Healthcare BUSINESS STRATEGY™

A Brief Analysis of the 2014 ACA Reinsurance and Risk Adjustment Results

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by Mark Farrah Associates

In January of 2014, the Affordable Care Act (ACA) established state-based Reinsurance and risk-adjustment programs to reduce the financial risk for participating health insurance companies selling coverage on the public exchanges. The goal of these programs is to protect against adverse selection and risk selection in the market while stabilizing premiums, ultimately resulting in healthier competition in health insurance markets.

The Reinsurance provision was designed to prevent large premium increases in the individual market. The program provides funding to individual health plans that incur high claims costs (costs exceeding the attachment point) for enrollees. The objective in a nutshell is to protect health plans against unusually high claims costs. This is a temporary, three year program that runs from 2014-2016.

HHS collects all Reinsurance contributions. The ACA set national levels for Reinsurance funds at $10 billion in 2014, $6 billion in 2015, and $4 billion in 2016. Based on estimates of the number of enrollees, HHS set a uniform Reinsurance contribution rate of $63 per person in 2014, $44 per person in 2015 and $27 per person in 2016. While all health plans contribute funds to the program, only eligible Individual plans will receive funds back from the government.

The Risk Adjustment provision transfers funds from lower risk plans to higher risk plans for non-grandfathered individual and small group market plans, inside and outside the Exchange. This program is intended to deter insurance plans from intentionally targeting only healthy enrollees and protects companies that may attract sicker customers. Unlike Reinsurance, which ends after 2016, Risk Adjustment is permanent.

HHS developed a methodology to be used for Risk Adjustment by states or by HHS on behalf of states. The risk scores for eligible insurers (measures of each company's potential medical expenses based on their book of business) are compared with the average risk score per geographical area. This assessment determines which plans will be paid or charged by HHS.

Reinsurance and Risk Adjustment are designed to provide stability in the early years of health care reform, with Risk Adjustment continuing over the long-term. These complimentary programs have similar goals of which seek to mitigate any incentives for plans to attract healthier individuals and compensate those that enroll a disproportionately sick population.

On June 30th, 2015 the Department of Health and Human Services (HHS), through the Centers for Medicare & Medicaid Services (CMS), released a report detailing the 2014 results of both the Reinsurance and Risk Adjustment programs. The report named, "Summary Report on Transitional Reinsurance Payments and Permanent Risk Adjustment Transfers for the 2014 Benefit Year (https://www.cms.gov/CCIIO/Programs-and-Initiatives/Premium-Stabilization-Programs/Downloads/RI-RA-Report-Draft-6-30-15.pdf)", can be accessed from the CMS.gov website. Subscribers to Mark Farrah Associate's Health Coverage Portal may access key data found in this report with the benefit of NAIC company codes mapped to HIOS codes used for government reporting by health plans.

In this month's Healthcare Business Strategy report, we summarize some of the key findings found within the HHS report, starting with Reinsurance.

Size of Parent Organizations based on Volume of 2014 Individual Premiums	# of Parent Organizations	HHS Reported Aggregate Reinsurance Payments	NAIC Reported Aggregate Estimated Reinsurance	Variance Between HSS Calculation vs NAIC-Reported
$1Billion and Over	10	$3,638,815,307	$3,585,549,250	$53,266,057
$250 Million to $1 Billion	25	2,272,924,228	1,636,243,795	636,680,433
$100 Million to $250 Million	20	602,110,145	472,904,107	129,206,038
$25 Million to $100 Million	35	317,725,361	248,318,101	69,407,260
$10 Million to $25 Million	19	60,339,586	45,316,564	15,023,022
Total	**109**	**$6,891,914,627**	**$5,988,331,817**	**$903,582,810**

The variance analysis excluded plans, including CA managed care plans, which did not report financial information under the 2014 NAIC Annual Notes to the Financial Statement - Note 24E. Analysis also excluded plans that did not report premium information under the 2014 NAIC Supplemental Health Care Exhibit.

