House Committee on Oversight and Government Reform

The Operation of the Affordable Care Act's Risk Corridor Program

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The Affordable Care Act's risk corridor program is a reasonable approach to risk sharing in a public-private insurance partnership. It is not a bailout. The ACA's premium stabilization programs, including its risk corridor provisions, have helped reduce premiums for qualified health plans, saving American consumers and the federal government billions of dollars. The premium stabilization programs are, moreover, at this point a commitment of the federal government to private businesses. Breaking this commitment would be a breach of contract and possibly an unconstitutional taking. Just as the United States must honor its debts, it must honor its contracts.

The Risk Corridor Concept was an Innovation of the Bush Administration

First, a little history. In 2003, the George W. Bush administration faced a quandary. The administration was under tremendous political pressure to create an outpatient prescription drug benefit in the Medicare program, but was ideologically opposed to doing so through a public insurance program like the existing Medicare Parts A and B. The administration instead wanted to extend coverage through a government-subsidized private insurance program. But prescription drug-only private plans did not exist, therefore private insurers would have to create a new product. Insurers had no actuarial experience in pricing such a product, and the risk would be considerable. Private insurers would be reluctant to take on this risk.

The administration devised a solution that was at the same time both innovative and based on a long-tradition of public-private partnerships in insurance matters—risk corridors. Insurers that decided to offer a Medicare Part D drug plan would price their premiums based on their best actuarial estimates of what providing the coverage would cost. If actual costs exceeded 2.5 percent of expected spending, the government would absorb 75 percent of the excess loss.[1] If actual costs exceeded expected spending by more than 5 percent, the government would cover 80 percent of the excess loss. Conversely, if actual expenses fell below expected spending by more than 2.5 percent, the government would recover 75 percent of excess gains. The government would recover 80 percent of excess gains if actual costs fell more than 5 percent below expected costs. Additionally, the Bush prescription drug legislation offered to reinsure 80 percent of all drug costs above a catastrophic threshold. Since enrollees paid 5 percent of catastrophic costs, insurers were actually only responsible for 15 percent of catastrophic costs.

The rest is history. A Republican Congress created the Part D drug program.[2] With risk corridor and reinsurance protection, private insurers showed up to participate in the Part

D program, and they offered initial premiums below those that had been expected. The risk corridors are still in place a decade later, and the program has been widely seen as a success.

Although the risk corridor solution to sharing risk was innovative, there is a long history of the federal government covering risks that private insurers will not assume to make private insurance viable. The National Flood Insurance Program has for 35 years enabled private individuals to purchase flood insurance through the federal government, allowing private insurers to offer homeowners insurance at reasonable rates by excluding the costly risk of flooding.[3] Senator Rubio voted with two thirds of the Senate last week for bipartisan legislation to continue federal subsidies for flood insurance.[4] Similarly, the Terrorism Risk Insurance Act of 2002 allowed commercial insurers to continue to offer coverage for businesses at reasonable rates by reinsuring the risk of terrorist attacks.[5] The farm bill recently passed by this body reaffirms the provision of federal reinsurance for crop insurers.[6] Cost-plus contracts in the defense industry are also similar in nature—the government assumes the risk of cost overruns to incentives private businesses to perform a necessary task for the government.

The Affordable Care Act Premium Stabilization Programs

In 2009 and 2010, a new Congress faced a similar quandary to that presented by Medicare drug coverage. Congress was proposing to create a national program through which private insurers would offer coverage in the individual market without pre-existing condition underwriting through marketplaces known as exchanges. Insurers had little experience with offering health insurance in the individual market without health status underwriting, and were understandably reluctant, as they were with flood, crop, and terrorism coverage and outpatient drug coverage for seniors, to take on the risk by themselves.

