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Hits And Misses: A First Look At U.S. Health Insurers' ACA Premium Stabilization Programs

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Hits And Misses: A First Look At U.S. Health Insurers' ACA Premium Stabilization Programs

Standard & Poor's Ratings Services expected the early years of Affordable Care Act (ACA) implementation to result in some earnings and capital volatility for insurers. As a result, the three premium stabilization programs (reinsurance, risk adjustment, and risk corridors; referred to as the 3Rs) introduced under the ACA play an important part in more evenly spreading the insurance risk among insurers and somewhat offsetting the uncertainties in early years of ACA implementation.

On June 30, 2015, the U.S. Health and Human Services Department (HHS) released the much-anticipated numbers for two of the three premium stabilization programs--reinsurance and risk adjustment. The HHS report, titled "Summary Report On Transitional Reinsurance Payments And Permanent Risk Adjustment Transfers For The 2014 Benefit Years," provides the first detailed view of the "transitional reinsurance program" and "permanent risk adjustment program" as they pertain to all health plans that participated in the ACA marketplace for both individuals and small groups in 2014. These two programs, plus another called the "temporary risk corridors program" not covered in this HHS report, make up the 3Rs.

We've analyzed the HHS data about the 2Rs (reinsurance and risk adjustment programs) and compared it to what insurers recorded in their financial statements at year-end 2014. A positive variance between the companies' reported numbers and the HHS figures would indicate that health insurers will receive more reimbursement from or make lower payments to HHS than they had accounted for in their financial statements. However, a negative variance means they will receive less than they recorded, or have to pay in more than they reserved for, resulting in a negative impact on their financial statements this year.

Overview

- The ACA reinsurance program will pay more to insurers than the industry had expected.
- The ACA risk adjustment program is a zero sum game but most insurers were too optimistic in their assumptions.
- In general, Blue Cross Blue Shield Plans were more conservative in booking for the 2Rs than the public health insurers were.

How does the ACA reinsurance and risk adjustment program work?

The premium stabilization programs are a way to help reduce the uncertainties related to pricing and morbidity risk, especially during the initial years of ACA. The potential for heightened health-care utilization and claims, as well as the possibility of one insurer being selected against may dampen the interest of insurers participating in the individual market. These 3Rs are designed to offset somewhat the volatility and provide support to the overall marketplace.

ACA reinsurance program The ACA reinsurance program is a temporary or transitional market stabilization program that will operate for the benefit years 2014, 2015, and 2016. HHS will make reinsurance payments to health insurers based on claims cost per enrollee. It will assume (co-insurance) a portion of the claims cost per enrollee between a minimum level (attachment point) and a specified cap. For the 2014 benefit year, HHS will co-insure 100% of each enrollee's claim costs between an attachment point of $45,000 and a cap of $250,000.

