters, based upon the percentage enrollment in transitional plans in each state.
- To support this, it proposes requiring all issuers to submit enrollment data on transitional and non-transitional plans in 2015.
- This change would only apply to plans with allowable costs greater than 80% of after-tax premiums. (This is because plans with allowable costs less than the 80% threshold will likely have to pay rebates under the minimum medical loss ratio [MLR] requirement, so any increase in risk corridor payments to such a plan would just have to be paid out as a rebate to policyholders.)
- The government is also considering modifications to the MLR program to prevent this additional relief from being paid out to policyholders as rebates.

5 Among other simplifying assumptions, this estimate assumes that all members in the silver plan become eligible for reinsurance recoveries on January 1, 2014—in other words, that there are no late entrants into the plan. In reality, some members will enter partway through the year, which will lower the probability of triggering a reinsurance payment. This analysis also does not include any assessment of whether reinsurance funds collected will be sufficient to fund the new parameters fully (or, on the other hand, whether there might be funds left over that would be used to further increase payments).

6 For a primer and examples, see Norris, D., Leida, K. & van der Heijde, M. (October 2013). Risk corridors under the ACA. *Health Watch*. Retrieved from http://us.milliman.com/insight/2013/Risk-corridors-under-the-ACA/.

FIGURE 1: EXAMPLE MODEL PLAN (PRIOR TO TRANSITIONAL POLICY)

Premium Charged	[A]	$400	
Allowable Costs	[B] = 0.8*[A]	$320	80% of premium
Other Tax Liabilities	[C] = 0.075*[A]	$30	7.5% of premium
Administrative Costs	[D] = 0.08*[A]	$32	8% of premium
Pretax Profits	[E] = [A]-[B]-[C]-[D]	$18	
Federal Income Tax	[F] = 0.35*[E]	$6.30	35% of pretax profit
Profit Margin (pre-risk corridors)	[G] = ([E]-[F])/[A]	2.93%	
After-Tax Premiums Earned	[H] = [A]-[C]-[F]	$363.70	
Calculated Profits	[I] = MAX(0.03*[H],[A]-[B]-[C]-[D]-[F])	$11.70	
Allowable Administrative Costs	[J] = MIN([D]+[I],0.2*[H])+[C]+[F]	$80	
Target Amount	[K] = [A]-[J]	$320	
Risk Corridors Ratio	[L] = [B]/[K]	100%	
RC Receipt (payment)	[M]	$0	
Profit Margin (post-risk corridors)	[N] = ([A]-[B]-[C]-[D]-[F]+[M])/[A]	2.93%	

All dollar values are PMPM

In order to understand these proposed changes, it helps to work through some examples. First, let's take a look at how the state-specific adjustments to the profit floor and the allowable administrative costs ceiling might work in a hypothetical individual market. Consider a "model plan" with charged premium of $400 per member per month (PMPM), and costs and taxes following the percentages above, as shown in the table in Figure 1.

Suppose that, statewide, 20% of non-grandfathered individuals are in transitional plans. The government is considering assuming that allowable costs for these transitional plans are 80% of the full risk pool (or $320 PMPM in our example). Therefore, we would assume that the transitional plans' allowable costs are $256 PMPM. To make the full risk pool still balance to the overall market's allowable costs of $320 PMPM, the non-transitional plans' allowable costs would then need to be $336 PMPM (because $320 = 80% × $336 + 20% × $256).

As you can see in the table in Figure 2, the transitional policy has reduced our model plan's profit margin from 2.93% of premium to 0.32% of premium. What percentage point value can be added to the profit floor and the allowable administrative costs ceiling so that our model plan is made whole? In this case, by raising the floor on profits from 3% of premium to 7.94% of premium, the risk corridor program ameliorates the transitional policy for the model plan. (Note that the new calculated allowable administrative costs in this example are only 23% of premium, which does not hit the new ceiling of 24.94%).

These illustrative examples are simplified. In particular, they assume that all of the insurer's plans are qualified health plans subject to risk corridors. In reality, for insurance issuers that also have off-exchange plans that aren't subject to risk corridors, the picture is more complex. Essentially, under the rules, the issuer must pool claim costs and administrative expenses across qualified health plans (QHPs) and non-QHPs, but the risk corridor payments or receipts are based on the pro rata share of premiums in the QHPs (so the settlement is reduced and only provides a fraction of the risk sharing that would occur if all members were in QHPs).

