



U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES  
**OFFICE OF INSPECTOR GENERAL**

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**Testimony Before the United States House of Representatives**  
**Committee on Energy and Commerce**  
*Subcommittee on Health*  
*Subcommittee on Oversight and Investigations*

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***“The Affordable Care Act on Shaky Ground:  
Outlook and Oversight”***

Testimony of:  
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Office of Inspector General  
U.S. Department of Health and Human Services

**September 14, 2016**

**10:00 a.m.**

**Location: HVC-210 U.S. Capitol Building**

Good morning, Chairman Pitts, Chairman Murphy, Ranking Members Green and DeGette, and members of the Subcommittees. I am Gloria Jarmon, Deputy Inspector General for Audit Services for the Office of Inspector General (OIG), U.S. Department of Health and Human Services (HHS). Thank you for the opportunity to appear before you today to discuss OIG's oversight of health insurance marketplaces.

The Patient Protection and Affordable Care Act (ACA) established health insurance exchanges (commonly referred to as "marketplaces") to allow individuals and small businesses to shop for health insurance in all 50 States and the District of Columbia. States can choose to operate their own State marketplaces. Thirteen States (including the District of Columbia) are operating their own State marketplaces. The ACA provided funding assistance to States for planning and establishing State marketplaces.

OIG has identified oversight and operation of the health insurance marketplaces as a Top Management Challenge for HHS. OIG has completed a significant body of audits and evaluations regarding the Federal and State marketplaces and other ACA provisions of high interest and concern to the Department, Congress, and other stakeholders and plans more work in this area. OIG's marketplace oversight strategy focuses on four areas that we have determined to be most critical: payment accuracy, eligibility systems, management and administration, and security of data and systems. (See the Attachment for a list of OIG's completed ACA work related to the marketplaces.)

Today, I will discuss the Consumer Operated and Oriented Plan (CO-OP) program and the State marketplaces, but I would like to note that OIG has performed multiple reviews related to the operations of the Federal marketplace, including reviews related to (1) systems for determining consumers' eligibility for qualified health plans and insurance affordability programs, (2) enrollment, (3) advance premium tax credits for individuals enrolled in qualified health plans, (4) the security of marketplace data and information technology (IT) systems, and (5) contracting.

#### OIG's Oversight of the CO-OP Program

The ACA established the CO-OP program to foster the creation of nonprofit health insurance issuers to offer qualified health plans. The ACA authorized the Secretary of HHS to provide startup and solvency loans to help establish CO-OPs. Startup loans were intended to help CO-OPs cover approved costs for beginning operations. CMS has awarded \$2.44 billion to 23 CO-OPs, of which \$358 million was for startup loans; the remaining \$2.08 billion was for solvency loans. The startup loans were originally treated as debt that each CO-OP was expected to repay within 5 years of the disbursement. Solvency loans were structured to comply with applicable State insurance laws to meet capital reserve requirements and were expected to be repaid within 15 years. State insurance regulators require insurance issuers to maintain specified levels of capital reserves to continue to conduct business.

OIG's past work related to the CO-OP loan program examined the Centers for Medicare and Medicaid Services' (CMS) selection process for awarding financial loans to CO-OPs, early implementation of the loan program, and the financial solvency of the CO-OPs. On the basis of that work, we concluded that CMS awarded CO-OP loans in accordance with applicable Federal requirements, but we also identified several risks that indicated a critical need for additional CMS oversight of the CO-OPs as they prepared to become operational. For instance, we identified a risk that CO-OPs could exhaust all startup loan funding before they became fully operational or before they earned sufficient operating income to be self-supporting. We also found that after becoming operational, most CO-OPs had lower-than-expected enrollment numbers and significant net losses and that these factors might limit some CO-OPs' ability to repay loans. We made recommendations to CMS to improve its oversight of the loans and of the financial solvency of the CO-OPs.<sup>1</sup> Twelve of the original 23 CO-OPs had closed as of December 31, 2015. After issuance of our reports, 4 additional CO-OPs closed (as of August 31, 2016), leaving only 7 of the original 23 CO-OPs in business.

