Campaign 2012
VOTER GUIDE

Making Health Care Reform Work: Why Broad Participation Is Necessary

American Academy of Actuaries

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MAKING HEALTH CARE REFORM WORK: WHY BROAD PARTICIPATION IS NECESSARY

A major goal of the Affordable Care Act (ACA) is to guarantee all Americans access to affordable health insurance coverage. It is designed to accomplish this, in part, through changes to the individual and small group health insurance markets.[1] To ensure that people in poor health have access to health insurance, the law prohibits insurers from denying coverage or charging higher premiums to those with higher expected costs due to their health status. These prohibitions generally will result in an increase in average health insurance premiums, unless a broad cross-section of people participate in the private health insurance market—the young as well as the old, and the healthy as well as the sick.

This guide is intended to assist voters in their understanding of why broad participation in the health insurance system is necessary to avoid higher premiums and how to evaluate candidates' positions on health care reform.

[1]This guide will focus on the individual health insurance market, but similar considerations apply in the small group market as well.

UNDERSTANDING THE EFFECT OF PARTICIPATION ON PREMIUMS

Why do premiums depend on who buys coverage?

The largest component of health insurance premiums is the medical spending paid on behalf of enrollees. As a result, health insurance premiums reflect the health care costs of an insurer's enrollees. Because health spending is skewed—a small share of consumers account for a large share of total health spending—if an insurer attracts a disproportionate share of unhealthy individuals, premiums then will be higher than they would be if the insurer attracted an average population.

To illustrate, suppose that there are two groups of people—Group A contains one healthy person (with health costs of $1000) and four sick people (with health costs of $5000 each) and Group B contains four healthy people and only one sick person. The average health costs of Group A and B are $4200 and $1800, respectively. The premiums for Group B, which includes more healthy participants, therefore would be much lower than those for Group A.

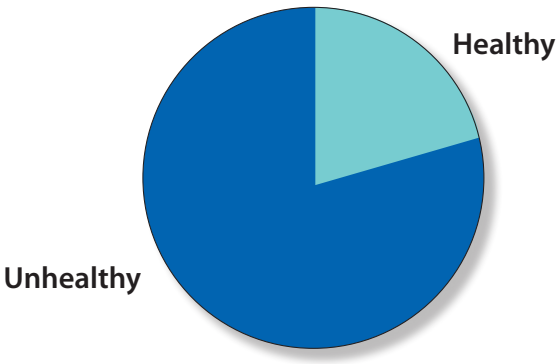
What is risk pooling?

The pooling of risk is fundamental to insurance. A health insurance risk pool is a large group of individuals whose medical costs are combined to calculate premiums. Pooling risks together allows the higher costs of the less healthy to be offset by the relatively lower costs of the healthy. In general, the larger the risk pool, the more predictable and stable the premiums can be.

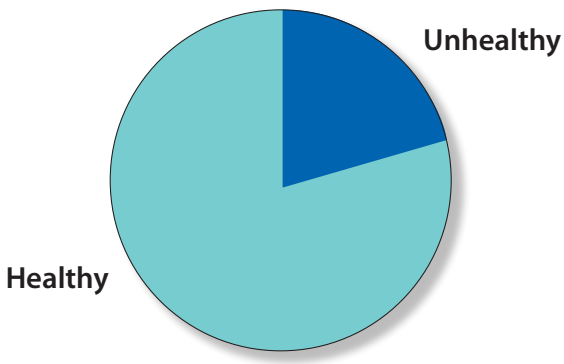
Is the size of a risk pool the only factor?

No. Although larger risk pools are typically more stable, a large risk pool does not necessarily mean lower premiums. The key factor is the average health care costs of the enrollees included in the pool. Just as a pool with healthy individuals can result in lower-than-average premiums, a large pool with a large share of unhealthy individuals can have higher-than-average premiums.

Group A
Average Costs = $4200



Group B
Average Costs = $1800



What is "adverse selection"?

"Adverse selection" describes a situation in which an insurer (or an insurance market as a whole) attracts a disproportionate share of unhealthy individuals. It occurs because individuals with greater health care needs, when given the opportunity, are more likely to purchase health insurance and to purchase health insurance with richer benefits than individuals with lesser health care needs.

Why is adverse selection a problem?

