Risk Adjustment and Reinsurance Issues and Recommendations

Key Takeaways

Risk Adjustment

- The Affordable Care Act (ACA) requires the federal government to develop a risk adjustment methodology that will be used to compensate certain plans with membership that is less healthy (more risky) than average by assessing plans with membership that is healthier (less risky) than average. States with a state-based Exchange have the option of developing an alternate risk adjustment methodology, subject to federal review. The Technical Advisory Group (TAG) **recommends that North Carolina defer to the federal risk adjustment model for now, but evaluate the possibility of developing a State-specific model in future years.**

- States implementing a state-based Exchange have the option to administer risk adjustment in the state, or defer administration to the federal government. The TAG **recommends that North Carolina defer administration of the risk adjustment program to the federal government for the first year** and monitor the federal risk adjustment process for potential State administration of the program in the future.

Reinsurance

- The ACA establishes a temporary, transitional reinsurance program to help stabilize premiums for coverage in the individual market for the years 2014 through 2016. Each state must decide if it wants to administer the program and if it wants the federal government to collect contributions. The TAG **recommends that North Carolina administer the reinsurance program within the State, while deferring the responsibility to collect insurer and third-party administrator (TPA) contributions to the federal government.** This recommendation should be reflected in North Carolina statute.

- The federal government sets a national contribution rate each year, which includes the minimum amount insurers and TPAs in each state must contribute to fund the reinsurance program administrative and claims costs. States that administer reinsurance have the option of increasing the federal assessment beyond the federally-required minimum. The **TAG recommends that any increase in the minimum assessment require action by the North Carolina General Assembly (NCGA).** This recommendation should be reflected in North Carolina statute.

- The ACA requires states that elect to establish reinsurance programs to enter into a contract with one or more applicable reinsurance entities (not-for-profit organizations). The TAG **recommends that the NCGA grant the North Carolina Department of Insurance (NC DOI) statutory authority to facilitate the establishment, through a selection and contracting process, of a reinsurance entity to administer the State's program**. The TAG further **recommends that NC DOI be legislatively authorized to serve in a technical advisory capacity to the reinsurance entity's board**, as necessary. These recommendations should be reflected in North Carolina statute.

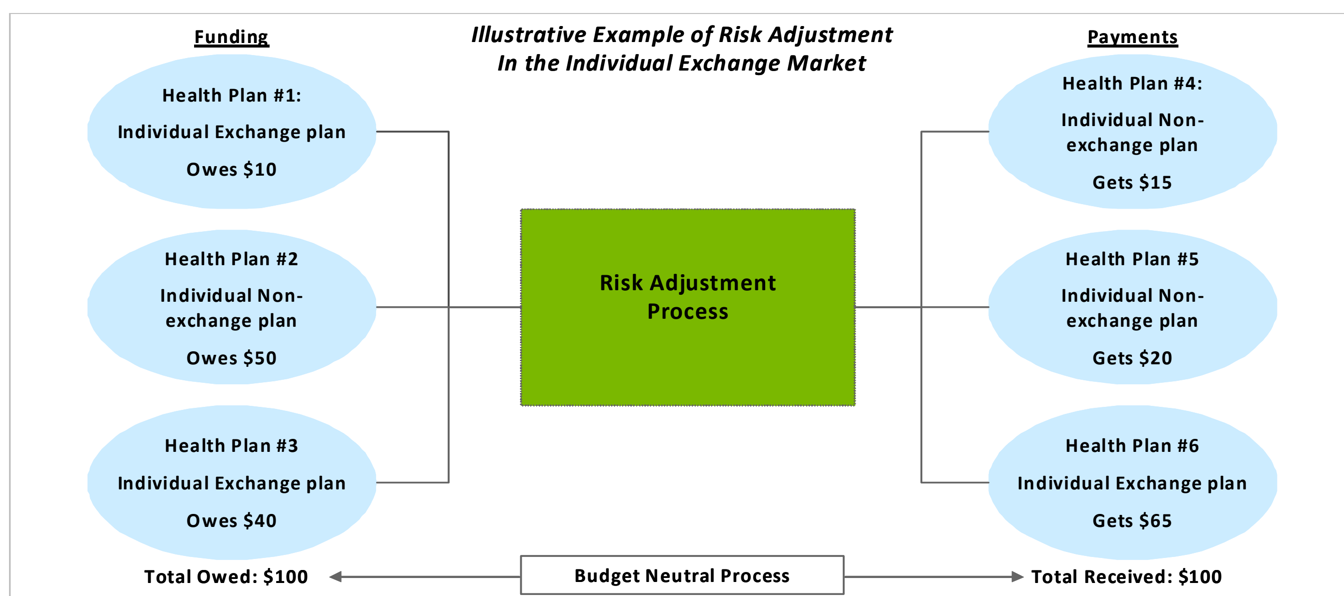
Risk Mitigation Mechanisms Under the ACA