In my testimony today, I will focus on OIG's most recent work, which examines the CO-OPs' conversion of startup loans into surplus notes (a bond-like instrument issued to provide needed capital). On July 9, 2015, CMS issued a memo to the CO-OPs that provided guidance to allow the CO-OPs to amend their startup loan agreements. According to the guidance, the amendments would allow CO-OPs to convert startup loans into surplus notes. Under the terms of a surplus note, CO-OPs are not required to make any repayment on a surplus note that could lead to financial distress or default. Loan conversions were intended to improve capital levels and to meet the 500-percent risk-based capital (RBC) requirements generally imposed by CMS, which represented the minimum amount of capital needed to support the CO-OP's business operations.<sup>2</sup> In accordance with National Association of Insurance Commissioners accounting principles, CO-OPs that converted their startup loans into surplus notes could record and report these loans as capital and surplus rather than as debt in financial filings with regulators.

In August 2016, OIG issued a report examining CMS's oversight and approval of CO-OPs' conversions of startup loans into surplus notes.<sup>3</sup> This work stemmed from a hearing entitled "Examining the Costly Failures of Obamacare's CO-OP Insurance Loans" held before the United States House Committee on Energy & Commerce, Subcommittee on Oversight & Investigations, on November 5, 2015. The hearing addressed financial challenges that CO-OPs faced and the effects on consumers and taxpayers. During the hearing, members expressed interest in OIG auditing the conversions of startup loans to surplus notes.

OIG determined that the 12 CO-OPs that converted startup loans to surplus notes on or before December 31, 2015, complied with CMS guidance and applicable accounting principles when

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<sup>1</sup> [Early Implementation of the Consumer Operated and Oriented Plan Loan Program; The Centers for Medicare & Medicaid Services Awarded Consumer Operated and Oriented Plan Program Loans in Accordance with Federal Requirements, and Continued Oversight Is Needed; Actual Enrollment and Profitability Was Lower Than Projections Made by the Consumer Operated and Oriented Plans and Might Affect Their Ability To Repay Loans Provided Under the Affordable Care Act](#)

<sup>2</sup> On the basis of a health insurance issuer's size and risk, RBC estimates the minimum amount of capital needed to support the issuer's business operations. Issuers with a higher level of risk must reserve a larger amount of capital. RBC is usually expressed as a percentage. CMS generally required CO-OPs to maintain an RBC of 500 percent but allowed for lower levels to increase the long-term sustainability of some CO-OPs.

<sup>3</sup> [Conversions of Startup Loans Into Surplus Notes by Consumer Operated and Oriented Plans Were Allowable but Not Always Effective.](#)

converting startup loans into surplus notes. However, CMS did not adequately document the potential impact of the conversions on the Federal Government's ability to recover the loan payments if the CO-OPs were to fail. Although the conversions provided increased levels of capital and surplus, 4 of the 12 CO-OPs approved for conversions ceased operations within 6 months of the conversion. Despite the conversions allowing CO-OPs to record the startup loans as capital and surplus instead of debt, RBC percentages were at levels below the CMS requirement of 500 percent for four of the eight operational CO-OPs as of December 31, 2015. On the basis of these findings, OIG made two recommendations to CMS to improve the decision-making process for any future conversions of startup loans to surplus notes: to document any potential negative impact from changes in distribution priority and to quantify the likely impact on the Federal Government's ability to recover loan payments.

We are reassessing the CO-OPs' financial condition to determine whether any improvements were made in 2015 and 2016, and to monitor actions by CMS to address underperforming CO-OPs. That work is expected to be issued during fiscal year 2017. We continue to keep abreast of emerging issues related to the CO-OP program and will determine whether additional oversight is warranted.

### CMS's Oversight of State Marketplaces

OIG's work has covered various aspects of State marketplace operations, such as enrollment services and eligibility determinations, States' use of establishment grant funds, and security of the marketplaces' data and systems.

#### *Enrollment and Eligibility*

OIG recently completed a series of reviews to determine whether State marketplaces had effective internal controls in place to ensure that individuals signing up for health insurance and receiving financial assistance through insurance affordability programs are eligible to do so. OIG reviewed the first open enrollment period (October 2013 through March 2014) at seven State marketplaces<sup>4</sup> and assessed internal controls over three broad areas: (1) verifying applicants' identity, (2) determining applicants' eligibility for enrollment in a qualified health plan and eligibility for insurance affordability programs, and (3) maintaining and updating eligibility and enrollment data.

