State Reinsurance Programs: Design, Funding, and 1332 Waiver Considerations for States

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STATE Health & Value STRATEGIES | *Driving Innovation Across States*

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Introduction and Purpose of the Brief

The Affordable Care Act (ACA) was designed in part to help bring stability to the individual health insurance market. But faced with a fluid federal regulatory environment, many states continue to encounter challenges including large premium increases and declining insurer participation. One solution to continued market instability is a state-based reinsurance program similar to the federal program that reduced premiums by more than 10 percent per year from 2014 to 2016.

Table 1. Four Reasons to Consider a State Reinsurance Program

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Reason	**Rationale and Support**
Reduce Premiums	• Reinsurance reduces insurer claims' costs by covering a portion of the most expensive claims with financing provided through a state-based funding source and a federal match. • States can use actuarial modeling to predict how much financing it will take to reduce premiums by 10% or 20%.
Attract Insurers	• Insurers are concerned that a small number of large claims can dramatically impact their overall costs in the individual market where there may not be a large enough pool of healthy participants to balance out their risk pools. • Insurer participation was higher before federal reinsurance was phased out in 2016, and insurers often cite federal or state-based reinsurance as the best way to make market participation more attractive.
Limit Volatility	• The individual market is small and vulnerable to the "5/50 rule": 5% of enrollees account for 50% of costs. • Reinsurance reduces market volatility by covering most claims' costs for the highest-cost enrollees with the least predictable claims.
Leverage Federal-State Partnership	• State reinsurance programs are eligible for federal matching funds.

The Trump Administration has strongly encouraged states to establish their own reinsurance programs. In 2017, the Department of Health and Human Services (HHS) and the Department of the Treasury approved three 1332 "state innovation" waivers for reinsurance programs. These waivers offset state program financing with federal "pass-through" funding equal to the federal savings generated by reducing premiums. This means that to fund their reinsurance programs, states only have to cover the net cost after the federal pass-through funding (offset) is applied.

Table 2. Overview of Approved 1332 Reinsurance Waiver Funding for 2018

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	Alaska	**Minnesota**	**Oregon**
Total Reinsurance Program Funding[1]	$60	$271	$90
Federal Pass-Through Funding	$58	$131	$54
State Funding Required (After pass-through funding)	$2	$140	$36
Percentage of Program Covered by Federal Dollars[2]	97%	48%	61%

There are several bills pending in the Congress that would provide reinsurance funding for all states in 2019, and there could be action on these bills in March.[3] While this would be a welcome development for market stabilization, it is highly uncertain whether there will be any such federal action. Even if a new law is enacted, it may require state action to access funding, and the terms of any new funding program could be less favorable for some states than the current 1332 process. In addition, states that take a "wait and see" approach may be at a real disadvantage for 2019 implementation, depending on when Congress acts, what federal resources are available for implementation, and what decisions have already been made by insurers in each state. For these reasons, states wishing to control their own destiny would be well advised to proceed under current law, with contingency plans to take advantage of any new federal program that offers them a better deal than the current 1332 process.

This topic brief provides a roadmap of policy, program design, and financing considerations for states that are contemplating development of a state-based reinsurance program under 1332 waiver authority.

Understanding the Potential Impact of a Reinsurance Program

Health care markets vary widely among states and within regions of the same state. Understanding how reinsurance might help a specific state market starts with a few questions.

- **What market problem does the state need to solve?** Reinsurance can be a strong tool if the key market problem is affordability of premiums, insurer withdrawals, or excess volatility/uncertainty. However, reinsurance will not help with other problems including network adequacy and cost-sharing burdens.
- **What is the average premium?** States with higher average premiums have more to gain from reinsurance, especially for unsubsidized enrollees paying full premiums. While reinsurance will not directly benefit subsidized enrollees, it will save the federal government money and 1332 waivers allow states to recoup those savings.
- **How much premium variation is there across rating areas?** States with large regional variations in premiums may be hard-pressed to retain insurers in high-cost areas; a targeted reinsurance program may be a solution to underserved areas in a state.
- **What does current insurer participation in the market look like?** Insurance regulators will want to consult with current market participants, as well as past and prospective participants, to understand what role reinsurance might play in their future participation.