The Affordable Care Act, therefore, contained three premium stabilization programs, two temporary and one permanent. The permanent program, risk adjustment, was intended to move revenue from insurers who ended up with a disproportionate share of low cost insureds to insurers who ended up with high cost insureds.[7] This is a zero-sum program that does not receive any federal funding. A three-year reinsurance program, like that in the Part D drug program, provided a backstop for all insurers in the individual market for high-cost cases, funded entirely by a fee imposed on all insurers and self-insured plans.[8]

Finally, a three-year temporary risk corridor program program, would, much like that created by Medicare Part D, assure insurers that offered qualified health plans through the exchanges that the risk that they took on by entering the program would be shared by the federal government.[9] The Affordable Care Act risk corridor program is less generous than the Bush administration's Part D program was in its first years. Risk sharing payments from the federal government do not kick in until expenses exceed expected revenues by 3 percent rather than 2.5 percent, and then only cover half the losses rather than 75 percent. Risk sharing payments do not increase to 80 percent of losses until costs exceeded expected revenues by 8 percent rather than 5 percent. Conversely, insurers

whose actual spending is less than expected spending will contribute less to the program. Regulations specifying the parameters of the premium stabilization programs were finalized in the spring of 2013, and were relied on by insurers in setting their premiums and entering into contracts with the government for marketing their policies for 2014.

The ACA Premium Stabilization Programs Reduce Premiums

The combined premium stabilization programs achieved their goal. In the 36 states served by the federal exchange, the marketplaces are served by an average of 8 insurers offering 53 plans.[10] In part because insurers did not have to charge a risk premium for the risk of underwriting a new product, premiums came in 16 percent below previous Congressional Budget Office projections, saving enrollees an average of $1100 per year.[11] This in turn will save the federal government $190 billion over ten years in premium tax credits.[12] A study released last week by Price Waterhouse Cooper found that ACA exchange premiums cost the same or less than comparable employer coverage.[13]

The CBO did not assign a cost to the ACA risk corridor program, presumably because it expected contributions from insurers with below projected costs would balance out pay-outs to insurers with above projected expenses. In fact, however, the Part D drug plan risk corridor program has turned out to be a net money maker for the federal government. In every year since 2006, the federal government has received more from the program than it has paid out, with annual receipts ranging from $100 million to $2.6 billion.[14] For the first two years, at least, far more insurers paid in that received payments. Simulations developed by actuaries for discussion by a National Association of Insurance Commissioner actuarial group last year suggested that the same thing might happen with the ACA risk corridor program.

Whether this will turn out to be true for ACA insurers remains to be seen. It is possible that at least in the first year, the risk corridor program will end up costing more than it brings in. Problems with the website in the first two months of its operation, which continue to exist in some states, have led to below expected early enrollments and stalled enrollment campaigns. Determined efforts to discourage enrollment by opponents of the ACA, including state efforts to impede the work of navigators and assisters, recently declared unconstitutional in Missouri;[15] direct campaigns to persuade young people not to enroll; and continuing efforts by ACA opponents to spread unfounded rumors about insecurity of personal information submitted to the exchange have depressed enrollment. Misinformation and confusion about the program are rampant.

Although enrollment through the exchanges is currently strong, and open enrollment lasts for another two months, it is possible that enrollment will come in below expectations. Since those most likely to sign up for coverage early are those who need it most, it is possible that the risk pool will be more costly than the pool insurers anticipated, although no one, including insurers, expected a normal risk pool for the first year of the program. Moreover, the political controversy surrounding the non-renewal of non-conforming individual insurance policies for 2014 forced the administration to allow the continuation

of 2013 individual policies for another year, changing the composition of the expected risk pool in those states that allowed renewal of 2013 policies.

The Risk Corridor Program is not a Bailout

If risk corridor payments do exceed contributions, this still would not be a bailout by any stretch of the imagination. A bailout occurs when the government intervenes to save a business from financial distress—often caused by the business' own unwise decisions—without a legal obligation to do so. When private businesses run into financial distress because of risky behavior of their own, and the government rescues them, that is a bailout. The problem with bailouts is that they create a moral hazard problem—private businesses are incentivized to take unreasonable risks with the potential for private gain, trusting government to rescue them if they lose instead. The Wall Street bailouts resulted in huge losses for investors, consumers, and the taxpayers, but often rewarded those who took the risks.

This is not how the risk corridor program operates. The government is encouraging insurers to take a risk, but is sharing, not assuming, that risk. The government has by law prospectively encouraged insurers to take a risk by assuming a contractual obligation to share that risk.