As discussed in Issue Brief #2, adverse selection occurs whenever individuals at greater risk of high health spending are more likely to seek coverage or choose a particular coverage option than low-risk individuals. Once a particular market segment begins to attract a disproportionate share of higher risk individuals, costs will rise in that segment. The ACA includes multiple measures designed to mitigate adverse selection in the small group and individual markets, including minimum coverage requirements, tax credits for small businesses, premium subsidies for individuals, risk adjustment and reinsurance.

This brief covers risk adjustment and reinsurance, which are two of three targeted programs designed to mitigate the impact of potential adverse selection and stabilize premiums in the individual and small group markets as insurance reforms and the Exchanges are implemented in 2014.[1] The remaining program, risk corridors, is not addressed in this brief since it will be administered solely by the federal government and no state policy decisions are required.

Risk Adjustment Program

The ACA requires states to implement in 2014 a permanent risk adjustment program in the individual and small group markets. Risk adjustment is a process through which the collective risk of insurers' enrolled members is assessed across different plans and insurers. Once relative risk is determined, adjustments are made to compensate plans who have higher than average risk, which means sicker than average members. Risk adjustment is funded by non-grandfathered plans with a lower-than-average risk population in or outside the Exchange in a state, while payments are made to non-grandfathered plans with a higher-than-average risk population. These adjustments will likely be implemented separately for the individual and small group markets, unless the State opts to merge them into a single risk pool.[2] Contributions are intended to equal payments, making the program budget neutral.



[1] Preamble to final rulemaking 45 C.F.R. part 153.
[2] In Issue Brief #1, the TAG recommends maintaining separate risk pools.

Issue #1: Development of a State-Specific Risk Adjustment Methodology

The federal government is developing a risk adjustment methodology that can be used to calculate risk adjustment payments in a state. The details of the federal methodology will be released in mid-October 2012, although initial indications suggest that the federal methodology will be similar to the methodology used for Medicare Advantage plans.

States operating a state-based Exchange have the option of developing an alternate risk adjustment methodology. States developing an alternate methodology must submit that methodology to the federal government for approval.

The lack of detail on the federal model makes it challenging to assess if the model is a good fit for North Carolina. TAG members noted that the key considerations in deciding if North Carolina should develop a state-specific risk adjustment model are 1) whether North Carolina would be sufficiently different from other states to require or benefit from a state-specific model and 2) whether a state-developed model would be a significant enough improvement over the federal model to merit the investment of time and resources that would be required to develop it. Since North Carolina does not have a Medicaid Risk Adjustment program or an all-payer claims database—two features often present in other states considering setting forth an alternative risk adjustment methodology—developing a risk adjustment methodology for approval for plan year 2014 would be difficult.

The TAG ultimately agreed that the cost and effort required to develop a state-specific model would not necessarily result in a better methodology than what is currently being developed by the federal government. Additionally, some insurers noted that North Carolina does not differ from other states to such an extent that a state-specific risk adjustment model is required.