The percentage of enrollees receiving federal subsidies in the individual market (both in and outside the marketplace) is the best predictor of how large a state's federal pass-through funding to offset state funding needs might be under a 1332 waiver. Federal pass-through funding will generally be larger than a state's subsidized percentage. For example, a state with 60 percent of their enrollees getting subsidies would have to finance less than 40 percent of its reinsurance program with state funds.

- **What is the profile of the state's highest cost enrollees?** Disease and accident patterns vary by state, and states may target specific high-cost conditions through a condition-based reinsurance program.

Designing a Reinsurance Program

Once a state determines that reinsurance may be beneficial, the next step is to answer questions that help to provide the parameters related to the scale and type of reinsurance program that is the best fit, given the state's unique market characteristics.

Table 3: Comparing the Two Reinsurance Models

	Benefits	Drawbacks
Condition-Based Model	Creates opportunity for better medical and cost management of expensive conditions.	Harder to implement in states with no prior experience with this model.
Attachment Point Model	Used in all states for federal program 2014-2016, and may be more familiar to legislators and stakeholders.	May not address state-identified cost drivers as well as condition-based model.

- **How large of a reinsurance program?** States typically start with a target for premium reduction of five percent to 20 percent and then use actuarial modeling to determine what level of reinsurance financing is needed to achieve that premium reduction. The next step is to calculate how much of that financing will be offset by federal pass-through funding. The final step is to determine what level of state financing net of federal offset is politically feasible.
- **What type of reinsurance program?** There are two broad types of reinsurance programs with many permutations.
  - A **condition-based model** identifies specific high-cost conditions to be included in the reinsurance program. Under this model, insurers typically cede some lives and premium to the reinsurance program. Insurers could still handle claims and patient management (e.g., pre-authorization, claim payment or denial, care coordination), but might not have financial responsibility for the claims.
  - An **attachment point model** focuses on all claims, including accidents, and is based on the claim's cost. This model features an attachment point, a coinsurance corridor, and a cap. The attachment point is the cost at which reinsurance starts to pay. In the coinsurance corridor, insurers pay a specified percentage of the claims cost with reinsurance covering the remaining part of the cost. The cap is the amount at which the claim is no longer eligible for reinsurance, and full responsibility reverts to the insurer.

Example: Maine's Condition-Based Reinsurance

Under Maine's pre-ACA reinsurance program, insurers were required to enroll people with a list of specific conditions into the reinsurance pool, and had the option of enrolling others. The plans ceded 90 percent of the premiums paid for these enrollees to the reinsurance pool.

For those enrolled, the reinsurance covered 90 percent of claims between $7,500 and $32,500, and covered 100 percent of claims over $32,500 with no cap.

Table 4. Example of Attachment Point Reinsurance

Federal Attachment Point Reinsurance	
Attachment Point	$45,000 (2014/2015) $90,000 (2016)
Coinsurance Rate	80% (2014) 50% (2015/2016)
Cap	$250,000

Sources: Kaiser Family Foundation, Explaining Health Care Reform: Risk Adjustment, Reinsurance, and Risk Corridors, August 2016.

State Financing Considerations

The funding sources for a reinsurance program must be adequate and should include funding sources outside of the individual market. Without outside subsidization, reinsurance may help stabilize the individual market but will not reduce premiums in the individual market overall.

Table 5. Sources of Reinsurance Program Funding

Source	Example
Policy Assessment	The federal reinsurance program assessed all health insurance coverage including the large and small group markets, as well as stop-loss and third party administrators (TPAs) to reach self-insured plans. Maine assessed health insurers and TPAs to reach all forms of health insurance except self-funded and self-administered plans.
State Premium Tax	Alaska's program is financed by a portion of the state's premium tax that applies to all lines of insurance.
State General Funds	Minnesota used general funds as one of several sources, which spreads costs across all taxpayers.
State Provider Assessments	Minnesota's funding includes a portion of the state's 2% provider tax, which applies to hospitals and other providers.

1332 Waiver Authorizing Legislation

Securing legislative authorization is typically the second most challenging step in the 1332 waiver process. Developing a strategy for legislative support and determining where this step fits in the timeline should be part of the early planning process. Federal law and guidance requires state legislative authorization for both the waiver and the reinsurance program. If there is an existing high-risk pool or reinsurance statute, that may provide a good starting point. The statute should be specific as to the size and funding source or sources for the reinsurance program. The legislation must make the operation of the reinsurance program contingent on federal approval of the waiver.