On the basis of our reviews of sampled applicants at the State marketplaces, we determined that certain internal controls were effective at the State marketplaces. These included internal controls for verifying applicants' incarceration status, verifying changes reported by enrollees that affect their eligibility, and maintaining applicant data and documentation related to resolving inconsistencies. However, we found that most of the State marketplaces had some ineffective internal controls for ensuring that individuals were enrolled in a qualified health plan in accordance with Federal requirements. Examples of ineffective internal controls included deficiencies in performing identity-proofing verification, appropriately calculating and verifying applicants' annual household income, verifying applicants' eligibility for minimum essential

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<sup>4</sup> The seven State Marketplaces we reviewed were Colorado, District of Columbia, Kentucky, Minnesota, New York, Vermont, and Washington. In addition, OIG prior work included separate reviews at California and Connecticut.

coverage through employer-sponsored insurance, and resolving inconsistencies in applicants' eligibility data. OIG made a number of recommendations to the State marketplaces for implementing specific procedures to better ensure that eligibility determinations are accurate and performed in accordance with Federal requirements. OIG also recommended in some instances that a State marketplace redetermine the eligibility of sample applicants on the basis of our audit findings. We plan to assess CMS's oversight of the seven State-based marketplaces.

#### *States' Use of Establishment Grant Funds*

The ACA provided \$5 billion in funding assistance to the States for the planning and establishment of marketplaces,<sup>5</sup> but grants had to be awarded before January 1, 2015; after January 1, 2015, marketplaces were required to be self-sustaining, meaning they could not use grant funds for operational purposes. CMS also provided guidance stating that after January 1, 2015, these Federal funds may not be used to cover maintenance and operating costs, which include rent, software maintenance, telecommunications, utilities, and base operational personnel and contractors.

In planning and establishing the marketplaces, States could use establishment grant funds for a variety of activities, including those that could benefit multiple State health programs. Accordingly, CMS's Funding Opportunity Announcements and subsequent grant award terms and conditions required marketplaces to allocate shared costs among Medicaid, the Children's Health Insurance Program, and qualified health plans consistent with Federal cost principles.<sup>6</sup>

OIG is completing a series of reviews of CMS establishment grants at eight State marketplaces across the Nation.<sup>7</sup> This work covers the period from the inception of the marketplace through December 31, 2014, and has primarily focused on whether marketplaces allocated costs to their establishment grants in accordance with Federal requirements. As of today, we have issued three reports on State marketplace establishment grants.<sup>8</sup> OIG reported that two of these States did not properly allocate costs for establishing a health insurance marketplace to their establishment grants in accordance with Federal requirements. These States used allocation percentages based on outdated, estimated enrollment data instead of the updated, better data that were available. We made recommendations to the States to refund to CMS misallocated amounts or work with CMS to resolve the amounts misallocated to the establishment grants.

In addition to reporting problems with the allocation of costs, OIG raised concerns about the level of detail in CMS's guidance regarding the types of operational costs that State marketplaces would not be able to charge against the Federal establishment grant after January 1, 2015. In

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<sup>5</sup> CMS provided several different funding opportunities to States, including early innovator cooperative agreements, planning and establishment grants, and establishment cooperative agreements.

<sup>6</sup> 2 CFR part 225.

<sup>7</sup> Colorado, District of Columbia, Kentucky, Maryland, Minnesota, New York, Nevada, and Vermont.

<sup>8</sup> [\*Nevada Misallocated Costs for Establishing a Health Insurance Marketplace to Its Establishment Grants\*](#), [\*The District of Columbia Claimed Allocated Costs to Its Establishment Grants in Accordance With Federal Requirements\*](#), and [\*Maryland Misallocated Millions to Establishment Grants for a Health Insurance Marketplace\*](#).

April 2015, OIG issued an early alert<sup>9</sup> to CMS, encouraging it to provide more specific guidance to State marketplaces about what it considered to be operating costs. OIG stated that without detailed guidance, State marketplaces might have used, and might continue to use, establishment grant funds for operating expenses after January 1, 2015, contrary to law. In response to the OIG early alert, in June 2015 CMS updated and issued revised guidance<sup>10</sup> that provided examples of allowable activities (e.g., outreach, education, and stabilizing marketplace IT systems) for which States could use establishment grant funds after January 1, 2015. The revised guidance further clarified the kinds of costs that CMS considered unallowable (e.g., rent, hardware/software maintenance, telecommunications, and utilities) because they were related to ongoing operations. OIG has not independently assessed the effectiveness of CMS guidance in ensuring that establishment grant funds were not used for operating costs after January 1, 2015. As part of our oversight of State marketplaces' use of establishment grant funds, we are considering additional work related to marketplace operational expenses incurred after January 1, 2015, and CMS's activities to prevent and detect use of establishment grant funds for unallowable purposes.