In order to broadly assess Reinsurance results, our analysts aggregated plan data by parent organization (e.g. Aetna, Anthem) and categorized findings based on the volume of 2014 Individual premiums. On average for 2014, actual Reinsurance funding from HHS exceeded the estimates calculated by the plans as reported in the 2014 NAIC Annual Notes to the Financial Statement - Note 24E. Our analysts did note that the Reinsurance revenue estimate reported by companies selling ACA Individual plans varied greatly from the HHS calculated amount. Reinsurance revenue was understated for 98 parent organizations while aggregate results for only 11 parent organizations were overestimated. The magnitude of underestimated Reinsurance at the aggregate Parent-level was not insignificant; in some cases the Reinsurance revenue was 30 to 40 percent underestimated.

Aggregating the HHS data by group shows that HCSC (Health Care Service Corporation) led the country in Reinsurance receipts from HHS. Anthem, Humana, Blue Shield of CA and Aetna rounded out the top five Reinsurance recipients.

Top 5 Reinsurance Receivers NAIC Parent	Total HHS Reinsurance Transfer $
HCSC GRP	$943,058,565
ANTHEM INC GRP	$776,743,061
HUMANA GRP	$549,371,066
BLUE SHIELD OF CA GRP	$363,050,265
AETNA GRP	$359,224,484

This assessment included data for all plans reported in the HHS summary report. MFA aggregated HHS Reinsurance Transfer payments by NAIC Parent organizations to identify top recipients.

Our analysis of the Risk Adjustment program started with looking only at plans for which we had complete reporting from the NAIC. Specifically, we identified plans that reported 2014 estimates for Risk Adjustment revenue/expense in Note 24E in the NAIC Annual Notes to the Financial Statement section. We found that slightly more than half the plans did not report these estimates. Also of important note, our analysts found numerous reporting irregularities primarily related to numerical sign (reporting of positive versus negative dollar values); these cases were corrected to ensure an accurate analysis of this program. Unlike Reinsurance, Risk Adjustment is here to stay and we expect that health plans will become more comfortable with their ability to accurately calculate and report on this important program in the future.

For this assessment, we analyzed aggregate results by parent organization, organizing companies by aggregate Individual and Small Group premium volume. Only plans that reported 2014 NAIC Risk Adjustment estimates were included. For Risk Adjustment, we observed the top two largest premium tiers benefitted from the program

overall with aggregate collections of $117 million and $122 million, respectfully. The mid-sized tier did not fare as well within the program. Overall, parent organizations in both mid-sized tiers will be funding the Risk Adjustment program during 2015 rather than receiving funds from the HHS program.

Size of Parent Organizations based on Volume of 2014 Individual & Small Group Premiums	# of Parent Organizations	HHS Reported Risk Adjustment Transfers	NAIC Reported Risk Adjustment Revenue	Variance Between HSS Calculation & NAIC Reported
$1Billion and Over	16	$117,301,572	$190,710,932	($73,409,360)
$250 Million to $1 Billion	26	122,312,705	249,079,456	(126,766,751)
$100 Million to $250 Million	11	(39,918,450)	(52,292,176)	12,373,726
$25 Million to $100 Million	10	(10,179,328)	(2,449,743)	(7,729,585)
$10 Million to $25 Million	8	13,755,954	9,449,658	4,306,296
Total	**71**	**$203,272,452**	**$394,498,127**	**($191,225,675)**

Analysis excludes plans, including CA managed care plans, which did not report financial information under the 2014 NAIC Annual Notes to the Financial Statement - Note 24E. Analysis excludes groups that did not report premium information under the 2014 NAIC Supplemental Health Care Exhibit. Excludes MA plans.

Generally, Risk Adjustment estimates were less accurate than the Reinsurance estimates. As indicated in the chart above, health plans struggled in estimating their Risk Adjustment impact. In this assessment, it was not uncommon for the HHS calculated Risk Adjustment amount to be 1x to 4x greater/less than plan estimates. Seven of the parent organizations in the largest tier had variances of this magnitude, eight parents in tier two, three in tier three, six groups in tier four and five groups in tier five, respectively. On a positive note, twenty groups had variances under +/- 25% from the HHS results.

58% of the parents' estimates were conservative and the actual impact of Risk Adjustment will be a positive adjustment to their financial statements as it ultimately impacts premiums. Conversely, 42% of the parents will recognize a negative impact to their statements based upon the HHS reported amounts.

