American Academy of Actuaries
ISSUE BRIEF
ISSUE BRIEF MAY 2015

Implications of Proposed Changes to the ACA in Response to King v. Burwell

Key Points

- A temporary extension of premium subsidies would only delay the market disruption.
- Eliminating the individual mandate could threaten the viability of the health insurance market.
- Depending on the extent of other ACA changes, allowing for insurance to be sold across state lines could result in adverse selection, but also could increase competition.
- Allowing for association health plans (AHPs) also could raise adverse selection concerns.

Policymakers are considering changes to the Affordable Care Act (ACA) in case the Supreme Court rules in King v. Burwell that federal premium subsidies are not available for individual market plans in states participating in the federally-facilitated marketplace (FFM). Various proposals would provide transitional coverage to those losing subsidies as well as make other changes to the ACA. Many of these changes also are being included in proposals to replace the ACA more broadly.

This issue brief examines the general approaches that are included in one or more of the proposals. Because many of the ACA components are interconnected, it's important to consider how changes to one component will affect or be affected by changes in other components. To put these approaches into context, it is useful to consider criteria identified by the American Academy of Actuaries' Health Practice Council as keys to a sustainable health care system. In particular:

- For insurance markets to be viable, they must attract a broad cross section of risks;
- Market competition requires a level playing field; and
- For long-term sustainability, health spending growth must be reduced.

This issue brief first reviews these market reform principles, including whether and how the ACA adheres to those principles. The brief then examines the extent to which changes to the ACA would conform to these criteria.

American Academy of Actuaries
Objective. Independent. Effective.™
1850 M Street NW, Suite 300, Washington, DC 20036
Tel 202 223 8196, Fax 202 872 1948
www.actuary.org

Mary Downs, Executive Director
David J. Nolan, Director of Communications
Craig Hanna, Director of Public Policy
Cori Uccello, Senior Health Fellow
Heather Jerbi, Assistant Director of Public Policy

Market Reform Principles

Insurance markets must attract a broad cross section of risks. For health insurance markets to be viable, they must attract a broad cross section of risks. In other words, they must not enroll only higher-risk individuals or groups; they need to enroll those who are lower risks as well. If an insurance plan enrolls predominately those with higher–than–average expected health care spending, otherwise known as adverse selection, then premiums will be higher than average to reflect this higher risk. Guaranteed-issue provisions, which prohibit insurers from denying coverage based on pre-existing conditions, can exacerbate adverse selection concerns by giving individuals the ability and incentive to delay purchasing insurance until they require health care services. Likewise, limiting or prohibiting premium variations by health status or other characteristics correlated with health spending can raise the premiums for younger and healthier individuals, relative to what they would pay if these characteristics could be used as rating factors. Such rules could cause younger and healthier individuals and groups to opt out of coverage, leaving a higher-risk insured population. The higher premiums that result from adverse selection may lead to more low risks opting out of coverage, which would result in even higher premiums. This process is typically referred to as a premium spiral.

The ACA imposes guaranteed issue and modified community rating requirements on the individual market. To avoid premium spirals due to these provisions, the ACA includes an individual mandate and premium subsidies, both integral components of the law. They provide incentives even for individuals in good health to obtain coverage, thereby reducing adverse selection. Without these provisions, fewer people would be insured and the individual market risk pools would be more heavily weighted to those with higher costs. This would result in higher premiums.

Market competition requires a level playing field. For health insurance markets to be viable, plans competing to enroll the same participants must operate under the same rules. If a set of plans or insurers operate under rules that are more advantageous to higher-risk individuals or groups, then higher risks will migrate to those plans; lower risks will migrate to the plans more advantageous to them. In other words, the plans that have rules more amenable to higher-risk individuals or groups will incur adverse selection. As a result, the premiums for these plans will increase over time, leading to more adverse selection and threatening the viability of these plans. To address these "level playing field" issues, the ACA imposes the same issue and rating rules, regardless of whether individual and small group market plans operate on or off the health insurance exchanges.

For long-term sustainability, health spending growth must be reduced. While health spending growth has slowed in recent years, the level of spending remains high and makes up a significant portion of household incomes and government budgets. In addition, there is evidence that we are not getting enough value for the health dollars spent. Maintaining a manageable rate of health spending growth is essential to ensuring a sustainable health care system. The ACA enacted provisions designed to slow spending growth through health care payment and delivery system improvements. These include initiatives on bundled payments and accountable care organizations (ACOs). Policymakers need to continue to pursue efforts to shift the health care payment and delivery systems to focus on cost-effective and high-quality care.

Proposed Changes to the ACA

If federal premium tax credits become no longer available in FFM states, enrollment in the individual market would decline precipitously among those previously eligible for premium assistance. Moreover, individuals with high-cost health care needs would be more likely to remain enrolled, while individuals with low-cost health care needs would be more likely to exit the market. Such adverse selection would cause average health costs, and therefore premiums, to rise.

Various proposals have been put forward that would temporarily extend the premium subsidies if the Supreme Court rules that they are not available in FFM states. These extensions are sometimes tied to other changes, such as eliminating the individual and employer mandates, giving states more flexibility to determine benefit

requirements, permitting the sale of insurance across state lines, and allowing for association health plans (AHPs). These provisions also have been included in proposals to replace the ACA altogether.

