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Obamacare and Insurance Rating Rules: Increasing Costs and Destabilizing Markets

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The Patient Protection and Affordable Care Act (PPACA)[1] sets new federal insurance rating rules that bar insurers and employer-sponsored health plans from imposing preexisting-condition exclusions under any circumstances, require insurers to provide individual insurance coverage on a guaranteed-issue basis, and limit the extent to which insurers can vary premiums based on an enrollee's age.

The new limitations on age rating and the blanket prohibition on the application of preexisting-condition exclusions are particularly counterproductive and will have a destabilizing effect on health insurance markets. As such, they are prime examples of PPACA's fundamental design flaws.[2]

Summary. Effective in 2014, Section 1201(4) of PPACA imposes new federal rules on how health insurers may "rate," or price, their products. Under the new rules, insurers will be allowed to vary premiums for coverage in the individual and small-group markets using only four factors: (1) by self-only versus family coverage, (2) by geographic "rating area," (3) by age, and (4) by tobacco use.

In the cases of age and tobacco use, the new rules also limit the extent of the permitted premium variations. For tobacco use, the maximum allowed variation will be 1.5 to 1, meaning that a plan will not be allowed to charge a tobacco user more than one-and-a-half times (or 50 percent above) the rate charged to a non-tobacco user. With respect to age rating, the maximum allowed variation for adults will be 3 to 1, meaning that a plan will not be allowed to charge a 64-year-old more than three times the premium charged a 21-year-old for the same coverage.

In addition, Section 1201(2)(A) prohibits employer-sponsored health plans and commercial health insurers from imposing a preexisting-condition exclusion on the coverage of any enrollee or applicant under any circumstances.[3] This blanket prohibition took effect for children (under age 19) on September 23, 2010, and will take effect for adults on January 1, 2014.[4]

Under prior law, insurers and employer self-insured health plans are required to provide coverage to enrollees in employer-sponsored plans on a guaranteed-issue basis and are prohibited from varying premiums based on individual health status.[5] Sections 1201(2) and (4) of PPACA extend those requirements to the individual market as well, effective January 1, 2014.[6]

Impact. The effects of PPACA's new rating rules will be to increase premiums (particularly for younger adults), increase the costs of coverage subsidies, and destabilize insurance markets.

Higher Premiums for Young Adults. Younger adults will be particularly hard-hit by PPACA's new restriction on age rating of premiums. The natural

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variation by age in medical costs is about 5 to 1—meaning that the oldest group of (non-Medicare) adults normally consumes about five times as much medical care as the youngest group. Thus, if an average 64-year-old consumes five times as much medical care as an average 21-year-old, PPACA's stipulation that an insurer cannot charge a 64-year-old more than three times what it charges a 21-year-old will have the effect of artificially "compressing" normal age-related premium variations.

This mandated "rate compression" forces insurers to both under-price coverage for older people and overprice coverage for younger individuals. Actuaries estimate that the effect will be to increase premiums for those ages 18–24 by 45 percent and those ages 25–29 by 35 percent while decreasing premiums for those ages 55–59 by 12 percent and those ages 60–64 by 13 percent.[7]

Forcing insurers to significantly overprice coverage for young adults will also result in more subsidies going to healthy young people than would otherwise be necessary if insurers had instead been allowed to continue charging lower premiums that more accurately reflect their lower health care costs.

More Difficulty Covering the Uninsured. While younger adults generally tend to be in good health, they also tend to earn less than older workers with more experience. That combination makes young adults more sensitive to changes in the price of health insurance and more likely to decline coverage if it becomes more expensive. Indeed, young adults are already the age cohorts that are most likely to be uninsured. According to the latest Census data, 31 percent of those ages 19–24 are uninsured and 30 percent of those ages 25–29 are uninsured.[8] Those two cohorts combined (ages 19–29) account for 30 percent of the total U.S. uninsured population and 36.6 percent—over a third—of all uninsured adults.[9] Thus, imposing rating rules that artificially increase the cost of health insurance for uninsured young adults is contrary to the goal of increasing health insurance coverage.

Perverse Incentives for the Healthy to Avoid Buying Coverage. The combined effect of PPACA's new rating rules will be to encourage individuals to wait until they need, or expect to need, medical care before purchasing health insurance or enrolling in an employer-sponsored plan. PPACA creates this perverse incentive because its new rating rules

1. Congress cannot build sound market-based health care reform on the foundation of a flawed health care law. Therefore, the health care law must be repealed in its entirety.