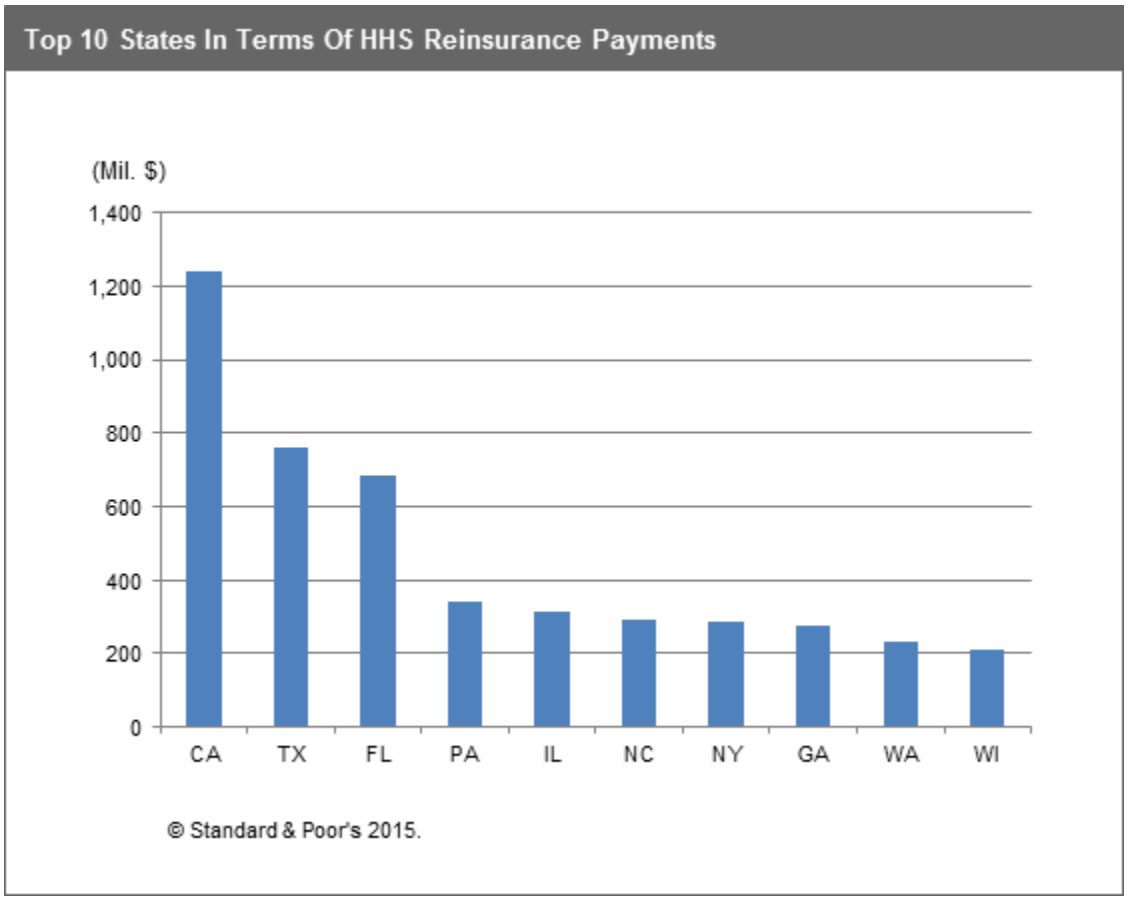
To fund this program, eligible health insurers are required to make reinsurance contributions on a per-member basis ($63 per covered life for 2014). The majority of the contributions will be for reinsurance payments to eligible individual market plans, followed by an annual contribution to the U.S. treasury. The rest will cover the costs to run the program.

ACA risk adjustment program The ACA risk adjustment program is a permanent market stabilization program that will operate in the ACA individual and small group insurance markets. Each eligible insurance company will calculate an average risk score for its enrollees based on age, gender, and diagnoses (and other adjustments). Then, a weighted average risk score will be calculated at a state level. Insurers that have lower-than-average risk scores will make payments into the program, which will be transferred to insurers with higher-than-average risk scores. The risk adjustment program is formulaically symmetrical and net neutral.

The Reinsurance Program Results In A Net Positive Variance For Insurers

HHS announced as part of the June 30 report that it would make $7.9 billion in reinsurance payments to 437 health insurance plans that participated in the ACA market in the 50 states and the District of Columbia. The top-10 states in terms of expected reinsurance receivables account for close to 60% of total reinsurance payments for the 2014 benefit year (see chart 1).

Chart 1



We found that about 90% of the insurers included in our study showed a positive variance for the ACA reinsurance program. On average, those insurers will receive 20% higher reinsurance receipts than they had booked in their financial statements at year-end 2014. The primary reason for the better-than-expected reinsurance receipts is that most insurers had booked their 2014 reinsurance receivables assuming that HHS would pay at an 80% co-insurance rate. But it turns out that HHS received more-than-required reinsurance contributions from the insurers and is therefore paying out at a 100% co-insurance rate.