Developing a 1332 Waiver Application

HHS has published a checklist[4] that provides a step-by-step guide to what a state must include in its waiver application. States can review the approved applications from Alaska, Minnesota, and Oregon to see how the checklist has been successfully used, and may also consult the standardized application template developed by the Robert Wood Johnson Foundation's State Health and Value Strategies program. Key areas of the waiver application include:

- **Goals for the Waiver**–Description of how the reinsurance program will achieve state goals such as lowering premiums, increasing enrollment, and encouraging insurers to remain in the market.
- **Authorizing Legislation**–Description of the state's legislation that authorizes both the 1332 waiver and the reinsurance program, and makes the operation of the reinsurance program contingent on federal approval of the waiver.
- **Funding**–Description of the funding sources used for the reinsurance program, the funding amount from each source, and the estimated amount of pass-through funding. Note that final pass-through funding will be determined using actual approved premiums, and funding will be provided in quarterly installments starting in April of the covered year.
- **Actuarial Analysis**–Actuarial modeling, including a baseline scenario without the reinsurance program, and a year-by-year comparison of premiums and coverage with and without the reinsurance program. States may be able to utilize in-house actuaries, though outside actuarial firms may shorten timelines.

- **Ten-Year Budget**–Economic analysis, including a ten-year budget that considers all costs associated with the program, including administrative costs and demonstrates that the waiver is deficit neutral.
- **Waiver Development Process**–List of public hearing dates and compliance with other public participation requirements. States must observe a 30-day public comment period and hold a minimum of two public hearings. The public comment period can rely on a draft waiver as long as the public has sufficient information to meaningfully give input. The public comment process must include consultation with federally-recognized American Indian tribes.

Planning the Waiver Timeline

State Health and Value Strategies has a to-do list for states considering a Section 1332 reinsurance waiver for plan year 2019. The first step listed in the to-do list is to sketch out a calendar for activities, which will vary depending on whether a state is a Federally Facilitated Marketplace (FFM) or a State-based Marketplace (SBM). The proposed due date for rate filings in FFM states is June 20, with SBM states having more flexibility in terms of their submission timelines. In 2017, the time from waiver filing to HHS approval decreased from seven months for Alaska to less than two months for Oregon, though Oregon was working closely with federal officials long before the state filed its final application. Indeed, the most important lesson on timeline is to be in close communication with HHS and Treasury, identifying and discussing any trouble spots, as well as understanding what other states may be in the queue. Federal officials may be open to allowing states to pursue various parts of their application simultaneously, with, for example, final legislative approval, public comment, and actuarial modeling taking place under overlapping timelines. To minimize risk, though, states should aim to submit their applications by March or April. Later filings may necessitate asking insurers to file two sets of rates or taking other actions that add complication to the process.

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The program connects states with experts and peers to undertake health care transformation initiatives. By engaging state officials, the program provides lessons learned, highlights successful strategies and brings together states with experts in the field. Learn more at *www.shvs.org*.

ABOUT MANNATT HEALTH

This brief was prepared by Joel Ario and Jessica Nysenbaum. Manatt Health is an interdisciplinary policy and business advisory division of Manatt, Phelps & Phillips, LLP, one of the nation's premier law and consulting firms. Manatt Health helps clients develop and implement strategies to address their greatest challenges, improve performance, and position themselves for long-term sustainability and growth. For more information, visit *www.manatt.com/ManattHealth.aspx*.

Endnotes

1. These amounts are set by the states, which have the flexibility to decide on the size of the reinsurance program, typically based on what percentage of premium reduction they have targeted.
2. If a state uses all of the federal funds to replace state dollars, this is the percentage of the total program covered by federal dollars.
3. Pending bills include the Collins-Nelson proposal, available at: https://www.congress.gov/bill/115th-congress/senate-bill/1835/text and Costello-Peterson proposal, available at: https://costello.house.gov/sites/costello.house.gov/files/Premium%20Relief%20Act.pdf
4. Centers for Medicare & Medicaid Services. *Checklist for Section 1332 State Innovation Waiver Applications, including specific items applicable to High-Risk Pool/State-Operated Reinsurance Program Applications*. CMS.gov. https://www.cms.gov/CCIIO/Programs-and-Initiatives/State-Innovation-Waivers/Downloads/Checklist-for-Section-1332-State-Innovation-Waiver-Applications-5517-c.pdf. May, 2017. Accessed February 26, 2018.