NEW YORK STATE
DEPARTMENT*of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

Decision Regarding Implementation of the Market Stabilization Pool for 2017 Pursuant to 11 NYCRR § 361.9, Subject to the Pending Order from the Second Circuit in *United Healthcare of New York v. Vullo* Enjoining Any Demand for Payment During the Pendency of Appeal

Introduction

Section 361.9 of 11 NYCRR provides the Superintendent of Financial Services with the authority to implement a New York market stabilization pool for plan year 2017 if the Superintendent "determines that the federal risk adjustment program has adversely impacted the small group health insurance market in the State and that amelioration is necessary." 11 NYCRR § 361.9(b)(2). The regulation specifies that the market stabilization pool will operate by the selection of a uniform percentage adjustment to be applied to the amount of federal risk adjustment payments and receipts. The percentage is calculated as the adjustment that the Superintendent has determined to be necessary, based on reasonable actuarial assumptions, to correct any adverse market impact factors identified. 11 NYCRR § 361.9(e)(1).

Pursuant to this authority, the Superintendent has determined, after reviewing the impact of the federal risk adjustment program on the small group health insurance market in this State for the 2017 plan year, that the federal risk adjustment program has adversely impacted the small group health insurance market in New York and that amelioration is necessary. Specifically, for the 2017 plan year, as set forth in 11 NYCRR 316.9(b)(1)(i), the federal risk adjustment program results in inflated risk scores and payment transfers in New York State because the calculation is based in part upon a medical loss ratio computation that includes administrative expenses, profits

and claims rather than only using claims. In New York, the minimum medical loss ratio is 82 percent, leaving 18 percent for administrative expenses and profit, which should not be included in the risk adjustment transfers as risk adjustment is intended to address medical claims paid by insurers. In addition, the federal risk adjustment program has caused market instability in New York in part because the use of the statewide average premium in the federal risk adjustment formula disadvantages smaller New York insurers, whose risk adjustment liabilities represent a larger portion of their premiums than larger insurers with greater market share, thereby undermining a competitive marketplace. This instability may be caused in part because the newer, smaller insurers do not have the detailed data necessary to prove that their insureds are less healthy for purposes of risk scoring. Accordingly, as explained further below and subject to the decision by the Second Circuit in *United Healthcare of New York v. Vullo*, ECF No. 18-2583, DFS will implement a market stabilization pool for the 2017 plan year pursuant to 11 NYCRR 361.9, with the uniform percentage necessary to correct the adverse market impact factors determined as 18 percent. Implementation of this decision will be delayed until the later of either when the Second Circuit renders its decision in *United Healthcare of New York v. Vullo* or when the present order by the Second Circuit enjoining any demand for payment is no longer in effect.

Background of 11 NYCRR § 361.9

The New York State Legislature authorized a risk adjustment program for New York's individual and small group markets in 1992. *See* N.Y. Ins. Law § 3233. The statute granted the Department of Insurance, a predecessor agency to DFS, market stabilization authority to establish and maintain a "pooling process involving insurer contributions to, or receipts from, a fund which shall be designed to share the risk of or equalize high cost claims." *Id.* § 3233(c)(1).

In 2013, pursuant to its authority under the Affordable Care Act (ACA), the United States Department of Health and Human Services (HHS) promulgated a federal risk adjustment program, which first became operational for the 2014 plan year. *See* 78 Fed. Reg. 15527 (Mar. 11, 2013); 42 U.S.C. §§ 18041(a)(1)(C), 18063(b). HHS has operated the federal risk adjustment program on behalf of the States, including New York, since that time. DFS's separate authority to also implement a state market stabilization regulation has continued to be set forth in the Insurance Law, without any amendment. In fact, throughout the country, insurance regulation – including for market stability, insurer solvency and rate review – is generally the responsibility of state insurance commissioners under their state insurance laws.

