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AMERICAN ACADEMY *of* ACTUARIES

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April 21, 2014

Centers for Medicare & Medicaid Services  
U.S. Department of Health and Human Services  
Attention: CMS-9949-P  
P.O. Box 8016  
Baltimore, MD 21244-8016

Re: Exchange and Insurance Market Standards for 2015 and Beyond – Proposed Rule

To Whom It May Concern,

On behalf of the American Academy of Actuaries<sup>1</sup> Risk Sharing Work Group, I appreciate the opportunity to submit comments on the proposed rule Patient Protection and Affordable Care Act: Exchange and Insurance Market Standards for 2015 and Beyond [CMS-99490P], addressing certain requirements related to the health insurance exchanges and market reforms for 2015. Specifically, our comments pertain to the Affordable Care Act (ACA) risk-sharing mechanisms.

**Risk Adjustment and Reinsurance Program Sequestration**

The executive summary of the proposed rule indicates that although risk adjustment and reinsurance payments are subject to sequestration for FY2015 and will be reduced by 7.3 percent, the sequestered funds will be paid to issuers after the beginning of the next fiscal year. Providing full risk adjustment and reinsurance payments to issuers will reduce uncertainty surrounding the program. Risk adjustment payments to issuers are expected to be made in August 2015. Under sequestration, 92.7 percent of those payments will be made on schedule, with the remaining 7.3 percent of payments delayed a few months. It is expected that a relatively short delay in payments would not pose major problems for issuers.

The risk adjustment and reinsurance programs were included in the ACA to more adequately compensate issuers for the risks that they bear, especially when they enroll high-cost individuals. Such programs reduce the incentives for issuers to avoid enrolling high-cost individuals. If full risk adjustment payments were not to be made to issuers enrolling a disproportionate share of high-cost enrollees, issuers may have an incentive to adjust their plan offerings to avoid high-cost enrollees. For example, they could reduce the availability of platinum plans. These plans, because of their low cost-sharing requirements, would be expected to attract a higher-cost

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<sup>1</sup> The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualifications, practice, and professionalism standards for actuaries in the United States.

enrollee population. To participate in the health insurance marketplaces, issuers must offer plans in the silver and gold tiers, but are not required to offer platinum level plans.

The reinsurance program is funded by an assessment on issuers and group health plans. The risk adjustment program is funded by risk adjustment charges on issuers in the individual and small group markets with members having better than average health status. Neither program uses federal funds to provide for payments.

### **Risk Corridor Budget Neutrality**

The proposed rule states, “We intend to implement this program in a budget neutral manner, and may make future adjustments to program parameters, upwards or downwards, as necessary to achieve this goal.” On April 11, CClIO released an FAQ, *Risk Corridors and Budget Neutrality*, providing further guidance regarding how risk corridor payments will be affected if risk corridor payments differ from collections. The FAQ notes that “if risk corridors collections are insufficient to make risk corridors payments for a year, all risk corridors payments for that year will be reduced pro rata to the extent of any shortfall. Risk corridors collections received for the next year will first be used to pay off the payment reductions issuers experienced in the previous year in a proportional manner, up to the point where issuers are reimbursed in full for the previous year, and will then be used to fund current year payments. If, after obligations for the previous year have been met, the total amount of collections available in the current year is insufficient to make payments in that year, the current year payments will be reduced pro rata to the extent of any shortfall. If any risk corridors funds remain after prior and current year payment obligations have been met, they will be held to offset potential insufficiencies in risk corridors collections in the next year.”<sup>2</sup>

Although the parameters of the risk corridor design are symmetrical, the design does not guarantee budget neutrality. The risk corridor program was established by ACA Section 1342 and the law directed that it be based on the Medicare Part D risk corridor program. The Part D risk corridor program is not budget neutral and has resulted in net payments to the Centers for Medicare and Medicaid Services (CMS). Similarly, the design of the ACA risk corridor program does not guarantee budget neutrality. The Congressional Budget Office (CBO) recently projected that the ACA risk corridor program as currently structured will result in a net payment to CMS.<sup>3</sup> If indeed the risk corridor parameters as currently structured would result in a net payment to the Department of Health and Human Services, any risk corridor payments to issuers would be able to be made as scheduled. A greater concern, however, is that, according to the FAQ, risk corridor payments to issuers would be reduced if the risk corridor formula would result in net payments to issuers.