FIGURE 2: EXAMPLE MODEL PLAN (AFTER TRANSITIONAL POLICY)

Premium Charged	[A]	$400	
Allowable Costs	[B]	$336	(under assumption above)
Other Tax Liabilities	[C] = 0.075*[A]	$30	7.5% of premium
Administrative Costs	[D] = 0.08*[A]	$32	8% of premium
Pretax Profits	[E] = [A]-[B]-[C]-[D]	$2	
Federal Income Tax	[F] = 0.35*[E]	$0.70	35% of pretax profit
Profit Margin (pre-risk corridors)	[G] = ([E]-[F])/[A]	0.32%	
After-tax Premiums Earned	[H] = [A]-[C]-[F]	$369.30	
Calculated Profits	[I] = MAX(0.0794*[H],[A]-[B]-[C]-[D]-[F])	$29.31	using floor of 7.94%
Allowable Administrative Costs	[J] = MIN([D]+[I],0.2494*[H])+[C]+[F]	$92.01	using cap of 24.94%
Target Amount	[K] = [A]-[J]	$307.99	
Risk Corridors Ratio	[L] = [B]/[K]	109.1%	
RC Receipt (payment)	[M]	$10.40	
Profit Margin (post-risk corridors)	[N] = ([A]-[B]-[C]-[D]-[F]+[M])/[A]	2.93%	

All dollar values are PMPM

FIGURE 3: POOLING EXAMPLE: OFFSET QHP LOSS WITH NON-QHP PROFIT, RC RECEIPT SMALLER, PROFIT FLOORS HIT

		QHP		NON-QHP		ADJUSTED QHP	
Premium Charged	[A]	80%	$1,000,000	20%	$250,000	80%	$1,000,000
Allowable Costs	[B]	85%	$850,000	70%	$175,000	82%	$820,000
Taxes	[C]	4%	$40,000	4%	$10,000	4%	$40,000
Administrative Costs	[D]	15%	$150,000	15%	$37,500	15%	$150,000
Raw Profits	[E]=[A]-[B]-[C]-[D]	-4%	-$40,000	11%	$27,500	-1%	-$10,000
Total Non-claims Cost	[F]=[C]+[D]	$190,000				$190,000	
After-tax Premiums Earned	[G]=[A]-[C]	$960,000				$960,000	
Profits (floored if necessary)	[H]=MAX((3%)*[G],[A]-([B]+[F]))	$28,800		$27,500		$28,800	
Allowable Administrative Costs	[I]=MIN([D]+[H],(20%)*[G])+[C]	$218,800				$218,800	
Target Amount	[J]=[A]-[I]	$781,200				$781,200	
Risk Corridors Ratio	[K]=[B]/[J]	108.81%				104.97%	
RC Receipt (payment)		**$24,573**				**$7,682**	
Profits Floored?		YES				YES	
Allowable Administrative Costs Capped?		NO				NO	

The tables in Figures 3 and 4 illustrate how this pooling can change the risk corridor results—and can even eliminate a risk corridor receipt that would have occurred in the absence of pooling. It is unclear whether transitional policies will be included in this pooling or not. If they are, their lower costs may be blended into the risk corridor formula, which could result in lower risk corridor receipts from the government (or higher payments to the government). Of course, it is also possible for non-QHP experience to have the opposite effect if it is less profitable than QHP experience. These examples do not reflect any changes to the profit floor or administrative cap (in other words, they assume that there are no transitional plans in this market).

In Figure 3 above, we see a hypothetical issuer that would have received a risk corridor payment of just under $25,000 on its QHP business, helping to offset a loss of $40,000. However, this issuer also has profitable non-QHP business. After blending, the risk corridor payment on the QHP business is reduced to less than $8,000.

In Figure 4 on page 5, the issuer has a slightly smaller loss on its QHP business than in Figure 3, while the non-QHP business is even more profitable. In this example, the entire risk corridor payment that the issuer would have received on the QHP business is offset by the positive financial results on the non-QHPs.

These examples also assume that the majority of a carrier's business is in QHPs. In fact, the opposite may be true for many carriers. In that case, the financial results of the non-QHPs may actually be the primary driver in the risk corridor calculation.

