
**Report to Congress on the impact on
premiums for individuals and families with
employer-sponsored health insurance from
the guaranteed issue, guaranteed renewal,
and fair health insurance premiums
provisions of the Affordable Care Act**



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Introduction

The “Department of Defense and Full-Year Continuing Appropriations Act, 2011” required this report to Congress on the impact of sections 2701 through 2703 of the Public Health Service (PHS) Act, as amended by the Affordable Care Act (ACA) on the premiums paid by individuals and families with employer-sponsored health insurance. Specifically, the Chief Actuary of the Centers for Medicare & Medicaid Services (CMS) is to provide an estimate of the number of individuals and families who will experience a premium increase and the number who will see a decrease as a result of these three provisions.

Section 2701 of PHS Act is titled “Fair Health Insurance Premiums” and requires adjusted community rating for plan years beginning on or after January 1, 2014. Specifically, premium rates in the individual and small group market charged for non-grandfathered health insurance coverage may only be varied on the basis of the following four characteristics:

- Individual or family enrollment.
- Geographic area – premium rates can vary by the area of the country.
- Age – premium rates can be higher for an older applicant than that for a younger applicant, but the ratio of premiums cannot exceed 3:1 for adults.
- Tobacco use – premium rates can be higher for smokers, but the ratio cannot exceed 1.5:1.

Section 2702 of the PHS Act requires the guaranteed issuance of health insurance coverage in the individual and group market subject to specified exceptions. This means that insurers that offer coverage in the individual or group market generally must accept all applicants for that coverage in that market. Under section 2703 of the PHS Act, group and individual health insurance coverage must be guaranteed renewable at the option of the plan sponsor or individual, subject to specified exceptions. These three sections do not apply to grandfathered health insurance coverage.

Background

Prior to the passage of the ACA, the insurance products in the small group market were already required to be guaranteed issue and renewable under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). In addition, large group policies are not subject to section 2701 of the PHS Act. Self-funded plans are also not subject to the provisions analyzed in this report. As a result, large group and self-funded plans will be unaffected by the new rating requirements. Since these three specific ACA provisions will not have any significant effect on the premium rates paid by individuals working for large sized employers, the remainder of this report will focus on health insurance policies in the small group market.

To help individuals with pre-existing conditions gain affordable insurance coverage, Sections 2702 and 2703 of PHS Act generally require guaranteed issuance and renewability of policies to any employer that applies for coverage offered in the applicable market within enrollment periods, regardless of the health histories of its employees or other prohibited factors. These requirements apply to all small group health insurance plans other than grandfathered plans (as defined by federal regulations at 45 CFR 147) beginning on or after January 1, 2014. Some analysts expect that these grandfathered plans will experience reduced enrollment as individuals leave for new plans that are not only cheaper due to lower administrative costs, but also offer more generous coverage, or leave for individual market coverage for which individuals may qualify for premium tax credits.¹ Under HIPAA, all states currently have adopted guaranteed issue and renewal requirements for small group policies.

¹ Linda Blumberg. July 2010. “How Will the PPACA Impact Individual and Small Group Premiums in the Short and Long Term?” Urban Institute. Washington, DC.

The Chief Actuary was required to estimate the impact of these three specific ACA provisions – fair health insurance premiums, guaranteed issue and renewability – on the premiums for individuals and families with employer sponsored health insurance. Since fully insured small group policies are already guaranteed issue and renewal in all states, we expect there is no material net impact of these two ACA provisions on premium rates. As a result, the premium rate impact in the small group market is expected to result from only the new adjusted community rating provision in section 2701 of the PHS Act.

Adjusted Community Rating for Small Employers

This new adjusted community rating criteria is a change from the current small group market industry practice that existed prior to when these criteria take effect. Previously, issuers in most states could vary premiums by factors such as: health status of the group, group size, and industry code or classification. Smaller firms, and those performing high-risk work, or firms with sick employees, received significantly higher premiums than those with a lower risk group. In addition, they could be subject to large premium increases based on a new diagnosis for a single employee.

The ACA created a new health insurance Exchange for small businesses called the SHOP (Small Business Health Options Program), to offer plans tailored for small employers with 100 or fewer employees.² All health plans (other than those offered through the SHOP) will be subject to the premium rating requirements of section 2701 of the PHS Act. Beginning 2014, most individuals must obtain a form of minimum essential coverage or face a penalty.³ Individuals with income between 100 and 400 percent of federal poverty level (FPL) may be eligible for premium tax credits and cost sharing reductions on a sliding scale to help reduce the cost if the coverage is obtained through the Exchanges.

