The Role of Reinsurance in Establishing the New Regime

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Reinsurance will play a key role in establishing the new regime contemplated by the Patient Protection and Affordable Care Act and the Health Care and Reconciliation Act of 2010 (together, the "Act"). The Act calls for the creation of state-based reinsurance programs, together with risk corridor and risk adjustment provisions, to support operation of an insurance exchange (the "Exchange") – a marketplace to be created under the Act by 2014 in which potential insureds who do not have adequate health coverage can procure insurance. The reinsurance programs, which will be in effect during the first three years of the Exchange's operation, aim to protect insureds, particularly high-risk individuals, against anti-selection based on health status. The Act also calls for establishment of a temporary reinsurance program to promote health coverage for early retirees.

State-Based Reinsurance Programs and Risk Provisions Supporting the Exchange

1. Transitional Reinsurance Program for Individual Markets

Section 1341 of the Act mandates establishment of state-based reinsurance programs no later than January 1, 2014, to facilitate initial operation of the Exchange. The reinsurance programs will be based on standards promulgated by the Secretary of Health and Human Services (the "Secretary"), in consultation with the National Association of Insurance Commissioners. Under the programs, health insurers and third-party administrators on behalf of group health plans will be required to make payments to a not-for-profit reinsurance entity established by or contracted with the state. By using the funds collected to make reinsurance payments to health insurers that cover high-risk individuals, the reinsurance entity will serve as a means to stabilize insurance premiums for the first three years of the Exchange's operation. The Secretary will develop criteria for determining whether an individual is considered as "high-risk" for purposes of the reinsurance programs. The criteria will include a list of 50 to 100 medical conditions that are indicative of individuals with preexisting or high-risk conditions, or will include any other comparable objective method of identification recommended by the American Academy of Actuaries. The Secretary will also develop a formula for calculating payments from health insurers and third-party administrators to the reinsurance entity. These payments may be based on a percentage of revenue of each issuer and the total costs of providing benefits to enrollees in self-insured plans, or on a specified amount per enrollee, and may be required to be paid in advance or periodically throughout the plan year.

The Act directs states to eliminate or modify existing state high-risk pools if necessary to carry out the reinsurance programs established under the Act. States are permitted to coordinate the high-risk pools with the reinsurance programs to the extent that the pools are not in conflict with such programs.

2. Establishment of Risk Corridors for Plans

Section 1342 of the Act provides that the target allowable costs for a qualified health plan in the individual and small group market should equal the total insurance premiums. It requires the Secretary to establish and administer a program of risk corridors for the first three calendar years of the Exchange to address any deviations from the target allowable costs. Under the program, a qualified health plan offered in the individual or small group market must participate in a payment adjustment system based on the ratio of the allowable costs of the plan to the plan's aggregate premiums. If a plan's costs are higher than 103% of total premiums, the Secretary will be required to make payments to the plan to address the excess. Conversely, if the costs are less than 97% of total premiums, the plan will be required to make payments to the Secretary. Administrative expenses are not included in determining allowable costs of the plan for purpose of the payment adjustment system. Additionally, allowable costs will be reduced by any risk adjustment and reinsurance payments received under Sections 1341 and 1343.

3. Risk Adjustment

Section 1343 of the Act protects against anti-selection based on health status by requiring states to impose charges on health plans in individual or small group markets consisting of insureds with lower than average actuarial risks, and making payments to plans consisting of insureds with higher than average actuarial risks. The Secretary is charged with developing, in consultation with states, criteria for carrying out these risk adjustment activities.

Reinsurance for Early Retirees

In addition to the reinsurance programs and risk provisions described above, Section 1102 of the Act further advances the Act's goal of increasing insurance availability to Americans. This section calls for the creation of a temporary reinsurance program for early retirees, effective no later than 90 days after enactment of the Act and ending on

January 1, 2014. Under this program, the Secretary will reimburse participating employment-based plans for part of the cost of providing health benefits to retirees aged 55 to 64 who are not eligible for Medicare, and their families. Amounts paid to a participating employment-based plan must be used to lower the costs borne directly by the participants and beneficiaries in the form of premiums, co-payments, deductibles, co-insurance, or other out-of-pocket costs. The payments cannot be used to reduce the costs of the employer maintaining the plan. The Secretary will develop a mechanism to monitor the appropriate use of payments by the plans.

For Further Information

If you have any questions, please contact the Edwards Angell Palmer & Dodge lawyer responsible for your affairs, or the authors of this Update, Eric D. Fader (212-912-2724) or Mohana Terry (212-912-2844).