Looking at Risk Adjustment from a macro standpoint, we find that Aetna will contribute the most funds towards Risk Adjustment as compared to all other parent organizations assessed within the HHS reported total due of $336 Million. Anthem and Humana are the other two for-profits in the top 5 list of payers and will both transfer/pay into the Risk Adjustment program. Preferred Medical Plan Inc. (FL) has announced that "As a result of uncertainties related to the final payments due under the Affordable Care Act's premium stabilization programs …", ACA 3Rs, that they will no longer be enrolling new members nor renewing existing members. Furthermore, Molina has acquired all of Preferred's Medicaid membership, effective 8/1/2015. There is little doubt these announcements are related to the impact of the Risk Adjustment program. Rounding out the top 5 payers list is the Co-Op Health Republic Insurance of NY who as of 4Q14 had reported total capital of $109M. The $80M in Risk Adjustment due amounts to 73% of their capital and surplus. It is important to note that neither of the bottom two plans reported estimated Risk Adjustment figures in their Annual 2014 NAIC filing.

Top 5 Risk Adjustment Payers NAIC Parent	Total HHS Risk Adjustment Transfer $
AETNA GRP	($335,589,323)
ANTHEM INC GRP	($190,251,845)
HUMANA GRP	($123,831,855)
PREFERRED MEDICAL PLAN INC	($97,122,696)
HEALTH REPUBLIC INS OF NY CORP	($80,235,544)

This assessment included data for all plans reported in the HHS summary report. MFA aggregated HHS Risk Adjustment Transfer payments by NAIC Parent organizations to identify top recipients.

On the other side of the Risk Adjustment program, the top 5 recipients of funding are composed of three for-profit companies and two non-profits. The non-profit Guidewell Mutual (doing business as Blue Cross Blue Shield of Florida) leads the industry in expected receipts of $262M. Both Guidewell and UnitedHealth appear to have been conservative in their estimates of the expected Risk Adjustment revenue, while Cigna and Assurant overestimated the revenue by 22% and 13%, respectively. The variances do not present any material impact to the financial statements of these parent organizations.

Top 5 Risk Adjustment Recipients NAIC Parent	Total HHS Risk Adjustment Transfer $
GUIDEWELL MUT HOLDING GRP	$262,250,011
UNITEDHEALTH GRP	$237,393,440
BLUE SHIELD OF CA GRP	$148,968,583
CIGNA HLTH GRP	$108,653,552
ASSURANT INC GRP	$105,532,559

This assessment included data for all plans reported in the HHS summary report. MFA aggregated HHS Risk Adjustment Transfer payments by NAIC Parent organizations to identify top recipients.

In conclusion, the variances identified in this assessment are not surprising considering this was the first year plans were required to comply with ACA reporting. We expect to see the quality of the reporting, especially in the Risk Adjustment area, to improve over the next two fiscal years. It is also important to note that we have only covered 2 of the 3Rs in this strategy report and are still waiting on the release of the Risk Corridor information. Please stay tuned for more information on this important industry topic in the near future.

Glossary

Attachment point -- Eligible insurance plans will receive Reinsurance payments when the plan's cost for an enrollee crosses a certain threshold... ($45,000 in 2014 and $70,000 in 2015).

Average risk scores -- The average risk score is the weighted average of all enrollees' individual risk scores, and represents the plan's predicted expenses (based on the demographics of enrollees).

Coinsurance Rate -- The percentage of the costs above an attachment point and below the Reinsurance cap that will be reimbursed through the Reinsurance program (80 percent in 2014 and 50 percent in 2015).

Individual risk scores -- based on each individual's age, sex, and diagnoses – are assigned to each enrollee. Diagnoses are grouped into a Hierarchical Condition Category (HCC) and assigned a numeric value that represents the relative expenditures a plan is likely to incur for an enrollee with a given category of medical diagnosis.

Reinsurance cap -- A dollar-amount threshold, above which the insurer is no longer eligible for Reinsurance... ($250,000 in both 2014 and 2015)

Additional Resources

Kaiser Family Foundation, "Explaining Health Care Reform: Risk Adjustment, Reinsurance, and Risk Corridors" January 22, 2014, http://kff.org/health-reform/issue-brief/explaining-health-care-reform-risk-adjustment-Reinsurance-and-risk-corridors/ (http://kff.org/health-reform/issue-brief/explaining-health-care-reform-risk-adjustment-reinsurance-and-risk-corridors/)

About Mark Farrah Associates (MFA)

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