The federal risk adjustment program has experienced certain challenges. In May 2016, for example, HHS determined that, based on its initial review of the 2014 risk adjustment numbers, certain insurers found themselves owing substantially higher risk adjustment payments than expected—particularly "new, rapidly growing, and smaller insurers." 81 Fed. Reg. 29146, 29152 (May 11, 2016). As New York's insurance regulator, DFS identified similar distortions, finding that under the federal program newer and smaller issuers in New York's health insurance market were expected to pay tens of millions of dollars into the federal risk adjustment pool, and that for those issuers the millions to be paid represented a significant portion of their revenue. In particular, DFS was concerned that the federal program would be unduly impacted by factors other than the actual relative health of members and would impact New York's markets, insurers and consumers adversely. In fact, compared to other States, New York's health insurance market has been disproportionately affected by the methodology that HHS had adopted for the federal risk adjustment program. In 2014 and 2015, New York had by far the largest aggregate amount of money transferred under the federal program: the nearly $200 million required to be

transferred among New York insurers in 2014 was more than four times the amount transferred in California, and in 2015, New York's pool of $342 million was more than twice California's.

DFS reviewed the federal program results for 2014 and 2015 and determined that portions of the extraordinarily large federal risk adjustment transfers in New York could be attributed to factors that had a disproportionate and adverse effect in this State. For example, DFS determined that the federal program led to inflated risk scores—and thus inflated payment transfers—because it treats certain non-claims expenses by insurers as "losses." Under New York law, only payments of claims are treated as losses for purposes of the health insurance rate-setting process. The federal risk adjustment program counts not only claims but also administrative expenses and profits in its payment transfer formula, which results in inflated risk scores and payment transfers in New York, contrary to the program's intended purpose.

Recognizing that state-specific differences may have a destabilizing effect on some States' markets, HHS in May 2016 expressly "encourage[d] States to examine whether any local approaches, under State legal authority, are warranted to help ease this transition to new health insurance markets." 81 Fed. Reg. 29146. HHS repeated this invitation several more times over the next two years. In December 2016, HHS again acknowledged the problem of "certain issuers, including some new, rapidly growing, and smaller issuers, ow[ing] substantial risk adjustment charges [under the federal program] that they did not anticipate," and "continue[d] to encourage States to examine whether any local approaches, under State legal authority" could address this specific problem. 81 Fed. Reg. at 94159. In November 2017, HHS again "recognized some State regulators' desire to reduce the magnitude of [federal] risk adjustment charge amounts for some issuers," and again invited States to pursue "any local approaches under State legal authority" to pursue that goal. 82 Fed. Reg. 51052, 51072 (Nov. 2, 2017).

Accordingly, in order to address the distortions caused by the federal risk adjustment program and to stabilize New York's health insurance market, DFS determined to exercise its state-law authority under Insurance Law § 3233 to implement the statutorily-authorized state-run risk adjustment program for the 2017 plan year. Thus in 2016 DFS promulgated, first as an emergency regulation and later as a final regulation, 11 NYCRR § 361.9, which provides for a state risk adjustment program for plan year 2017. The final regulation also provides for a state risk adjustment for plan years 2018 and thereafter. This final regulation was proposed as a Notice of Revised Rulemaking on May 16, 2018 and was subject to a public comment period as required by the State Administrative Procedures Act. DFS received and considered comments and on August 15, 2018 adopted the final regulation. This regulation was specifically designed to "ameliorate the disproportionate impact" of federal risk adjustment on New York markets and to address New York specific factors such as "carriers' networks and plan designs, carriers' solvency and financial conditions, and market stability." See 11 NYCRR §§ 361.9(b)(2); 361.10(b)(1)(iii). Pursuant to the final regulation, the Superintendent is empowered to require a uniform adjustment of up to 30 percent of the amount received from the federal risk adjustment program in 2017. Id. § 361.9(e)(1).