Adverse selection increases premiums for everyone in a health insurance plan or market because it results in a pool of enrollees with higher average health care costs. Adverse selection is a byproduct of a voluntary health insurance market in which people can choose whether and when to purchase insurance coverage, depending in part on how their anticipation of a need for health care compares with the insurance premium charged. The higher premiums that result from adverse selection, in turn, may lead to more healthy individuals opting out of coverage, which would result in even higher premiums. This process typically is referred to as a "premium spiral" or "adverse selection spiral." Avoiding such spirals requires minimizing adverse selection and instead attracting a broad base of healthy individuals, over which the costs of sick individuals can be spread. Attracting healthier individuals ultimately will help keep premiums more affordable and stable for all members in the risk pool.

BROADENING PARTICIPATION IN THE HEALTH INSURANCE MARKET

For health insurance markets to provide affordable coverage on a financially sound basis they must attract a broad cross section of risk.

What does the ACA do to broaden participation?

The ACA includes a number of provisions that are intended to broaden participation in the health insurance system. Among the more significant of these are:

- An individual coverage mandate,
- Premium subsidies for low-income individuals,
- A limited open-enrollment period,
- Subsidies for certain small employers that provide health insurance to their employees, and
- Penalties for certain large employers that don't offer affordable coverage to their employees.

What is the individual coverage mandate?

The individual mandate is a requirement, which applies to most U.S. citizens and legal residents, to obtain qualifying health care coverage.[2] Individuals who do not comply with the mandate must pay a financial penalty that is phased in over a three-year period from 2014 to 2016.

Year	Penalty
2014	Greater of $95 or 1 percent of taxable income
2015	Greater of $325 or 2 percent of taxable income
2016 and beyond	Greater of $695 (increased annually) or 2.5 percent of taxable income

How do premium subsidies help?

The ACA provides premium subsidies for certain low- and moderate-income individuals and families. By lowering premiums, premium subsidies increase the likelihood that coverage will be affordable for those individuals and families and that even young and/or healthy individuals will find value in purchasing health insurance coverage.

How does a limited open-enrollment period help?

The ACA includes a provision for an annual open-enrollment period, during which individuals may purchase coverage regardless of their health status. Individuals who decide not to buy coverage must wait until the next open-enrollment period.[3] This encourages even healthy consumers to purchase coverage during the open-enrollment period because their ability to wait to purchase coverage at the last minute if they get sick is reduced or eliminated.

What happens if the individual mandate is repealed?

If the individual coverage mandate were repealed, it likely would reduce the number of individuals buying coverage compared to if the mandate were present. The lack of a mandate could result in adverse selection if other provisions in the law that allow people to move in and out of the health insurance market as they need insurance remain intact. This in turn would put upward pressure on premiums.

[2]Certain people are exempt from the mandate including those for whom coverage is deemed to be unaffordable.
[3]Exceptions are made for certain qualifying life events, such as the birth of a child.

While the direction of these changes is clear, estimates of the size of resulting premium increases vary, which illustrates the uncertainty surrounding the impact of the various ACA provisions aiming to expand access to health insurance. The effects on the number of Americans with health insurance coverage and insurance premiums depends on how individuals and employers respond to not only the mandate, but also the premium subsidies, open-enrollment rules, and other provisions of the ACA. Without a mandate, the effectiveness of other provisions intended to broaden participation would be even more important.

Are there other ways to induce greater participation?

Yes. The Medicare Part B program (which covers physician and outpatient hospital services) and Part D prescription drug program, for example, include a late-enrollment penalty for seniors who initially choose not to participate. This can also be applied to the private insurance market. Another approach could be to automatically enroll individuals into coverage but allow them to opt out if they'd prefer to decline coverage. Longer time between open-enrollment periods also could induce individuals to purchase coverage sooner rather than later, as could allowing insurers to impose pre-existing exclusions for late enrollees.

Is broadening participation enough to ensure a viable health insurance market?

No. Although broad participation is essential for health insurance markets to provide affordable coverage on a financially sound basis, other requirements also must be met. First, market competition requires a level playing field. In other words, the rules governing the insurance market must apply similarly to all insurers. And perhaps most importantly, for the insurance system to be sustainable over the long term, the growth in health spending must be reduced.

HOW TO LEARN MORE

The more you know about how health insurance markets work and the critical role risk pooling plays in making coverage affordable, the better equipped you will be to evaluate what candidates have to say about health care reform. You may want to start with the following Academy publications to learn more:

The Individual Medical Insurance Market: A Guide for Policymakers (October 2008)

Risk Classification in the Voluntary Individual Health Insurance Market (March 2009)

Critical Issues in Health Reform: *Premium Setting in the Individual Market* (March 2009)

Critical Issues in Health Reform: *Market Reform Principles* (May 2009)

Critical Issues in Health Reform: *Individual Mandate* (May 2009)

Critical Issues in Health Reform: *Risk Pooling* (July 2009)

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