### *Data and Systems Security*

Because the State marketplaces handle consumers' personally identifiable information (PII), OIG identified the security of the marketplaces' data and systems as a critical oversight area. CMS requires that marketplaces follow Federal IT security standards and additional requirements, including standards related to (1) monitoring, periodically assessing, and updating security controls and (2) developing and using secure electronic interfaces.

To date, we have completed reviews of data and systems security in five States and are close to completing reviews of two others.<sup>11</sup> All States for which we have completed reviews implemented some security controls to protect PII; however, vulnerabilities existed in those States, and each had at least one vulnerability that, if exploited, could have exposed PII and other sensitive information. Multiple States had weaknesses in patch and vulnerability management and failed to conduct required periodic penetration testing, which is an authorized attempt to locate and exploit vulnerabilities. Without an annual external network penetration test, a State cannot ensure that adequate controls are in place to defend against external threats that could result in unauthorized access to consumer PII and sensitive system information. States generally agreed with our recommendations to improve security and in many instances reported that they took immediate action to correct vulnerabilities identified by OIG.

### Conclusion

OIG is committed to continued oversight of the Federal and State marketplaces and related programs to help ensure that they operate efficiently, effectively, and economically. Given the magnitude and complexity of these programs, close oversight is essential. OIG has a substantial body of work underway and planned to ensure that taxpayer dollars are spent for their intended

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<sup>9</sup> [\*Early Alert: Without Clearer Guidance, Marketplaces Might Use Federal Funding Assistance for Operational Costs When Prohibited by Law.\*](#)

<sup>10</sup> FAQs on the Clarification of the Use of 1311 Funds for Establishment Activities (June 8, 2015).

<sup>11</sup> We have completed reviews of California, Colorado, Kentucky, New Mexico, and Washington and are close to completing reviews of Minnesota and New York.

purposes in a system that operates efficiently and is secure. Our ongoing and planned marketplace work will examine critical issues, such as payment accuracy, eligibility systems, management and administration, and security of data and systems. We will continue to make recommendations for improvements, as appropriate, and follow up, as necessary, with CMS and States to encourage prompt implementation of our recommendations.

Thank you, again, for inviting OIG to speak with the Subcommittees today. We hope that our work and this testimony will assist you in your oversight efforts.

**ATTACHMENT: RELATED OFFICE OF INSPECTOR GENERAL  
REPORTS**

<b>Report Title</b>	<b>Report Number</b>	<b>Date Issued</b>
<b>Payment Accuracy</b>		
<i>Conversions of Startup Loans Into Surplus Notes by Consumer Operated and Oriented Plans Were Allowable but Not Always Effective</i>	<a href="#">A-05-16-00019</a>	08/04/2016
<i>Nevada Misallocated Costs for Establishing a Health Insurance Marketplace to Its Establishment Grants</i>	<a href="#">A-09-14-01007</a>	02/17/2016
<i>CMS Could Not Effectively Ensure That Advance Premium Tax Credit Payments Made Under the Affordable Care Act Were Only for Enrollees Who Paid Their Premiums</i>	<a href="#">A-02-14-02025</a>	12/31/2015
<i>The District of Columbia Claimed Allocated Costs to Its Establishment Grants in Accordance With Federal Requirements</i>	<a href="#">A-03-14-03300</a>	11/04/2015
<i>Actual Enrollment and Profitability Was Lower Than Projections Made by the Consumer Operated and Oriented Plans and Might Affect Their Ability to Repay Loans Provided Under the Affordable Care Act</i>	<a href="#">A-05-14-00055</a>	07/29/2015
<i>CMS's Internal Controls Did Not Effectively Ensure the Accuracy of Aggregate Financial Assistance Payments Made to Qualified Health Plan Issuers Under the Affordable Care Act</i>	<a href="#">A-02-14-02006</a>	06/16/2015
<i>Early Alert: Without Clearer Guidance, Marketplaces Might Use Federal Funding Assistance for Operational Costs When Prohibited by Law</i>	<a href="#">A-01-14-02509</a>	04/27/2015
<i>Review of the Accounting Structure Used for the Administration of Premium Tax Credits</i>	<a href="#">OEI-06-14-00590</a>	03/31/2015
<i>Maryland Misallocated Millions to Establishment Grants for a Health Insurance Marketplace</i>	<a href="#">A-01-14-02503</a>	03/26/2015
<i>The Centers for Medicare and Medicaid Services Awarded Consumer Operated and Oriented Plan Program Loans in Accordance With Federal Requirements, and Continued Oversight Is Needed</i>	<a href="#">A-05-12-00043</a>	07/30/2013
<i>Early Implementation of the Consumer Operated and Oriented Plan Loan Program</i>	<a href="#">OEI-01-12-00290</a>	06/16/2013
<b>Eligibility Systems</b>		
<i>Not All of the Vermont Marketplace's Internal Controls Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-01-14-02507</a>	03/09/2016
<i>Not All of the District of Columbia Marketplace's Internal Controls Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-03-14-03301</a>	02/22//2016