In April 2018, HHS endorsed New York's approach in its final rule implementing the federal risk adjustment program for 2019. As HHS observed, a "few commentators noted that New York has already taken action to reduce transfers under the State's authority"—a reference to 11 NYCRR § 361.9—"and requested clarification whether other States could take steps under existing State authority." 83 Fed. Reg. 16930, 16960 (Apr. 17, 2018). In particular, HHS noted that commenters had inquired whether States could "implement[] any State-specific adjustments" like New York's without obtaining HHS approval. *Id.* HHS responded to these inquiries by again confirming its approval of "local approaches under State legal authority" to respond to

distortions caused by the federal risk adjustment program, and concluded that "States that take action and make adjustments do not generally need HHS approval as these States are acting under their own State authority and using State resources." *Id.*

In August 2018, DFS's risk adjustment regulation was upheld by the United States District Court for the Southern District of New York. The Court found that DFS's "use [of] a risk adjustment methodology developed by the [DFS] that is sensitive to factors unique to New York health insurance markets and intended to remedy the adverse consequences of the [federal risk adjustment program] in New York" is entirely lawful and proper and concluded that challenges to DFS's regulation are "without merit." *See* Opinion and Order, *United Healthcare of New York Inc. v. Vullo*, 17-cv-07694-JGK, ECF Doc. No. 66 (Aug. 10, 2018). The District Court's decision was appealed by United Healthcare to the United States Court of Appeals for the Second Circuit, and that appeal remains pending. *See United Healthcare of New York v. Vullo*, ECF No. 18-2583. On November 19, 2018, the Second Circuit issued an Order enjoining any demand for payment from any insurer while the appeal is pending. The implementation of this decision will be delayed until the court renders a decision in that case, and the injunction is lifted by the Second Circuit and the Regulation is upheld.

Analysis

On July 9, 2018, HHS issued the final 2017 risk adjustment transfer amounts in its "Summary Report on Permanent Risk Adjustment Transfers for the 2017 Benefit Year." [1] The Superintendent, consistent with 11 NYCRR 361.9, has reviewed the impact of the federal risk adjustment program on the small group health insurance market in New York for 2017 (which in

[1] *Available at* https://downloads.cms.gov/cciio/Summary-Report-Risk-Adjustment-2017.pdf.

2017 consisted of 21 separate issuers), including payment transfers, the statewide average premium and the ratio of claims to premiums, to determine whether the market stabilization mechanism authorized under 11 NYCRR 361.9 is necessary. Based on the factors set forth below, the Superintendent has determined that it is necessary to establish, and is hereby establishing, the market stabilization mechanism authorized for plan year 2017. The Superintendent has further determined that the uniform percentage necessary to correct the adverse market impact factors specified below is 18 percent. 11 NYCRR 361.9(e)(1).

As in previous years, the 2017 federal risk adjustment formula included administrative expenses, profits and claims rather than only claims. Under New York law, only payments of claims are treated as losses for purposes of the health-insurance rate-setting process. Specifically, New York law limits insurers in the small group market to a minimum loss ratio of 82 percent, meaning that no more than 18 percent of premiums can be spent on administrative expenses or booked as profit. See §§ Ins. Law 3231(e)(1)(B), 4308(c)(3). By including not only claims but also administrative expenses and profits in its payment transfer formula, the federal risk adjustment program for 2017 resulted in inflated risk scores and payment transfers in New York. Accordingly, the Superintendent has determined that an 18 percent uniform percentage adjustment will be applied to the amount of federal risk adjustment payments and receipts based on this factor. It is worth noting that, for the 2018 plan year and forward, HHS has recognized the distortion created by this factor and has reduced risk adjustment transfers by 14 percent in the aggregate.

The Superintendent has further determined that HHS's use of the statewide average premium disadvantages small group insurers in New York. As noted by HHS:

> The risk adjustment transfer formula generally calculates the difference between the revenues required by a plan, based on the health risk of the plan's enrollees, and the

> revenues that a plan can generate for those enrollees. These differences are compared across plans in the State market risk pool and converted to a dollar amount based on the Statewide average premium. Thus, each plan in the risk pool receives a risk adjustment payment or charge designed to compensate for risk for a plan with average efficiency. 74 Fed. Reg. 16930, 16954 (April 17, 2018).