Also notable is that after assuming 100% co-insurance for 2014, HHS will still have close to $1 billion in excess reinsurance contributions. This excess will be used for reinsurance payments for 2015. There was some market expectation that HHS might use the excess to offset the potential underfunding in the risk corridors program (see The Unfunded ACA Risk Corridor May Make The U.S. Insurance Market Less Stable, Not More, published May 1, 2015, on RatingsDirect).

The Risk Adjustment Program Results Show More Than Half Of Insurers Have A Negative Variance

The story is quite different when it comes to the risk-adjustment program. Of the 3Rs, the risk adjustment program is

the only permanent market-stabilization feature introduced to the commercial insurance marketplace as part of the ACA. (Reinsurance and risk-corridors are temporary risk-stabilization programs that expire after 2016.) It has also proven to be harder for insurers to evaluate the accurate risk adjustor for 2014. Based on the HHS release, we estimate that the total amount of risk-adjustment payments transferring between insurers is $2.3 billion for 2014 and relates to more than 756 health insurance plans in the individual and small-group market.

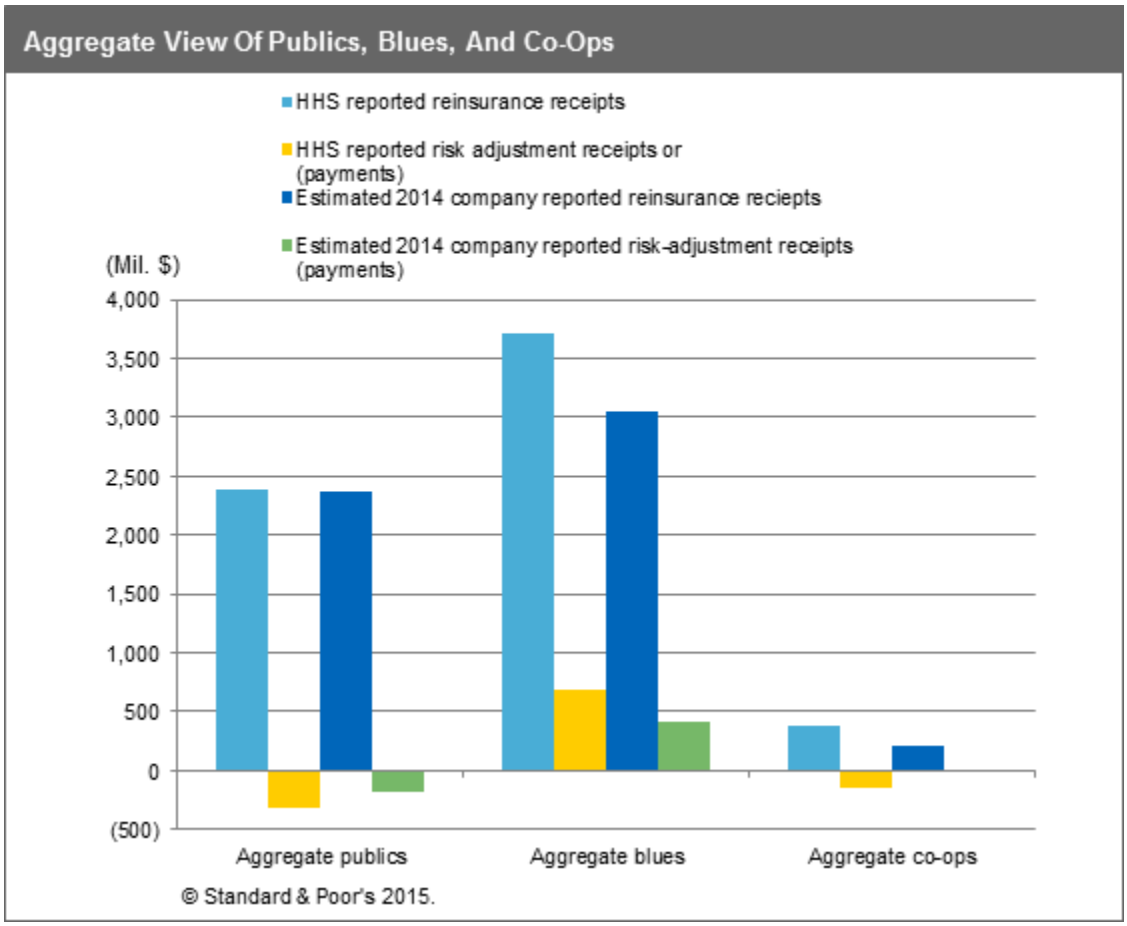
For more than 50% of the insurers in our study, we found a negative variance when comparing the HHS net risk adjuster numbers to the amount they booked as of year-end 2014. Using risk scores for members is not new to health insurance in the U.S. especially because the Medicare Advantage market uses a risk adjustment program. However, it is new to the commercial risk pool (individuals under age 65 and small groups), leading to unknowns in the process. What complicates the issue is that to calculate risk adjustment payments or receipts, each insurance company needs to know not only the average risk score of its own members but also the average risk score of the state it is in. Given that 2014 was this program's first year, calculating the average risk score by state was perhaps more an art than a science.

