CHOICES

Improving Risk Adjustment to Improve the Market Today

March 29, 2016

The Risk Adjustment program established in the Affordable Care Act was designed to increase affordable health insurance choices for consumers by promoting a stable and competitive health insurance market. Unfortunately, some unintended consequences of the program have had the opposite effect. CMS, through its recent policy paper and an upcoming open forum, is sensibly considering improvements to Risk Adjustment. However, the policy paper and recent guidance from CMS does not go far enough to address several failings of the program, the consequences of which are currently harming, and not helping, consumers and the insurance market. The key concerns are as follows:

- **CMS is not fully recognizing the current negative effects**. CMS' efforts to make incremental improvements to the program are helpful but generally fail to recognize the broader negative and de-stabilizing impact the current system has had on the market.
- **Flaws in the program require near term solutions.** Delaying significant structural changes until 2018 is likely too long of a timetable for many carriers to remain in an unstable market.
- **States should be given flexibility to make changes**. States should have more authority to limit the impact of Risk Adjustment given their knowledge of their markets and their responsibility to monitor solvency and protect consumers.

Transfer payments for Risk Adjustment have been difficult to predict, highly variable, and in some cases very large in relation to insurers' premium amounts. This variability was especially true for smaller plans that are growing quickly. According to CMS, the median percentage of premium paid for risk adjustment for the smallest plans was 13%, and for the next quartile, the percentage of premium paid was 35%. A payment that is both very large and very unpredictable is a significant problem for any health plan or insurance carrier. The number of health plans that were forced out of the individual market last year has been widely publicized. There were many reasons for these market exits, but one factor that was frequently cited was the inability to afford Risk Adjustment transfer payments that were much larger than expected. Without changes, Risk Adjustment could contribute to additional market exits and may also lead to higher premiums to reflect the additional risks created by the program.

A recent analysis from the actuarial firm Milliman points out that more than half of the carriers in the individual market recorded $0 in estimated Risk Adjustment transfers in their 2014 annual financial statements. In some cases, this was a data-driven prediction, but, especially for smaller carriers and those new to the market, it likely reflected the absence of reliable data. Even the minority of carriers that guessed the correct direction of their transfers (either positive or negative) still tended to significantly underestimate the size of the transfer.

The CHOICES coalition commends CMS for acknowledging the need to make improvements to the Risk Adjustment program, and both for issuing the policy paper and for convening the policy

forum this month to review proposed solutions. We have several concerns, however. The policy paper, while lengthy, was virtually silent about the negative effects of risk adjustment on the insurance market and on consumers. In addition, CMS is planning for changes to take effect in 2018, even though changes are urgently needed for 2015, 2016, and 2017. A number of states have also taken up this issue to maintain stability in their own markets. Unfortunately, as a federally run program under the guidance of CMS, states have been left with very few options to make the adjustments they are seeking.

It is daunting to consider changes to a program that is already in effect for this year, but in this instance it may be necessary. Health plans and insurance carriers are continuing to find it very difficult to estimate the impact of Risk Adjustment with any degree of confidence. The effects of this uncertainty vary from state to state, but CMS should consider addressing problems immediately, rather than in 2018, and at a minimum, state regulators need to have the flexibility to respond to the challenges that are specific to each state and its unique health insurance market.

Proposed Near-Term Solutions:

In the near term, the most feasible remedies are likely to be at the state level. The market for health insurance varies state by state, and state-level dynamics may dictate different responses to the market problems experienced with Risk Adjustment. The proposed solutions below could be adopted by any state that choses to do so, if federal regulators would allow the states reasonable latitude to develop solutions appropriate to each market. Since the Risk Adjustment transfers are determined within each state's "market rating areas," any change adopted in a given state would not affect the Risk Adjustment calculations in any other state.

The CHOICES coalition has identified several examples of possible solutions that could be implemented for the 2015-2017 Risk Adjustment determinations:

Solution #1: Calculate State Risk Adjustment Transfers as a Percentage of CMS Amounts

Under this approach, state insurance regulators could choose to set state Risk Adjustment transfers as a fixed percentage of the transfer amounts determined by the normal CMS Risk Adjustment program. This approach would limit the overall amount of dollars exchanged between carriers by reducing each individual transfer by a set percent. This solution would reduce all payments and receivables proportionately, thereby reducing the overall financial strain on the state insurance market in question.

Solution #2: Impose Limit on Risk Adjustment Payables ("Circuit Breaker")

This proposal would limit a carrier's Risk Adjustment payment to no more than a certain percentage of its gross premiums. It would limit the amount affected plans were required to pay into the Risk Adjustment program. This would particularly support smaller plans that face high payments relative to their smaller premium base.

Solution #3: Apply a "Credibility Approach" at the Carrier Level

This proposal would reduce the application of Risk Adjustment for plans with either small enrollment and/or a high proportion of new members. For these plans, data about risk is either unavailable or especially unpredictable. This method might be implemented, for example, by excluding newly enrolled members from the normal Risk Adjustment calculation and instead using relative demographic factors only to provide a predictable risk adjustment estimate. As plans grew to adequate size, or as the percentage of new enrollees declined to normal levels, Risk Adjustment profiling would apply to its full extent.

Consumers for Health Options, Insurance Coverage in Exchanges in States, or CHOICES, is a coalition dedicated to preserving and promoting consumer choice through strengthening the stability and viability of individual and small group insurance markets. Through its member organizations, CHOICES works with regulators to ensure equity in premium stabilization programs, endeavors to lower barriers to entry for prospective insurance participants, and works to secure a healthy regulatory and policy environment in which health plans can compete fairly.