In New York, however, where one insurer has over 50 percent market share and will receive over 88 percent of the total federal risk adjustment transfers for 2017, the use of the statewide average premium is not properly reflective of the purposes of risk adjustment, resulting in market destabilization for smaller and newer insurers and disparate impact on premiums paid by consumers. Those smaller and newer insurers will not be able to effectively compete against a dominant market participant if all insurers are forced to move their premiums towards the statewide average premium. In fact, the Superintendent has determined that "the federal risk adjustment program will adversely impact the small group health insurance market in New York in 2017 to such a degree as to require a remedy." 11 NYCRR 361.9(b)(1).

This destabilization is evident in the disparate amounts of the 2017 federal risk adjustment transfers. For 2017, New York's total transfers are the second highest in the nation (second to California), as are the transfers calculated on a per member per month basis (second to Hawaii). The transfers disproportionately impact smaller insurers and newer entrants to the market, which typically have narrower networks. For the 2017 federal risk adjustment program, fifteen insurers paid into the pool and only four insurers received payments from the pool. The vast majority of the federal risk adjustment transfers for 2017 – over $216.6 million or 88 percent of the total transfers -- went to one insurer with over a 50 percent market share. Eleven of the fifteen insurers paying into the pool were smaller insurers, i.e., with less than 3 percent market share.

Moreover, for most of the smaller insurers, the 2017 federal risk adjustment liability represents a significant portion of their premium revenue. One small insurer's risk adjustment

liability is 63.4 percent of their premium; three small insurers' liability is over 40 percent; for three small insurers it is over 20 percent. By comparison the average risk adjustment receipt is just 4.55 percent of premium for those companies that are receivers of 2017 federal risk adjustment funds, with no receipt greater than 9.3 percent of premium. The size of these transfers forces smaller insurers to raise their premium rates -- to consumers' detriment -- and undermines a competitive small group marketplace by favoring one dominant insurer to the competitive disadvantage of many other smaller insurers, based on transfers that are not wholly tied to the sound purposes of the risk adjustment program. Thus, without DFS action, the federal risk adjustment program would cause market instability in New York, unfairly disadvantage smaller and newer insurers, and create barriers to entry into the small group market.

The Superintendent has also reviewed the federal risk adjustment formula as it relates to family tiering in New York, as set forth in the regulation. Specifically, the federal formula inflates the plan liability risk scores in New York because it excludes children who do not count toward family rates or family policy premiums when calculating a plan's number of billable members. DFS has reviewed the 2017 federal risk adjustment results and has determined that this exclusion also had some additional impact on the transfers. DFS calculates that for 2017 this factor had a less than one percent impact on the amount of 2017 federal risk adjustment transfers.

While 11 NYCRR 361.9 authorizes the Superintendent to implement a uniform percentage up to 30 percent, the Superintendent has determined that a uniform percentage of 18 percent is the appropriate percentage to correct the adverse market conditions specified above.

Determination

For the reasons stated above, the Superintendent has determined that the 2017 federal risk adjustment program has adversely impacted the small group health insurance market in New York and that amelioration is necessary to protect market stability. The uniform percentage referenced in 11 NYCRR 361.9(e)(1) shall be 18 percent, to be implemented in the event the stay in the pending litigation is lifted. This is the amount that the Superintendent has determined is necessary to correct the adverse market impact of risk adjustment for the small group health insurance market in New York for plan year 2017. This decision applies solely to the 2017 plan year for the small group health insurance market. The Department will review future years, for both the small group and individual markets, based on the facts and circumstances in those years.

Following, and subject to, the Second Circuit's resolution of *United Healthcare of New York v. Vullo*, ECF No. 18-2583 and the termination of the Second Circuit's injunction enjoining any demand for payment, the Department of Financial Services will implement and administer the New York market stabilization in accordance with 11 NYCRR 361.9 and the court's order, and will provide separate guidance on the timing of payments by and to issuers at the appropriate future date.

January 17, 2019

IT IS SO ORDERED,

Maria T. Vullo

Superintendent