Issue Brief

AHIP

America's Health Insurance Plans

Affordable Care Act Premium Stabilization Programs: How Reinsurance, Risk Corridors, and Risk Adjustment Protect Consumers

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The Affordable Care Act (ACA) creates three interconnected risk management programs intended to protect consumers by stabilizing premiums during the initial years of the law's implementation. Two of these programs (*Reinsurance and Risk Corridors*) are temporary and will provide much needed premium stability for consumers in the first three years of the reformed markets. The third program (*Risk Adjustment*) is designed to protect against adverse selection in the reformed marketplace.

Together, these three programs—commonly known as the "3Rs"—help to create a stable and predictable environment for consumers seeking health insurance coverage during the initial years of the reformed marketplace. The American Academy of Actuaries notes that the 3Rs will facilitate "competition based on efficient care management and quality rather than risk selection."[1] Similar programs were successfully used to mitigate risk among private plans offered under Medicare. The 3Rs will serve the same purpose for the 2014 reforms under the ACA by creating confidence in the new marketplaces and stability in premiums for consumers.

A Closer Look: How Do the 3Rs Work?

Temporary Reinsurance Program (2014-2016)

The ACA establishes a temporary reinsurance fund that will be used to pay a portion of the costs for individuals with very high medical expenses. For the 2014 benefit year, the reinsurance program will pay at least 80 percent of the claims cost for non-grandfathered individual market enrollees between $45,000 and $250,000. All health plans will contribute a set amount of money to the reinsurance program for each year of its operation, totaling $10 billion in 2014, $6 billion in 2015, and $4 billion in 2016.

The reinsurance program will help health plans meet the needs of high-cost enrollees while making individual market premiums more affordable for consumers. The Department of Health and Human Services (HHS) estimated that the reinsurance program reduced premiums in the individual market in 2014 by 10-15 percent compared to what they would have been absent this program.[2] Alternatively, the phase-down of available reinsurance funds will have an upward pressure on premiums in 2015.

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Temporary Federal Risk Corridor Program (2014-2016)

New benefit mandates, regulatory requirements, and the ACA's broad insurance reforms dramatically transformed the insurance marketplace in 2014. Although health plans have made assumptions about the cost of coverage in this new market, there is still substantial uncertainty about how this population will use health care services. The risk corridors program will limit volatility in the individual and small group markets, resulting in a more stable marketplace and options for consumers that accurately reflect the cost of coverage.

For each year of the risk corridor program, qualified health plans (QHPs) and the federal government will share in the risk associated with the uncertainty of the new marketplace. If the amount a health plan collects in premiums exceeds their medical expenses by a certain amount, the plan will make a payment to the federal government. If premiums fall short of this target, the risk corridor program transfers a portion of this shortfall to the health plan.

Like the reinsurance program, the risk corridors program is a temporary measure designed to ease the transition between the old and new marketplace and help stabilize premiums for consumers. As health plans gain more experience setting premiums in this new market over time, the protections provided by risk corridors will become less critical for protecting market stability.

Risk Adjustment Program (2014 and Subsequent Years)

The ACA's risk adjustment program is designed to spread risk among health plans to prevent problems associated with adverse selection. Under this program, health plans that enroll disproportionately higher risk populations (such as individuals with chronic conditions) will receive payments from plans that enroll lower risk populations. Payments and transfers are only between health plans, and apply only to individual and small group plans both inside and outside of the exchange.

By spreading risk across all health plans in a state, risk adjustment promotes market stability as it protects consumers with complex medical conditions. Preventing adverse selection will lead to a more robust marketplace and more affordable coverage options for consumers.

Precedent of Federal Risk Mitigation Programs: Medicare Part D

The federal government has employed mechanisms under several health coverage programs to promote a stable and competitive market. One such example is the Medicare prescription drug program, or Part D, where Medicare beneficiaries may enroll in prescription drug plans offered by private Part D sponsors. Medicare Part D includes similar versions of the three risk mitigation programs under the ACA. All three programs are permanent features of the Part D program.

- The Centers for Medicare & Medicaid Services (CMS) provides reinsurance payments to Part D sponsors when a beneficiary's prescription drug costs reach a catastrophic threshold, providing additional support to sponsors with high cost enrollees.

- CMS administers a risk corridor program in which Part D sponsors share risk above and below predetermined payment-to-cost ratio thresholds established by law. The risk corridors have broadened over time, meaning Part D sponsors are more likely to be at full risk than they were during the initial years of the program.

- CMS reimburses Part D sponsors on a risk adjusted basis that provides payments to Part D plans that enroll more individuals with complex conditions to more accurately reflect costs of addressing these beneficiaries' health care needs. A similar system is used to risk adjust payments to Medicare Advantage plans.

Together, these programs have been instrumental in the creation of a new insurance market that is noted for its highly competitive nature and choices for consumers.

The Growing Importance of the 3Rs

Health plans price their insurance policies with a set of assumptions about the people who will enroll in coverage. The ACA is predicated on achieving near universal participation—providing coverage to the young and healthy as well as the old and unhealthy—and granting all persons access to health insurance without regard to pre-existing conditions.

Several regulatory and policy changes have upended many of the assumptions that health plans relied upon when setting prices for the first year of ACA-compliant coverage and endanger the success of a stable market. In November 2013, the administration announced a transitional policy that allowed individuals to remain in their pre-ACA policy into 2015. In early 2014, this transitional policy was extended so that people could remain in pre-ACA coverage into 2017. Allowing a large number of pre-ACA plans to exist past 2014 presents significant pricing and operational concerns for health plans. A recent analysis by Milliman found that, as a result of these policy changes:

"…the ACA individual marketplace faces more serious risk pool composition challenges than would have been reasonably expected at the beginning of open enrollment…The potential for adverse selection—caused by having two parallel markets operating under different rules—poses a significant risk to the viability of the ACA individual medical marketplace."[3]

Because of this increased uncertainty, the 3Rs will play a more critical role in creating a stable market for consumers. It is imperative that these programs work as intended, with additional support as needed, so that health plans can keep premiums low and provide as many coverage options as possible for consumers in years to come.

1 American Academy of Actuaries. Research Brief: Design and Implementation Considerations of ACA Risk-Mitigation Programs. June 4, 2012. http://www.actuary.org/files/AAA-SOA_research_brief_on_3Rs_060412.pdf.

2 77 FR 73199, December 7, 2012.

3 Milliman memorandum on "The Risk Corridor Program and Budget Neutrality." April 11, 2014. Available at: http://www.ahip.org/MillimanReport/Risk-Corridors41114/

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