There is considerable uncertainty as to whether small employers will decide to terminate their existing offer of health insurance coverage and send their employees to individual market Exchanges. Many factors may be relevant to their decisions.⁴ For example, the decision could depend heavily on the extent to which employees are eligible for a premium tax credit on the individual market Exchanges. Some expect that it would be cheaper for employees with income below 250 percent of FPL to buy coverage from the individual market Exchanges given the premium tax credits and cost-sharing reductions available at these income levels.⁵ Small employers with predominantly low-wage, part-time and seasonal employees may find it to their financial advantage to terminate existing coverage. Small businesses with 50 or fewer workers may find terminating existing coverage particularly attractive since they are not required by the ACA to offer affordable minimum essential health insurance coverage, and their workers have access to health insurance in the new Exchanges. Alternatively, it may be financially attractive for small employers with relatively healthy employees to continue to provide coverage but convert to a self-insured arrangement with stop-loss coverage. If such coverage becomes widely available, some analysts expect a substantial increase in self-insured small employers.⁶ However, small group employers will also have to consider employee resistance and administrative complexity to substitute alternative

² States have the option to lower the threshold to 50 or fewer employees.

³ ACA exempts certain groups of individuals from this mandate. They include members of an exempt religious sect or division, a health care sharing ministry, or Native American Tribes. Illegal immigrants, individuals or households who do not have file a tax return because their income is too low or cannot afford the cheapest health insurance are also exempt from this mandate.

⁴ Alan Reuther. September 2011. “Workers and Their Health Care Plans.” Center for American Progress. Washington, DC.

⁵ Center for Labor Research and Education. 2010. “The Affordable Care Act and Collective Bargaining.” UC Berkley.

⁶ Christine Eibner, et al. 2011. “Employer Self-Insurance Decisions and the Implications of the Patient Protection and Affordable Care Act as Modified by the Health Care and Education Reconciliation Act of 2010.” RAND. Santa Monica, CA.

types of compensation for employer's health benefits contributions, which may encourage small employers to continue to offer insurance coverage on a tax-favored basis.

Prior to 2014, insurers could set lower premiums for small employers with younger and healthier employees due to their low expected health care needs, and significantly higher rates for small employers with older and sicker employees with greater expected health care needs. The ratio of premiums charged between old and young ages was typically 5:1 or more, and could translate into much higher premiums for firms with older employees. In addition, gender could also be used as a rating factor. Before 2014, employers with more women of childbearing age were commonly charged higher premiums.

The adjusted community rating under ACA prohibits the use of gender, health status and claims history as rating factors, and restricts the premium rating ratio for adults to between young and old ages. These changes are expected to further relieve the financial burdens for older and sicker individuals as coverage could become more affordable for them. However, for younger and healthier individuals, premiums could increase since health status is no longer permitted as a rating factor and the new age rating band is limited to 3:1 for adults, less than what insurers typically have used.

Some analysts are concerned with the possibility of adverse selection, which prompts small employers with younger and healthier individuals to drop coverage or switch to other forms of coverage such as self-insurance, leaving the remaining risk pool with only the sickest individuals thereby raising premiums significantly. The propensity for adverse selection is mitigated by other ACA provisions that encourage small employers to offer coverage and premium stabilization programs in the fully insured market such as risk adjustment. For example, small employers with 25 or fewer employees whose average annual salary is less than \$50,000 may be eligible for small business tax credit on a sliding scale if they contribute at least 50 percent of the total premium. Many analysts believe that these and other factors will help attract a broad and stable group of employers to reduce the negative impact on premiums and avoid the adverse selection problem.

Estimates by Independent Modelers

A number of independent modelers developed estimates of post-ACA premium rates and enrollment of small group coverage for a number of states and the country as a whole. For example, some of their findings are summarized below.

- Wisconsin – A study by Gorman Actuarial and Dr. Jonathan Gruber predicted that the small group market is expected to see relatively small premium rate increase – 1.3 percent. Fifty-three percent of small group plans, or 63 percent of the small group employees, will experience a premium rate increase of 15 percent, while 47 percent of small groups or 37 percent of the employees will experience a 16 percent decrease.⁷ Most of the impact is due to elimination of health status as a rating factor.
- Maine – A study by Gorman Actuarial and Dr. Jonathan Gruber estimated that a large majority (89 percent) of small employers are expected to experience a premium rate increase of 12 percent on average, while the remaining 11 percent will experience an average premium rate decline of 17 percent.⁸ The impact is largely due to the elimination of group size as a rating factor.

⁷ Jennifer Smagula and Jonathan Gruber. July 2011. "The Impact of the ACA on Wisconsin's Health Insurance Market." <http://www.dhs.wisconsin.gov/aboutdhs/docs/WI-Final-Report-July-18-2011.pdf>.

⁸ Jennifer Smagula and Jonathan Gruber. May 2011. "The Impact of the ACA on Maine's Health Insurance Markets." http://www.maine.gov/pfr/insurance/reports/pdf/Impact_ACA.pdf.

- Ohio – A study from Milliman estimates that, before the application of tax subsidies, the small group premium rates are going to increase by 5 to 15 percent.⁹
- National – Actuaries at Oliver Wyman examined the national impact on premium rates of adjusted community rating, guaranteed issue and renewal using a database of actual claims covering over 6 million people.¹⁰ They predict that the small group premium rates will increase by 20 percent.