The Effects Of These 2Rs Vary Among Public Companies, Blues, And Co-Ops

We looked at each insurer in the three groups that have significant market interest--the for-profit public insurance companies (publics), not-for-profit Blue Cross Blue Shield plans (Blues), and the consumer-operated and -oriented plans (co-ops)--to understand the impact of the stabilizers and their variances on the insurers.

Our study indicates that the 2Rs have the least impact on the overall operations of the publics and the most impact on the co-ops. This is definitely a result of the difference in diversification and scale of these entities' operations. We also found that the Blues were more conservative of the three groups in recording reinsurance or risk-adjustment receivables, thereby seeing the most positive variance when compared to the HHS release (see chart 2). Also, the Blues on aggregate will be net receivers in the risk adjustment program, indicating that their membership base had higher actuarial risk than their competitors in their respective states.

Chart 2



Four of the eight publics included in our study had a net negative variance when comparing the HHS data to the estimated 2014 numbers booked in the company's financial statements (see table 1). Furthermore, to understand the credit impact of these programs, we compared the variance and the total amount received from the programs to the companies' capital base. The proportional impact of the variance to capital is fairly minimal, given that the majority of publics have diversified operations and significant scale relative to the amounts involved in the 2Rs. On average, the 2Rs account for less than 1% of total reported year-end capital for the publics.

Table 1

Impact Of The 2Rs On Publicly Traded Health Insurers

(Mil. $)	HHS reported reinsurance receipt	HHS reported total risk adjustment receipt or (payment)	Estimated 2014 Company reported Reinsurance reciept	Reinsurance variance	Estimated 2014 company reported risk-adjustment receipt (payment)	Risk adjustor variance	Net variance*	Net variance as a % of reported capital	Total 2Rs¶ receipt/payment as % of reported capital
Anthem Inc. group	776.7	(190.3)	753.3	23.4	(86.8)	(103.4)	(80.0)	(0.3)	2.4
Humana group	549.4	(123.8)	585.8	(36.4)	41.0	(164.9)	(201.3)	(2.1)	4.4
Aetna group	359.2	(335.6)	370.0	(10.8)	(276.0)	(59.6)	(70.4)	(0.5)	0.2

Table 1

Impact Of The 2Rs On Publicly Traded Health Insurers (cont.)

Assurant Inc. group	255.5	105.5	238.9	16.6	107.4	(1.9)	14.7	0.3	7.0
Health Net Inc. group	214.2	(78.8)	234.0	(19.8)	(72.4)	(6.4)	(26.2)	(1.5)	7.9
Cigna health group	202.2	108.7	166.5	35.7	138.0	(29.4)	6.3	0.1	2.9
UnitedHealth group	102.2	235.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	1.0
Centene Corp. group	14.1	(44.6)	11.0	3.1	(43.7)	(0.9)	2.2	0.8	(1.6)
Molina Healthcare Inc. group§	7.6	1.7	4.6	3.0	3.5	(1.7)	1.2	0.1	0.9

*Net variance = reisurance variance + risk adjustment variance. ¶Total 2Rs refers to sum of HHS reported reinsurance and risk adjustment data. N.A. - Not available. All estimates based on publicly available information from various sources, including SEC filings, insurance statutory filings, and public earning calls. §Estimated 2014 numbers do not include California entity.