Issuers will make decisions on whether to offer qualified health plans (QHP) on the health insurance marketplaces based on the rules and programs in place at the time of QHP application. The presence of the risk corridor program creates an incentive for issuers to participate in the

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<sup>2</sup> <http://www.cms.gov/CClIO/Resources/Fact-Sheets-and-FAQs/Downloads/faq-risk-corridors-04-11-2014.pdf>

<sup>3</sup> Congressional Budget Office, The Budget and Economic Outlook: 2014-2024 (February 2014). Available at [http://.cbo.gov/sites/default/files/cbofiles/attachments/45010-Outlook2014\\_Feb.pdf](http://.cbo.gov/sites/default/files/cbofiles/attachments/45010-Outlook2014_Feb.pdf).

marketplaces because it reduces the risk associated with pricing uncertainty. This could be particularly important for smaller and new issuers that may not be able to fully absorb the risk of mispricing in the new market. By encouraging issuer participation, the risk corridor program promotes competition in the marketplaces and more choice for consumers.

Issuers that participated on the marketplaces in 2014 likely considered the presence of the risk corridor in their decisions to participate. The 2014 Notice of Benefit and Payment Parameters preamble stated, “The risk corridors program is not statutorily required to be budget neutral. Regardless of the balance of payments and receipts, HHS will remit payments as required under section 1342 of the Affordable Care Act.”<sup>4</sup> The new budget neutrality policy as described in the FAQ would change the basic nature of the risk corridor program retroactively and will factor into issuers’ decisions to offer QHPs for 2015 and 2016.

The Risk Sharing Work Group would like to raise the following additional issues and questions on budget neutrality in the risk corridor program.

1. According to the FAQ, risk corridor payments to plans would be reduced if risk corridor collections are insufficient to cover risk corridor payments. This changes the nature of the risk corridor program from one that shares risk between issuers and CMS to one that shares risk between competing issuers. In effect, issuers that overpriced would subsidize issuers that underpriced. It does not appear that contributing issuers would be required to increase their contributions so that full payments could be made to issuers receiving risk corridor payments. Doing so would further change the market dynamics, especially if issuers that priced more accurately were required to make contributions to subsidize competitors that underpriced and as a result gained market share.
2. For Medicare Part D, CMS has been a net receiver of risk corridor payments and the CBO recently projected that CMS would be a net receiver under the ACA risk corridor program. The FAQ suggests that even if issuers overprice overall and CMS collects more than is paid out, payments to issuers receiving payments would not increase and CMS would not distribute risk corridor charges back to the issuers. More clarification on this issue is needed. In addition, if risk corridor charges are returned in part to contributing issuers, more information is needed regarding how this would affect the medical loss ratio (MLR) calculation.
3. If payments exceed charges for 2014 and payments are decreased to equal charges to achieve budget neutrality, then the risk corridor program will not fully achieve its goal of mitigating risk due to mispricing and may put some issuers at risk of solvency problems. Structuring the program to use future excess charges to reimburse issuers with payment cuts alleviates some concerns, but the uncertainty of the receipt and the timing of payment may be a concern for issuers and there is still the possibility that not all the risk corridor payments would be made.

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<sup>4</sup> <http://www.gpo.gov/fdsys/pkg/FR-2013-03-11/pdf/2013-04902.pdf>

4. Any reductions in risk corridor payments to issuers to achieve budget neutrality would cause a disconnect between the risk corridor program and the MLR rebate calculations. According to the FAQ, issuers will need to incorporate formula-derived risk corridor payments from CMS, assuming full payments, in their MLR calculations. However, the risk corridor payments might be delayed, reduced, or eliminated, leaving the issuers facing the financial costs of cash-flow timing and possibly paying rebates on revenue they may never receive.
5. Premium rates may be set more conservatively under the new structure of the risk corridor program. The funds might not be available to compensate issuers with losses, so issuers may build in additional risk margin.
6. The change in the risk corridor program may impact issuer participation in 2015 and 2016, especially for issuers not previously selling in the marketplaces. The FAQ states that any 2014 shortfall will be reimbursed from 2015 collections before 2015 payments are made. While it seems reasonable to prioritize 2014 payments given that these issuers participated assuming a non-budget neutral risk corridor, this prioritization further weakens the 2015 and 2016 protections. Although issuers will gain more experience data over time, reducing pricing uncertainty and the need for risk corridors, just as in 2014, only limited health spending data will be available when insurers set their 2015 premiums.
7. The FAQ states that CMS “will establish in future guidance or rulemaking how we will calculate risk corridors payments if risk corridors collections (plus any excess collections held over from previous years) do not match risk corridors payments as calculated under the risk corridors formula for the final year of the program.” Since the presence of the risk corridor program is a consideration for participation and pricing, this guidance should be finalized before the QHP filing deadline for the 2016 benefit year.