OACT Estimates

This analysis focuses on the number of people with health insurance coverage through their employer whose premium rates are expected to increase or decrease as a result of the guaranteed issue, guaranteed renewability, and premium rating provisions of the ACA only. Other factors affecting rates such as changes in product design, provider networks, or competition are not considered. In addition, other provisions of the ACA, including the coverage expansions, the extension of dependent coverage to age 26, the individual mandate, and the employer mandate will impact the availability of coverage, the take-up of that coverage, and the premium rates charged to those who currently have employer-sponsored insurance, but those impacts are not included in this estimate. We prepared a more complete report on the financial effects of the ACA in 2010.¹¹ As mentioned previously, the effect on large employers is expected to be negligible, therefore our evaluation examines the impact on employees of fully-insured small firms.

In 2012, about 18 million people were enrolled in the small group health insurance market through employers with 50 fewer employees.¹² About 8 percent of small firms offered a self-insured health plan¹³, therefore about 17 million people received coverage in the fully-insured small group health market. These 17 million people will be affected by the new premium rating requirements contained in the ACA. Before the premium rating provision of the ACA took effect, firms with employees who had better than average health risks would typically pay lower premiums, and therefore, they were more likely to be the firms that offer health insurance. As a result, most of people with coverage in the small group market have premium rates that are below average. Based on our review of the available research and discussions with several actuarial experts¹⁴, we have estimated that roughly 65 percent of small employers offering health insurance coverage have premium rates that are below average.

Once the new premium rating requirements go into effect, it is anticipated that the small employers that offer health insurance coverage to their employees and their families would have average premium rates. Therefore, we are estimating that 65 percent of the small firms are expected to experience increases in their premium rates while the remaining 35 percent are anticipated to have rate reductions. The individuals and families that receive health insurance coverage from their small employer generally contribute a portion of the premium. For this analysis, if the employer premium increases, it is assumed that the employee contribution will rise as well. Similarly, if the employer

⁹ Jeremy Palmer, Jill Herbold and Paul Houchens. August 2011. “Assist with the First Year of Planning for Design and Implementation of a Federally Mandated American Health Benefit Exchange.” Milliman.

¹⁰ Jason Grau and Kurt Giesa. December 2009. “Impact of the Patient Protection and Affordable Care Act on Costs in the Individual and Small-Employer Health Insurance Markets.” http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/files/archive/2011/YBS009-11-28_PPACA120309.pdf.

¹¹ Detailed estimates of the Medicare savings and costs by provision are available in an April 22, 2010 memorandum by Richard S. Foster titled “Estimated Financial Effects of the ‘Patient Protection and Affordable Care Act,’ as Amended.” This report also includes estimates by the Office of the Actuary for the effects of the health reform legislation on other Federal expenditures, insurance coverage of the U.S. population, and total national health expenditures.

¹² Medical Loss Ratio Data and System Resources, Public Use File for 2012, Centers for Consumer Information and Insurance Oversight, 2013. <http://www.cms.gov/CCIIO/Resources/Data-Resources/mlr.html>.

¹³ See footnote 6.

¹⁴ The estimates from the experts we consulted ranged from 60 to 67 percent.

premium is reduced, the employee contribution is assumed to decrease. This results in roughly 11 million individuals whose premiums are estimated to be higher as a result of the ACA and about 6 million individuals who are estimated to have lower premiums.

There is a rather large degree of uncertainty associated with this estimate. The impact could vary significantly depending on the mix of firms that decide to offer health insurance coverage. In reality, the employer's decisions to offer coverage will be based on far more factors than the three that are focused on in this report so understanding the effects of just these provisions will always be challenging. Using their Compare model, RAND analyzed the impact of the entire ACA on small group premiums and determined that the effect would be minimal.¹⁵ Further, note that the number of affected individuals will be smaller in 2014 because (i) a number of small group plans were renewed early, and (ii) about half of the states have allowed extensions to their pre-ACA rating rules under the transitional policy announced by CMS on November 14, 2013.

Summary

The Affordable Care Act requires all non-grandfathered health insurance coverage in the individual and group markets to be guaranteed issue and guaranteed renewable. In addition, all non-grandfathered insurance plans and policies in the individual and group markets can vary premium rates based only on age, family status, geography, and tobacco use, and the variation in the age and tobacco use factors is limited. This new premium rating requirement will impact the premiums paid by individuals and families working for small employers who offer health insurance. Specifically, we have estimated that the premium rates for roughly 11 million people will increase and about 6 million people are expected to experience a premium rate reduction due to sections 2701 through 2703 of the PHS Act.

¹⁵ Christine Eibner, et. al. 2013. "The Affordable Care Act and Health Insurance Markets: Simulating the Effects of Regulation." RAND. Santa Monica, CA.