The Blues included in our study (see table 2) have been among the early adopters of the insurance exchanges and hold strong positions in the individual and small-group markets in their home states. The majority had a positive variance, indicating that they were generally conservative in reporting receivables for the reinsurance and risk-adjustment programs. The proportional net impact of the 2Rs is higher for the Blues than what it was for the publics, but still not very significant. On average, the 2Rs account for less than 10% of total reported year-end surplus for the Blues.

Table 2

Impact Of The 2Rs On Blue Cross Blue Shield Plans

(Mil. $)	HHS reported reinsurance receipt	HHS reported total risk adjustment receipt or (payment)	Estimated 2014 company reported reinsurance reciept	Reinsurance variance	Estimated 2014 company reported risk-adjustment receipt (payment)	Risk adjustor variance	Net variance*	Net variance as a % of reported capital	Total 2Rs¶ receipt/payment as % of reported capital
HCSC Group	943.1	(0.8)	913.4	29.7	(54.0)	53.2	82.9	0.8	9.5
Blue Shield of CA Group	363.1	149.0	411.0	(47.9)	0.0	149.0	101.0	2.4	12.3
Guidewell Mut Holding Group	331.1	262.3	347.8	(16.7)	153.3	108.9	92.2	5.3	33.8
Blue Cross and Blue Shield of North Carolina	263.7	31.1	247.8	15.9	40.4	(9.2)	6.7	0.3	12.8
Highmark Group	201.9	(0.8)	221.4	(19.5)	42.2	(42.9)	(62.5)	(1.6)	5.1
Independence Health Group Inc.	200.7	(69.1)	153.2	353.9	(52.3)	(16.8)	30.7	12.6	7.2
BCBS Of Michigan group	158.7	28.4	140.0	18.7	5.9	22.5	41.3	1.2	5.6
Premera Blue Cross group	124.7	(38.0)	97.3	27.3	(36.2)	(1.8)	25.5	1.8	6.1

Table 2

Impact Of The 2Rs On Blue Cross Blue Shield Plans (cont.)									
BCBS of MN group	117.3	19.4	86.4	30.8	5.7	13.7	44.5	3.5	10.6
BCBS of TN group	116.4	4.7	94.3	22.1	0.0	4.7	26.8	1.5	7.0
BCBS of AL group	97.3	2.5	75.0	22.4	0.0	2.5	24.9	2.3	9.3
Cambia Health Solutions Inc.	88.5	73.4	67.4	21.1	0.0	73.4	94.5	4.3	7.4
Carefirst Inc. group	86.1	5.5	68.9	17.2	0.0	5.5	22.7	1.0	4.1
Louisiana Health Services group	70.7	9.9	60.0	10.8	6.9	3.0	13.8	1.2	7.0
Horizon BCBSNJ group	68.1	(2.7)	56.7	11.4	15.0	(17.7)	(6.2)	(0.3)	2.9
Arkansas BCBS group	64.7	15.0	42.4	22.3	7.5	7.5	29.9	25.0	66.8
Blue Cross of ID group	46.1	(6.7)	0.0	46.1	(2.1)	(4.6)	41.5	7.9	7.5
Blue Cross Blue Shield of Arizona Inc.	43.2	15.8	34.3	8.9	10.0	5.8	14.7	1.4	5.7
Blue Cross and Blue Shield of Nebraska	38.6	5.0	34.4	4.2	3.9	1.1	5.3	1.2	10.1
BCBS Of KC group	37.4	30.3	25.2	12.2	16.0	14.3	26.5	4.6	11.7
BCBS of MA group	37.3	N.A.	31.4	5.9	50.0	N.A.	N.A.	N.A.	N.A.
BCBS of SC group	26.2	7.6	21.6	4.6	0.8	6.8	11.4	0.5	1.6
BCBS of KS group	26.0	8.8	22.6	3.3	8.7	0.1	3.4	0.4	4.6
Lifetime HealthCare group	25.5	59.9	20.4	5.1	50.0	9.9	15.1	1.3	7.4
Wellmark Inc. group	25.4	10.4	19.1	6.3	(2.1)	12.5	18.8	1.1	2.0
BCBS of VT group	25.1	2.7	20.8	4.3	0.0	2.7	7.0	5.0	20.1
Blue Cross & Blue Shield of Rhode Island	23.4	3.5	19.4	4.0	1.8	1.6	5.7	2.1	10.2
Hospital Services Association of NE PA group	20.1	3.0	19.8	0.3	4.9	(1.9)	(1.6)	(0.3)	4.6
Hawaii Medical Service Association	13.0	16.0	8.8	4.2	6.5	9.5	13.7	3.5	7.4