<b>Report Title</b>	<b>Report Number</b>	<b>Date Issued</b>
<b>Eligibility Systems – continued</b>		
<i>Not All of the Minnesota Marketplace’s Internal Controls Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-05-14-00043</a>	02/12/2016
<i>Not All of the Washington Marketplace’s Internal Controls Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-09-14-01006</a>	01/19/2016
<i>Not All of the Colorado Marketplace’s Internal Controls Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-07-14-03199</a>	12/28/2015
<i>The Kentucky Marketplace’s Internal Controls Were Generally Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-04-14-08036</a>	10/14/2015
<i>Not All Internal Controls Implemented by the New York Marketplace Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-02-14-02020</a>	09/21/2015
<i>Not All of the Federally Facilitated Marketplace’s Internal Controls Were Effective in Ensuring That Individuals Were Properly Determined Eligible for Qualified Health Plans and Insurance Affordability Programs</i>	<a href="#">A-09-14-01011</a>	08/06/2015
<i>Marketplaces Faced Early Challenges Resolving Inconsistencies With Applicant Data</i>	<a href="#">OEI-01-14-00180</a>	07/02/2014
<i>Not All Internal Controls Implemented by the Federal, California, and Connecticut Marketplaces Were Effective in Ensuring That Individuals Were Enrolled in Qualified Health Plans According to Federal Requirements</i>	<a href="#">A-09-14-01000</a>	06/30/2014
<b>Management and Administration</b>		
<i>HealthCare.gov: Case Study of CMS Management of the Federal Marketplace</i>	<a href="#">OEI-06-14-00350</a>	02/22/2016
<i>CMS Did Not Identify All Federal Marketplace Contract Costs and Did Not Properly Validate the Amount To Withhold for Defect Resolution on the Principal Federal Marketplace Contract</i>	<a href="#">A-03-14-03002</a>	09/18/2015
<i>CMS Did Not Always Manage and Oversee Contractor Performance for the Federal Marketplace as Required by Federal Requirements and Contract Terms</i>	<a href="#">A-03-14-03001</a>	09/14/2015
<i>Federal Marketplace: Inadequacies in Contract Planning and Procurement</i>	<a href="#">OEI-03-14-00230</a>	01/20/2015
<i>An Overview of 60 Contracts That Contributed to the Development and Operation of the Federal Marketplace</i>	<a href="#">OEI-03-14-00231</a>	08/26/2014

<b>Report Title</b>	<b>Report Number</b>	<b>Date Issued</b>
<b>Security of Data and Systems</b>		
<i>Public Summary Report: Washington State Implemented Security Controls Over the Web Site and Database for Its Health Insurance Exchange but Could Improve Protection of Personally Identifiable Information</i>	<a href="#"><u>A-09-15-03005</u></a>	06/01/2016
<i>Public Summary Report: Connect for Health Colorado Generally Protected Personally Identifiable Information on Its Health Insurance Exchange Web Sites and Databases but Could Continue To Improve Information Security Controls</i>	<a href="#"><u>A-07-15-00454</u></a>	02/10/2016
<i>The Centers for Medicare and Medicaid Services' Implementation of Security Controls Over the Multidimensional Insurance Data Analytics System Needs Improvement</i>	<a href="#"><u>A-06-14-00067</u></a>	09/21/2015
<i>California Implemented Security Controls Over the Web Site and Databases for Its Health Insurance Exchange but Could Improve Protection of Personally Identifiable Information</i>	<a href="#"><u>A-09-14-03005</u></a>	04/30/2015
<i>Health Insurance Marketplaces Generally Protected Personally Identifiable Information but Could Improve Certain Information Security Controls</i>	<a href="#"><u>A-18-14-30011</u></a>	09/22/2014
<i>Observations Noted During the OIG Review of CMS's Implementation of the Health Insurance Exchange-Data Services Hub</i>	<a href="#"><u>A-18-13-30070</u></a>	08/02/2013