A temporary extension of premium subsidies would only delay the market disruption.

An immediate or near-term elimination of federal premium subsidies would cause massive disruption in the individual market. Potentially millions of people would drop coverage, and the average costs of those remaining insured would soar. Insurers could face solvency concerns, especially those for whom exchange business is a relatively large share of their book of business. In 2015, insurers would be unable to increase premiums to meet the higher costs, because the 2015 premiums are already in place and ACA regulations prohibit midyear changes. In addition, the deadline for insurers to submit rates for 2016 occurs before the court will issue its ruling. Unless insurers are given flexibility to revise rates if premium subsidies will no longer be available in 2016, premiums likely would be insufficient to cover claims.

Depending on exactly how it is done, extending the premium subsidies through the 2016 plan year (or longer) could help mitigate these concerns for the short term. Individuals who would have otherwise lost their premium subsidies could maintain their coverage, thereby limiting the adverse selection that would result in higher average costs. However, if subsidies are made available only to those already receiving them, individuals who would be newly eligible for subsidies, due for instance to a change in income or loss of employer-sponsored coverage, would not benefit from the temporary premium subsidy extension. This would lead to lower overall enrollment in the individual market, as some individuals would transition out of coverage, but few would transition in. The risk profile of the market could deteriorate somewhat as a result. Also, if the premium subsidies were structured to phase out over the period of the extension, individuals would begin dropping coverage, with the average costs of those retaining coverage likely rising. These factors could threaten insurer solvency, especially if, as per some proposals, insurers are prohibited from increasing premiums during the period of the subsidy extension.

Even if a temporary extension of premium subsidies would help avoid disruption in the short term, it is likely that the disruption would be only delayed, not avoided altogether. If the subsidies are ultimately eliminated, potentially millions of individuals will drop coverage and premiums will increase substantially, unless other equally strong mechanisms are implemented that would encourage participation by a broad cross section of risks.

Eliminating the individual mandate could threaten the viability of the health insurance market.

When health insurance markets include guaranteed issue and modified community rating requirements to ensure that coverage is available to people with pre-existing conditions, market viability depends on attracting a broad cross section of risks. If individuals with lower-cost health care needs opt to forgo coverage, average costs of those purchasing coverage will be higher, potentially creating a premium spiral. By encouraging enrollment among low-risk individuals, the ACA's individual mandate helps mitigate these adverse selection concerns.

Weakening or eliminating the individual mandate could result in adverse selection that would raise premiums and threaten the viability of the market, unless alternative provisions are implemented that would create equally strong incentives for low-risk individuals to obtain coverage. An elimination of the premium subsidies would in itself weaken the individual mandate. Without

The primary drafter of this publication is the Academy's senior health fellow, Cori E. Uccello, MAAA, FSA, FCA, MPP. Members of the Health Practice Council include: Catherine M. Murphy-Barron, MAAA, FSA, vice president; Shari A. Westerfield, MAAA, FSA, vice chairperson; Rowen B. Bell, MAAA, FSA; Karen Bender, MAAA, ASA, FCA; April S. Choi, MAAA, FSA; Tim P. Deno, MAAA, FSA; Audrey L. Halvorson, MAAA, FSA; Warren R. Jones, MAAA, ASA; Laurel A. Kastrup, MAAA, FSA; Darrell D. Knapp, MAAA, FSA; Nancy F. Nelson, MAAA, FSA; Michael E. Nordstrom, MAAA, ASA; Donna C. Novak, MAAA, ASA, FCA; Jeffrey P. Petertil, MAAA, ASA, FCA; Geoffrey C. Sandler, MAAA, FSA; John J. Schubert, MAAA, ASA, FCA; David A. Shea Jr., MAAA, FSA; P.J. Eric Stallard, MAAA, ASA, FCA; Michael J. Thompson, MAAA, FSA; Cori E. Uccello, MAAA, FSA, FCA, MPP; Rina Vertes, MAAA, FSA; Thomas F. Wildsmith, MAAA, FSA; and Dale H. Yamamoto, MAAA, FSA, FCA, EA.

access to premium subsidies, many individuals would be exempt from the mandate because they would not be considered to have an affordable health insurance option available to them.[1]

Generally, alternatives to an individual mandate include less frequent open enrollment periods with penalties for late enrollment, an expanded reinsurance program, high-risk pools, allowing greater premium variations across individuals, or allowing coverage opt-outs with assessments for uncompensated care.[2] Although such voluntary incentives would provide incentives for healthy individuals to obtain coverage when first eligible, they would likely not be as effective as a strong individual mandate. For instance, applying a late enrollment penalty in the future when an individual eventually obtains insurance would be less effective at encouraging insurance coverage than levying a more immediate penalty to individuals who don't obtain coverage. In addition, special consideration would be needed to ensure access to coverage for vulnerable populations, for instance those with low incomes or pre-existing health conditions.

Depending on the extent of other ACA changes, allowing for insurance to be sold across state lines could result in adverse selection, but also could increase competition.