Table 2

Impact Of The 2Rs On Blue Cross Blue Shield Plans (cont.)

Blue Cross Blue Shield of Wyoming	7.9	5.6	6.7	1.2	0.0	5.6	6.8	2.7	5.4
Mississippi Insurance group	6.5	4.9	6.3	0.2	0.0	4.9	5.1	0.9	2.0
Capital Blue Cross group	5.6	9.9	0.0	5.6	0.0	9.9	15.5	1.9	1.9
HealthNow New York Inc.	3.2	20.6	0.0	3.2	9.7	10.9	14.1	2.9	4.9

*Net variance = reisurance variance + risk adjustment variance. ¶Total 2Rs refers to sum of HHS reported reinsurance and risk adjustment data. N.A. - Not available. All estimates based on publicly available information from various sources, including SEC filings, insurance statutory filings, and public earning calls.

Less than half of the co-ops have a negative variance (see table 3). Perhaps there is some irony in the fact that HHS data show that Cooportunity Health (the Iowa based co-op) would have received the largest reinsurance receipt relative to the other co-ops. Cooportunity was put into liquidation earlier this year. Our study also indicates that almost all the co-ops see a relatively high impact of the 2Rs on their financials. On a weighted average basis, the 2Rs account for close to 25% of total reported year-end surplus for the co-ops. The market stabilization programs are particularly important for smaller plans that still do not have adequate scale or diversification. The co-ops add to the number of competitors in the marketplace, but without the support of stabilization programs, they will find it hard to succeed in this risk-bearing venture.

Table 3

Impact Of The 2Rs On Health Insurance Co-Ops

(Mil. $)	HHS reported reinsurance receipt	HHS reported total risk adjustment receipt or (payment)	Estimated 2014 company reported reinsurance reciept	Reinsurance variance	Estimated 2014 company reported risk-adjustment receipt (payment)	Risk adjustor variance	Net variance*	Net variance as a % of reported capital	Total 2Rs¶ receipt/payment as % of reported capital
Cooportunity Health	71.7	(2.3)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Kentucky Health Cooperative Inc.	58.2	(7.9)	N.A.	58.2	N.A.	(7.9)	50.4	77.2	77.2
Health Republic Insurance of New York Corp.	58.2	(80.2)	61.4	(3.1)	0.0	(80.2)	(83.4)	(76.5)	(20.2)
Common Ground Healthcare Cooperative	37.2	(23.2)	31.0	6.2	(2.2)	(21.0)	(14.8)	(40.1)	38.0
Maine Community Health Options	35.4	(0.8)	22.1	13.4	0.0	(0.8)	12.6	48.4	133.4