   The House of Representatives has taken a major step towards full repeal of the Patient Protection and Affordable Care Act (PPACA—otherwise known as "Obamacare"). Until full repeal occurs, Congress must continue to focus on the core failures and consequences of PPACA and block its implementation to allow time to achieve repeal and lay the groundwork for a new market-based direction for health care reform.
2. Patient Protection and Affordable Care Act of 2010, Public Law 111–148, and Health Care and Education Reconciliation Act of 2010, Public Law 111–152.
3. New Section 2701 of the Public Health Service Act as added by the Patient Protection and Affordable Care Act of 2010, Public Law 111–148 § 1201(2)(a).
4. Patient Protection and Affordable Care Act of 2010, Public Law 111–148 § 1255.
5. 42 U.S. Code § 300gg, 300gg-1, and 300gg-11.
6. New Section 2701 of the Public Health Service Act as added by the Patient Protection and Affordable Care Act of 2010, Public Law 111–148 § 1201(2)(a), and new Section 2702 of the Public Health Service Act as added by Public Law 111–148 § 1201(4).
7. Oliver Wyman, "Impact of Changing Age Rating Bands in 'America's Healthy Future Act of 2009,'" Marsh Mercer Kroll, September 28, 2009, at *http://www.oliverwyman.com/ow/pdf_files/OW_En_HLS_PUBL_2009_AgeRatingAnalysisFinal.pdf* (January 14, 2011).
8. Kaiser Family Foundation, "Adults' Health Insurance Coverage by Age Group, 2008," October 8, 2009, at *http://facts.kff.org/chart.aspx?cb=57&sctn=160&ch=1256* (January 14, 2011).
9. Kaiser Family Foundation, "Characteristics of the Uninsured, 2008," October 8, 2009, at *http://facts.kff.org/chart.aspx?ch=480* (January 14, 2011).

eliminate all existing rating "penalties" on individuals who do not buy coverage when they are healthy. Indeed, this perverse incentive will be further exacerbated by the extent to which other provisions of PPACA—such as new mandated benefits and restrictions on varying premiums by age—artificially increase health insurance premiums for individuals.

Imposition of an Individual Mandate to Fix Problems Created by Rating Rules. Inclusion in PPACA of an individual mandate to obtain health insurance coverage was, in large measure, an attempt by the legislation's authors to counter the perverse incentives created by their own badly designed changes in insurance rating rules—particularly the prohibition on applying preexisting-condition exclusions under any circumstances. Still, it is likely that even with the mandate, many younger and healthier individuals will not buy coverage, as they will face higher premiums due to PPACA's "rate compression" provisions and new benefit mandates, making it cheaper for them to simply pay the fine.

A New Direction. PPACA's new federal health insurance rating rules are counterproductive and destabilizing to insurance markets. The new Congress should simply scrap PPACA's restrictive pricing rules and leave any regulation in this area to the states, as has been the case until now.

With respect to preexisting-condition exclusions, it is important to note that the authors of PPACA addressed what is, in reality, a very limited (though legitimate) problem with a solution that will create much bigger new problems.

Over 90 percent of Americans with private health insurance are covered by employer group plans where existing rules governing the application of preexisting-condition exclusions are not an issue. Under current law, individuals with employer-sponsored insurance cannot be denied new coverage, be subjected to preexisting-condition exclusions, or be charged higher premiums because of their health status when switching to different coverage. Thus, in the group market, preexisting-condition exclusions apply only to those without prior coverage or those who wait until they need medical care to enroll in their employer's plan.

These existing rules represent a fair approach: Individuals who do the right thing (getting and keeping coverage) are rewarded; individuals who do the wrong thing (waiting until they are sick to buy coverage) are penalized.

The one legitimate problem is that those same rules do not currently apply to the individual health insurance market—which constitutes 9.4 percent of the total market for private health insurance. Thus, an individual can have purchased non-group health insurance for many years and still be denied coverage or face preexisting-condition exclusions when he or she needs or wants to pick a different plan.

The obvious, modest, and sensible reform is to simply apply to the individual health insurance market a set of rules similar to the ones that already govern the employer group market.

Thus, instead of a blanket prohibition on the use of preexisting-condition exclusions, as done under PPACA, the new Congress should return to the more sensible current-law approach for employer-sponsored coverage and then simply extend it to individual market coverage. Such a strategy fixes any legitimate problems without destabilizing health insurance markets—and in the process eliminates the rationale for retaining PPACA's unpopular and unworkable individual mandate.

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