The TAG recommends that North Carolina defer to the federal risk adjustment model for now but evaluate the possibility of developing a state-specific model in future years, once the State has had time to evaluate North Carolina's utilization of the federal risk adjustment model and its relative strengths and shortcomings for the state.

Issue #2: Administration of the Federal Risk Adjustment Model in North Carolina

States implementing a state-based Exchange have the option to administer risk adjustment in the state, or defer administration to the federal government. In final rulemaking, the federal government clarified that federal officials will use a distributed model to collect data, whereby insurers will summarize data for submission to the government. The federal government will not collect detailed claims data.

Given the federal selection of a distributed model, the TAG noted only limited benefits at this time to retaining administration of the federal risk adjustment methodology in the State. Those benefits were primarily associated with the potential for better coordination with the reinsurance program (discussed elsewhere in this brief) and faster responses to insurer questions regarding risk adjustment. Those benefits do not outweigh the concerns associated with administration, notably the potential for risk adjustment administration to distract from other areas of health reform implementation and the lack of resources and in-house expertise required for administration.

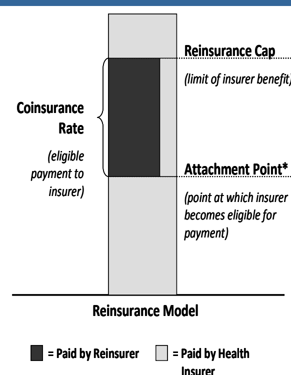
The TAG recommends that North Carolina defer administration of the risk adjustment program to the federal government for the first year and monitor the federal risk adjustment process for potential State administration of the program in the future.

Reinsurance Program

The ACA establishes a temporary, transitional reinsurance program to help stabilize premiums for coverage in the individual market and to protect insurers against migration of an unknown number and risk of high cost individuals for the years 2014 through 2016. Reinsurance will pay a certain amount of the costs between the attachment point and reinsurance cap for high cost individuals.

Reinsurance is funded by all commercial health insurance plans both in and out of the Exchange, including grandfathered plans and third-party administrators (TPAs) on behalf of all self-insured group health plans. Reinsurance payments are made to non-grandfathered individual market plans in or outside of the Exchange. The federal government will set each year a national contribution rate based on aggregate targets set in the ACA, which will include the minimum amount insurers and TPAs in each state must contribute to fund the reinsurance program administrative and claims costs.

Payment Model for Reinsurance



*Attachment point is met when expenses for all covered benefits in a benefit year meet a certain $ amount

Issue #3: Administration of Reinsurance in North Carolina

States have the option to operate a state-based reinsurance program, regardless of whether the state establishes an Exchange, or defer operation of the reinsurance program to the federal government. States that administer reinsurance have the option of increasing the federal assessment beyond the federally required minimum either to fund administrative fees or claims payments. States who administer reinsurance also have the ability to adjust the different "levers" associated with reinsurance for their state, namely the attachment point, coinsurance rate, and reinsurance cap.

Collections of reinsurance contributions was noted by many states to be a key hurdle in establishment of state-based reinsurance programs. However, final rulemaking clarified that regardless of whether a state establishes a state-based reinsurance program, the federal government will collect contribution funds from TPAs on behalf of self-insured plans. The federal government will also collect reinsurance contributions from fully insured plans if requested by the state. The federal collection of reinsurance contributions still enables states to operate a reinsurance program, which would primarily consist of distributing payments to recipient entities and making adjustments to the reinsurance formula. One caveat is that the federal government will only collect additional amounts over the federal rates for administrative expense for a state and will not collect additional amounts for reinsurance payments for a state should the state elect to increase the assessment beyond the federally required minimum payment.

The TAG discussed that having the option to modify the payment model is beneficial since it allows the State to tailor the reinsurance program to meet North Carolina's specific needs. Some concerns were raised that administration of reinsurance at the State level provides an opportunity to increase the reinsurance assessment above what the federal government will require, a move that would not be favorably viewed by some groups (*e.g.*, self-funded groups) who do not receive any benefits from the program. The TAG agreed that decisions about the assessment, which affect the market broadly or impact a large number of stakeholders, should be the province of the North Carolina General Assembly (NCGA) and be subject to the legislative process.