FIGURE 4: POOLING EXAMPLE: LOSING RC PAYMENTS ALTOGETHER FROM IMPACT ON NON-QHP PLAN, PROFIT FLOORED IN EACH CASE

		QHP		NON-QHP		ADJUSTED QHP	
Premium Charged	[A]	80%	$1,000,000	20%	$250,000	80%	$1,000,000
Allowable Costs	[B]	84%	$840,000	65%	$162,500	80%	$802,000
Taxes	[C]	4%	$40,000	4%	$10,000	4%	$40,000
Administrative Costs	[D]	15%	$150,000	15%	$37,500	15%	$150,000
Raw Profits	[E]=[A]-[B]-[C]-[D]	-3%	-$30,000	16%	$40,000	1%	$8,000
Total Non-Claims Cost	[F]=[C]+[D]	$190,000				$190,000	
After-tax Premiums Earned	[G]=[A]-[C]	$960,000				$960,000	
Profits (floored if necessary)	[H]=MAX((3%)*[G],[A]-([B]+[F]))	$28,800	$40,000	$28,800		$28,800	
Allowable Administrative Costs	[I]=MIN([D]+[H],(20%)*[G])+[C]	$218,800				$218,800	
Target Amount	[J]=[A]-[I]	$781,200				$781,200	
Risk Corridors Ratio	[K]=[B]/[J]	107.53%				102.66%	
RC Receipt (payment)		$17,682				$0	
Profits Floored?		YES				YES	
Allowable Administrative Costs Capped?		NO				NO	

CATASTROPHIC PLANS AND EXEMPTIONS FROM THE INDIVIDUAL MANDATE

On December 19, 2013, the government also announced[7] that consumers in the individual market who were notified that their policies would not be renewed will be eligible for a hardship exemption from the individual mandate.

To claim the exemption, consumers must fill out a form and submit documentation of their policy cancellation. Consumers in canceled plans and "who consider other available policies unaffordable" are also given the option to enroll in a catastrophic plan if one is available in their area. Unlike the November 14 changes, it appears that this change was not intended to be optional, as no mention is made of state regulatory authority.

"Catastrophic" plans are high-deductible plans with a cost-sharing design set by regulation;[8] they provide coverage that is slightly less comprehensive than bronze plans. Until this change, catastrophic plans could only be purchased by individuals under age 30 or individuals for whom other coverage was unaffordable. In the federal risk adjustment program, catastrophic-plan members are in their own risk pool (separate from the metallic tier plans).

From a health plan's perspective, this change raises several concerns.

- As these individuals have had individual coverage, one would expect many of them to value health insurance, and choose to purchase some level of coverage for 2014.
- Just as with policies exempted from 2014 requirements under the November transitional guidance, consumers who choose to either forgo coverage or sign up for a catastrophic plan are likely to be relatively healthy. Therefore, this change is also likely to increase claim cost levels in the non-transitional individual market risk pools relative to what was assumed when plans were priced.
- Because the hardship exemption paperwork is a hassle to fill out, many individuals shopping for a low-cost alternative could instead elect bronze-level coverage.
- It is not clear how or whether this additional anti-selection might be taken into account in the modifications to the risk corridor program discussed above. In effect, this guidance allows consumers whose issuers either were not allowed to renew canceled plans, or chose not to, the option of substituting a catastrophic plan for their canceled plan. These new catastrophic plan enrollees would not be counted as transitional policies under the current proposed rules, and neither would individuals who choose to forgo coverage altogether under the new exemption.

7 Centers for Medicare and Medicaid Services, Center for Consumer Information and Insurance Oversight (December 19, 2013). Options Available for Consumers with Cancelled Policies. Retrieved from http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/cancellation-consumer-options-12-19-2013.pdf.

8 45 C.F.R. §156.155. Retrieved from http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=1&SID=8016074054d10ed258e5be63cd4abd67&ty=HTML&h=L&n=45y1.0.1.2.71&r=PART#45:1.0.1.2.71.2.27.12.

ENROLLMENT: THERE IS NO SUBSTITUTE

The uncertainty surrounding the individual and small group health insurance markets in 2014 was extraordinarily high even before the transitional policy for canceled plans or the recent challenges with exchange web sites. The "three Rs" premium stabilization mechanisms as originally proposed had the potential to provide meaningful protection to issuers in some situations, but they certainly do not completely protect an insurer in all cases.

At the moment, the proposed changes to the reinsurance program appear to provide material relief to insurers in the individual market in 2014. The changes to the risk corridor program could provide relief, but a lot will depend on how exactly the administration changes the parameters in the formula—and indeed, whether the other changes in the proposed rule survive in the final version.

As insurers set their rates for 2015 in the spring of 2014, they will certainly be taking these changes into account. However, as Dr. Mario Molina, CEO of Molina Healthcare, said, "The best thing we can do to mitigate risk is getting…as many people enrolled as possible. There is no substitute."[9]

In the individual market in particular, the ultimate success of the new reformed risk pools will depend in large part on whether a sufficient number of young and healthy people sign up. The administration's one-month delay of the due date for 2015 premium rate filings aims to maximize the chances that insurers will see as many enrollees as possible before rates are due.

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9 Cheney, K. & Haberkorn, J. (November 19, 2013). President Obama to insurers: No bailout. Politico. Retrieved from http://www.politico.com/story/2013/11/health-care-insurers-meeting-barack-obama-100028.html.

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