Health insurance is licensed and regulated primarily at the state level, which has resulted in varying rules and standards across states. Although states have the ability to permit the sale of insurance across state lines, few have done so to date and no out-of-state insurers have entered the market in those states.[3]

Some recent federal proposals would allow insurance licensed in one state to be sold in another state. Aside from concerns regarding how insurers would set up local provider networks and how consumer protections would be enforced, allowing for insurance to be sold across state lines would raise adverse selection concerns due to an un-level playing field. Higher-risk individuals could purchase plans licensed in states with stricter regulations (e.g., guaranteed issue, community rating, comprehensive benefit requirements), and lower-risk individuals could purchase plans licensed in states with looser regulations. Premiums for the plans licensed in states with stricter regulations would increase accordingly, which could lead to even fewer insurance purchases of those state-licensed plans among the low-risk population. However, allowing insurance purchases across state lines could increase the number of issuers offering coverage, thereby increasing competition and consumer choice. Such competition could result in lower premiums.

From an adverse selection perspective, the more that the rules governing insurance offers are consistent across states, the less concern there is regarding allowing insurance purchases across state lines. The ACA harmonized many of the rules applying to the individual and small group markets. Insurance in all states must abide by the same guaranteed issue and modified community rating rules. Although states have mandated benefits to varying degrees, the federal essential health benefit requirements have narrowed the differences in requirements across states.

If coupled with increased flexibility for states to change their issue, rating, or benefit requirements, however, permitting the purchase of insurance across state lines would increase adverse selection concerns and threaten the viability of the insurance market in states with more restrictive rules.

Allowing for association health plans (AHPs) also could raise adverse selection concerns.

Another proposed approach would be to allow small businesses to band together to offer health insurance through an association health plan. AHPs raise some of the same adverse selection concerns as allowing insurance purchases across state lines. If an AHP is allowed to choose a single state as its "applicable authority" and can follow

1. Individuals are exempt from the individual mandate if the premium for the lowest-cost available plan exceeds 8.05 percent of household income. See https://www.healthcare.gov/fees-exemptions/exemptions-from-the-fee/
2. For more details regarding alternatives to an individual mandate, see: Cori E. Uccello, Written statement to the Committee on Ways and Means, Subcom-mittee on Health, U.S. House of Representatives, Hearing on Individual and Employer Mandates in the President's Health Care Law. April 15, 2015. Available at: http://actuary.org/files/Acad_Testimony_to_W&M_on_Mandates_042715.pdf. See also, Government Accountability Office, "Private Health Insurance Coverage: Expert Views on Approaches to Encourage Voluntary Enrollment," 2011. Available at: http://www.gao.gov/new.items/d11392r.pdf.
3. For more information on state-level laws that would permit insurance sales across state lines, see Sabrina Corlette, et al., "Selling Health Insurance Across State Lines: An Assessment of State Laws and Implications for Improving Choice and Affordability of Coverage." The Center on Health Insurance Reforms, Georgetown University Health Policy Institute, October 2012. Available at: https://georgetown.box.com/shared/static/5d14x1i4326aknbf6y80.pdf

the issue, rating, and benefit rules of that state nationwide, an un-level playing field would result. For instance, if an AHP chooses a state with looser restrictions on issue, rating, and benefit requirements, the AHP would be allowed to use that state's requirements in all states, even those with more restrictive requirements. Non-AHP insurance plans, however, would continue to be subject to each state's requirements. Market fragmentation would result, with lower-cost groups moving to the AHP and higher-cost groups remaining in traditional insured plans at higher premiums. The viability of the traditional insured plans would be threatened. Market fragmentation also could result if the AHP is treated as a large group under a state's issue and rating rules, thereby avoiding the more restrictive rules that apply to the small group market. Small businesses with lower-risk employees would benefit from the less restrictive rules of the AHP, whereas small businesses with higher-risk employees would benefit from the rules in the small group market.

As with purchasing coverage across state lines, the more that the rules governing AHPs are consistent with those governing traditional insurance, the less adverse selection concern there is regarding AHPs. Although the ACA harmonized many of the rules applying to the individual and small group markets, if coupled with increased flexibility for states to change their issue, rating, or benefit requirements, AHPs could threaten the viability of the insurance market in states with more restrictive rules. In addition, if AHPs are subject to the rules applying to large groups rather than those applying to small groups, AHPs could threaten the viability of the traditional small group market.

Conclusion

The American Academy of Actuaries' Health Practice Council has identified three key considerations that are vital when determining whether particular market reform approaches will lead to a sustainable health system with increased access to affordable health insurance. In particular, for insurance markets to be viable they must attract a broad cross-section of risks; market competition requires a level playing field; and for long-term sustainability, health spending growth must be reduced.

As policymakers consider making changes to the ACA, either as transitional approaches if the Supreme Court rules that premium subsidies are not available in FFM states or as more general approaches to replacing the ACA, these principles need to be followed. Otherwise, the viability of the health insurance market could be threatened, potentially resulting in higher numbers of uninsured, higher premiums, and insurer insolvencies.