The necessity of such a program, and impliedly the hypocrisy of trying to make an election issue out of it, has been recognized by conservatives such as Christopher Holt of the American Action Forum,[16] Yevgeniy Feyman in Avik Roy's column at Forbes,[17] and Avik Roy himself. [18] Feyman recognizes that opposition to these programs is short-sighted, since such programs will no doubt be necessary if Republican premium support proposals ever succeed. Feyman states:

> . . . any conservative reform plan for universal coverage will have to use similar methods of risk adjustment. The point here is simple – if you want insurers to participate more broadly in the individual market, you'll need to offer a carrot to offset the unavoidable uncertainties. And railing against risk corridors now will make them a hard sell further down the road. Risk adjustment mechanisms get you the buy-in of insurers, but they also helps keep premiums at manageable levels while insurers develop enough experience to properly price plans on their own. This helps encourage people to enroll in these plans, which in turn helps insurers develop the necessary pricing experience – resulting in a virtuous cycle.

The direct beneficiaries of the premium stabilization programs are American consumers, who are paying lower insurance premiums because of the program. Taxpayers also benefit because premium tax credit payments are lower if premiums are lower. Indeed, whatever happens in 2014, in the end the taxpayer will likely come out ahead under the risk corridor program alone, as was true under the Part D program, but time will tell.

Repealing the Risk Corridor Program would be Illegal, Unwise, and Possibly Unconstitutional

Repeal of the risk corridors also would raise questions about the trustworthiness of the federal government. The federal government has entered into a contract with insurers that provide coverage through the exchanges. That contract incorporates the federal laws and regulations governing the exchanges, including the risk corridor program. Insurers relied on the terms of the ACA, including the risk corridor program, in setting their premiums. The government, like a private party, is bound by its contracts.

Indeed, the failure of the United States to honor its commitment to private insurers under the risk corridor program could be an unconstitutional taking, prohibited by the Fifth Amendment, as contractual rights are property rights for purposes of the Fifth Amendment[19] even though the federal courts prefer to find a breach of contract rather than a taking when both are possible claims. Moreover, the Supreme Court has recognized, honoring its contracts is in the "Government's own long-run interest as a reliable contracting partner in the myriad workaday transaction of its agencies."[20] This includes a general implied covenant of good faith and fair dealing as well as the express terms of the contract.[21]

But most importantly, refusing to honor its obligations would be foolish. Removing the back-stop of the risk corridor program would put private insurers at much higher risk, possibly leading to insolvencies that would need to be covered at great expense by the state and federal governments. It would certainly lead to fewer insurers participating in the exchange in 2015, and to higher premiums. Since the full cost of premiums in exchange coverage is borne by the federal government once lower- and middle-income enrollees pay a set percentage of their income, the cost of the program to the federal government would increase dramatically. These are, no doubt, results desired by opponents of the ACA, but are they good for the nation? Moreover, consider the consequences for all federal programs if the United States cannot be trusted to honor its commitments when it contracts with private businesses.

Conclusion

The risk corridor program is not a bailout. It is a contractual commitment of the United States government to private businesses with which it has partnered to offer a public service. It is modeled after a successful program created by the Bush administration. Just as the United States must not default on its debts for narrow political purposes, it must not breach its contracts. Doing so is not only a possible violation of the Constitution, but also foolish and short-sighted public policy.