Table 3

Impact Of The 2Rs On Health Insurance Co-Ops (cont.)									
Consumers Choice Health Insurance Co.	33.1	(6.3)	26.2	6.9	0.0	(6.3)	0.6	1.2	49.6
Colorado Health Insurance Cooperative Inc.	19.6	(4.5)	16.1	3.5	1.3	(5.8)	(2.3)	(9.5)	62.8
Montana Health Cooperative	10.8	3.5	7.4	3.5	0.9	2.5	6.0	23.2	55.1
Arches Mutual Insurance Co.	10.2	(4.1)	8.2	2.0	(3.2)	(1.0)	1.1	4.3	24.7
Nevada Health Co Op	10.1	(3.6)	8.8	1.3	0.0	(3.6)	(2.3)	(14.3)	40.0
Louisiana Health Cooperative Inc.	9.9	(7.5)	4.6	5.3	2.8	(10.3)	(5.0)	(35.1)	16.6
Land of Lincoln Mutual Health Insurance Co.	4.8	0.4	3.8	1.0	(0.3)	0.7	1.7	5.0	15.2
Health Republic Insurance Co. (OR)	4.1	(1.3)	3.9	0.2	(1.6)	0.3	0.5	6.8	36.7
Compass Cooperative group	3.9	2.8	2.8	1.2	2.9	(0.1)	1.1	13.9	87.5
New Mexico Health Connections	3.2	(6.7)	2.4	0.7	(6.6)	(0.1)	0.7	2.9	(15.0)
HealthyCT Inc.	1.9	(1.1)	1.5	0.4	0.0	(1.1)	(0.7)	(1.1)	1.4
Oregon's Health Co-op	1.0	0.2	0.5	0.6	(0.4)	0.6	1.1	25.0	28.2
Coordinated Health Mutual Inc.	0.9	(3.4)	0.7	0.2	1.7	(5.1)	(4.8)	(9.8)	(5.0)
Evergreen Health Cooperative	0.3	(0.4)	0.3	0.0	1.3	(1.7)	(1.6)	(20.5)	(0.6)
Consumers Mutual Insurance of Michigan	0.3	(1.1)	0.1	0.2	0.0	(1.1)	(0.9)	(5.9)	(5.5)

Table 3

Impact Of The 2Rs On Health Insurance Co-Ops (cont.)									
Community Health Alliance Mutual Insurance Co.	0.2	(0.1)	0.0	0.2	0.0	(0.1)	0.1	0.5	0.5
Minuteman Health Inc.	0.0	0.0	0.0	(0.0)	(1.2)	1.2	1.2	13.3	0.0

*Net variance = reisurance variance + risk adjustment variance. ¶Total 2Rs refers to sum of HHS reported reinsurance and risk adjustment data. N.A. - Not available. All estimates based on publicly available statutory financial statements.

The Full Picture Still Needs The Risk Corridors Information

The entire impact of the market stabilization features is incomplete without the risk-corridors information, which HHS will release during the next 30-60 days. It is also likely that some insurers may appeal the published receipts or payables of the 2Rs. The net impact and variances by insurers may change once the remaining links to the ACA chain are available. Actual payments will likely not reach insurers till fourth-quarter 2015.

Notwithstanding what the final 3Rs look like, it is clear that they have a fairly important role in supporting the marketplace. That raises a question: What happens once the two temporary stabilizers (risk corridors and reinsurance programs) expire in 2016? Insurers will need to fend for themselves to a greater extent. They will no longer be able to rely on these stabilizers to offset pricing and plan design mistakes or weak cost controls. Pricing will become more rational with potentially less variability between competitors in each market. With pricing less of an issue, insurers will need to find ways to differentiate themselves like they've never done before--with improved branding, products, and customer service.

Related Criteria And Research

- Industry Economic And Ratings Outlook: The U.S. Health Insurer Outlook Remains Stable As Sector Visibility Improves, July 9, 2015
- The Unfunded ACA Risk Corridor May Make The U.S. Insurance Market Less Stable, Not More, May 1, 2015
- Other U.S. Health Insurance Co-Ops Could Be Going Down The Same Bumpy Road As Iowa's CoOportunity Health, Feb. 10, 2015
- Singing The ACA Blues: U.S. BCBS Plans Stand Strong In The Post-Reform Insurance World, Jan. 7, 2015