### **Risk Corridor Formula Adjustments**

The proposed rule would change the 2015 risk corridor formula by raising the ceiling on allowable administrative costs by 2 percentage points from 20 percent to 22 percent, and raising the profit margin floor by 2 percentage points from 3 percent to 5 percent. These changes aim to mitigate additional administrative costs and uncertainty regarding the enrollee risk profile due to the extensions of plans that are not ACA-compliant, as well as other costs associated with transitioning to the 2014 ACA rules. The changes would apply nationwide.

The proposed nationwide approach is reasonable because it is administratively simple, there are increased administrative costs incurred by all issuers due to changing ACA-related infrastructure requirements, and because of continued uncertainty in pricing assumptions when setting 2015 rating factors. As the proposed rule outlines, these increased costs include those associated with renewal extensions, risk profile monitoring, the protracted phase-outs of high-risk pools, measuring projected reinsurance payments, and implementing the collection methodology for risk adjustment and reinsurance. Many of these additional costs will be incurred regardless of whether a particular state adopted the transitional policy.

Larger issuers may be able to absorb the additional administrative costs with less than a 2 percent increase in administrative costs. However, smaller issuers, co-ops, and new issuers established to compete in the marketplace will generally incur 2 percent or more in increased administrative costs, as they are less likely to have a large enough enrollment over which to spread the increased expenses.

The preamble of the proposed rule indicates that the further adjustments to the risk corridors formula would help to mitigate these additional administrative costs and uncertainties around operations and the risk pool, and would help to stabilize the market as it continues to transition to full compliance with ACA provisions. The additional protection provided by the adjustments should encourage participation in the marketplaces which would contribute to stability.

The 2 percentage point increase in the profit floor and the 2 percentage point increase in the allowable administrative cost ceiling is a reasonable approach to address the expected additional costs and uncertainty resulting in part from the transitional policy changes, and to encourage stability in the markets. If only the ceiling on administrative cost is increased, the risk corridor will not provide additional protection for efficient issuers that have adverse claim experience and will not provide additional encouragement for these issuers to participate in the marketplaces. Similarly, if only the profit margin floor is changed, it will not reflect the additional costs incurred for smaller start up issuers that have relatively higher administrative costs.

### **Revision to the Allocation of Reinsurance Contributions Collected**

Under the proposed rule, reinsurance contributions collected will first be allocated to the reinsurance pool and administrative expenses, and second to the U.S. Treasury.

The transitional reinsurance program supplements the ACA risk-adjustment program and compensates plans when they have enrollees with especially high claims. The program further reduces the incentives for plans to avoid high-cost individuals and helps to stabilize premiums during the initial years. The presence of the reinsurance program, as with the risk adjustment and risk corridor programs, helps encourage insurers to participate in the market. In addition, the reinsurance program will affect premiums—by offsetting a portion of the costs of high-cost enrollees in the individual market, issuers can offer lower premiums.

When determining premiums for 2014, insurers made assumptions regarding the extent to which reinsurance payments would offset enrollee claims, and therefore would reduce premiums. These assumptions reflected a total reinsurance pool of \$10 billion, as specified in the ACA. Reducing the amount of reinsurance contributions allocated to the reinsurance pool could result in reinsurance payments lower than insurers expected when determining premiums. Any uncertainty regarding whether the scheduled 2015 reinsurance pool of \$6 billion will be fully funded will affect assumptions used when insurers determine the 2015 premiums. This is particularly relevant as there is already uncertainty regarding the number of total covered enrollees and their relative morbidity costs. Therefore, further uncertainty regarding the magnitude of the reinsurance funding level could put upward pressure on premiums.

By prioritizing that the reinsurance contributions will be used first for reinsurance payments, the proposed rule would provide more certainty that the reinsurance payments will be fully funded and may result in insurers more fully offsetting premiums by anticipated reinsurance payments.

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We appreciate the opportunity to provide these comments and would welcome the opportunity to discuss them with you in more detail. If you have any questions or would like to discuss further, please contact Heather Jerbi, the Academy's assistant director of public policy, at 202.785.7869 or [Jerbi@actuary.org](mailto:Jerbi@actuary.org).

Sincerely,

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American Academy of Actuaries