[1] 42 U.S.C. § 1395w-115(d).
[2] 42 U.S.C. §§ 1395w-111 et seq.
[3] 42 U.S.C.§§ 4001 et seq.
[4] http://politics.nytimes.com/congress/votes/113/senate/2/19
5 Pub. L. 107–297, 116 Stat. 2322 as amended by Pub. L. 109-144, 119 Stat. 2660, and Pub. L. 110-160, 121 Stat. 1839.
[6] 7 U.S.C. § 1508.
[7] 42 U.S.C. § 18063
[8] 42 U.S.C. § 18061.
[9] 42 U.S.C. § 18062.
[10] ASPE, Health Insurance Marketplace Premiums for 2014 (2013) http://aspe.hhs.gov/health/reports/2013/MarketplacePremiums/ib_marketplace_premiums.cfm
[11] Ibid.
[12] Topher Spiro and Jonathan Gruber, The Affordable Care Act's Lower than Projected Premiums will Save $190 billion (2013) http://www.americanprogress.org/issues/healthcare/report/2013/10/23/77537/the-affordable-care-acts-lower-than-projected-premiums-will-save-190-billion/
[13] PWC, Health Insurance Premiums: Comparing ACA Exchange Rates to the Employer Market**,** pwchealth.com/cgi-local/hregister.cgi/reg/pwc-hri-health-insurance-premium.pdf
[14] http://cms.hhs.gov/Medicare/Medicare-Advantage/Plan-Payment/Plan-Payment-Data.html?DLSort=0&DLPage=1&DLSortDir=ascending
[15] St. Louis Effort for Aids v. Huff (W.D. Mo. January 23, 2014), http://media.npr.org/documents/2014/jan/missouriorder.pdf
[16] Reinsurance, Risk Corridors and Bailouts, Oh My! http://www.realclearpolicy.com/articles/2014/01/23/reinsurance_risk_corridors_and_bailouts_oh_my_810.html
[17] Obamacare's Risk Corridors Won't be a Bailout of Insurers (2014) http://www.forbes.com/sites/theapothecary/2014/01/22/obamacares-risk-corridors-wont-be-a-bailout-of-insurers/
[18] http://www.forbes.com/sites/theapothecary/2014/01/10/humana-obamacare-exchange-enrollment-more-adverse-than-previously-expected/
[19] Lynch v. United States, 292 U.S. 571, 579 (1934).
[20] Robert Meltz, When Congressional Legislation Interferes with Existing Contracts: Legal Issues (CRS 2012); United States v Winstar Corporation, 518 U.S. 839, 883 (1996).
[21] Centex Corp. v. United States, 395 F.3d 1283 (Fed.Cir. 2005).

Timothy Stoltzfus Jost
Curriculum Vitae

Timothy Stoltzfus Jost, J.D (University of Chicago, cum laude, Order of the Coif), holds the Robert L. Willett Family Professorship of Law at the Washington and Lee University School of Law. Prior to coming to Washington and Lee in 2001, Professor Jost taught for twenty years at Ohio State University where he held appointments in the law and medical schools and the Newton D. Baker, Baker and Hostetler Chair. He has also taught courses at the Universities of Virginia, Houston, Oxford, Toronto, Osgoode Hall (York), and Göttingen. He was the recipient of two Fulbright grants, a Western European Research Grant in 1989 and a grant to study in Germany in 1996 and 1997.

Professor Jost is a coauthor of a casebook, *Health Law,* used widely throughout the United States since 1989 in teaching health law and now in its seventh edition. He is also the author or editor of *Health Care at Risk, A Critique of the Consumer-Driven Movement*; *Health Care Coverage Determinations: An International Comparative Study* (recently translated into Chinese), *Readings in Comparative Health Law and Bioethics; Medicare and Medicaid Fraud and Abuse;* and *Regulation of the Health Care Professions.* He also co-authored a casebook on property law.

Professor Jost has published over 150 monographs, articles, and book chapters on health care regulation and comparative health law and policy in law, medicine, and health policy journals. He edits two Social Science Research Network electronic journals and serves on the editorial boards of several print journals. In recent years he has participated in symposia and given presentations at Harvard, Yale, Chicago, Columbia, New York University, Texas, Virginia, Princeton, Georgetown, George Washington, Pennsylvania, Saint Louis, Indiana, Loyola Chicago, Case Western Reserve, Toronto, Alberta, and Chengdu and Tsinghua University in China. He has also spoken frequently at health reform conferences and at congressional and media briefings. He is interviewed regularly by the print and broadcast media and has been quoted recently in the Wall Street Journal, New York Times, Associated Press, Washington Post, Reuters, Politico, the Hill, NPR, and the Guardian, as well as in the trade press and regional newspapers.

Professor Jost blogs regularly for Health Affairs, the nation's leading health policy journal, where he is a contributing editor. In his widely read blog posts, he has analyzed virtually every rule and guidance issued by the Departments of Health and Human Services, Labor, and Treasury implementing Title I of the Affordable Care Act, as well as on many of the court cases involving the Affordable Care Act. The New England Journal of Medicine regularly publishes Professor Jost's Perspectives columns.

Professor Jost is an elected member of the Institute of Medicine, the American Law Institute, and the National Academy of Social Insurance, and a member of the American Society of Law and Medicine, and the American Health Lawyers Association, the American Society of Comparative Law, and the American Bar Association. He is also a funded consumer representative to the National Association of Insurance Commissioners.

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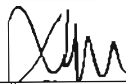
Signature:  Date: 2/1/14