The TAG also noted that it was preferable to defer all collection responsibilities to the federal government, which the TAG viewed as most administratively efficient. However, if the State opts to increase the reinsurance assessment to support additional reinsurance payments, the reinsurance entity would need to perform collections at that point for at least these additional funds, which may impact administrative costs.

The TAG recommends that North Carolina administer the reinsurance program within the State, while deferring the responsibility to collect insurer contributions to the federal government. The group recognized that deferring fully-insured collections responsibility to the federal government, combined with requiring NCGA action to increase the assessment beyond the federal amount, would likely have the effect of setting the contribution amount at the federally established minimum.

Issue #4: Establishment and Oversight of the Reinsurance Entity

States that elect to establish reinsurance programs must enter into a contract with one or more applicable reinsurance entities, defined in ACA as not-for-profit organizations. The TAG discussed at length different capabilities, characteristics, and authority this entity should have, as well as which organization should have responsibility for establishing the reinsurance entity.

Technical/Operational Capabilities of the Reinsurance Entity

In defining the criteria for the selection of a reinsurance entity, the TAG recommends that the entity have:

- the ability to process claims and make payments promptly;
- familiarity with reinsurance programs;
- capacity to house significant amounts of data for a long period of time to comply with federal auditing standards;
- sufficient longevity to pay reinsurance claims after 2016;
- familiarity with use of HIPAA transactions standards for data collection;
- low administrative costs; and
- transparency to build carrier's trust and the ability to perform tasks quickly and efficiently.

Governance Characteristics of the Reinsurance Entity

The TAG recommends that the entity have a governing board composed of insurer and self-funded plan representatives. Board representation should primarily consist of those insurers eligible to receive reinsurance payments, while also including insurers or self-funded plan representatives subject to assessment but not eligible for payments.

Authority to Make Reinsurance Policy Decisions

The TAG recommends that the reinsurance entity be granted the authority to make policy decisions related to program operations. As previously mentioned, the ability to increase the assessment beyond the federal minimum should reside with the NCGA.

The TAG recommends that the NCGA grant the NC DOI statutory authority to facilitate the establishment, through a selection and contracting process, of a reinsurance entity to administer the State's program. The establishment of this entity should take into account the capabilities, characteristics and authority considered by the TAG. The TAG further recommended that NC DOI should be legislatively authorized to serve in a technical advisory capacity to the reinsurance entity's board, as necessary.

About the Market Reform Technical Advisory Group (TAG)

The TAG is comprised of representatives of insurers, agents, academia, hospitals, providers, business and consumers who reside in North Carolina and have knowledge of North Carolina's health care system and marketplace. The TAG considers and makes recommendations on each issue after a review of applicable State and federal laws, relevant literature, national stakeholder recommendations, and pending or passed legislation in other states.

The TAG evaluates the market reform policy options under consideration by assessing the extent to which they: expand coverage; improve affordability of coverage; provide high-value coverage options in the Exchange; empower consumers to make informed choices; support predictability for market stakeholders, competition among plans and long-term sustainability of the Exchange; support innovations in benefit design, payment and care delivery that can control costs and improve the quality of care; and facilitate improved health outcomes for North Carolinians. The TAG acknowledges that tension exists between these values and seeks to provide policy recommendations that are best aligned with the overall public interest, while ensuring the continued strength and viability of the State marketplace.

The purpose of the TAG is to develop options and considerations and to identify areas of consensus to inform the recommendations to the North Carolina General Assembly (NCGA) on ACA-related market reforms. The TAG was convened pursuant to North Carolina Session Law 2011-391, which authorized the Commissioner of Insurance to study insurance-related provisions of the ACA and any other matters it deems necessary to successful compliance with the provisions of the ACA and related regulations.

For more information on the TAG go to: http://www.ncdoi.com/lh/LH_Health_Care_Reform_ACA.aspx