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RESEARCH SUMMARY

AFFORDABLE CARE ACT TURMOIL
Large Losses in the Individual Market Portend an Uncertain Future

The Affordable Care Act (ACA) significantly altered the rules governing health insurance, especially in the individual market. While the law has increased the number of people with health insurance, lower-than-expected enrollment in the new health insurance exchanges and significant insurer losses have resulted in substantial premium increases and insurer withdrawals from state markets. These negative outcomes cast increasing doubt on the ACA and its long-term sustainability.

A new study for the Mercatus Center at George Mason University uses 2014 data from the Department of Health and Human Services to analyze the performance of 174 insurers who offered qualified health plan (QHP) coverage to both individuals and small groups (generally firms with fewer than 50 workers). The study finds that, despite substantial subsidies, insurers suffered larger losses selling QHPs in the individual market than they did selling nearly identical policies in the small group market. These losses were driven largely by the fact that the population that enrolled in individual QHPs had much higher claims costs than the population enrolled in small group QHPs, or the population enrolled in either individual or group non-QHPs (i.e., plans in place before the ACA exchanges launched and ACA-compliant plans that are not certified as QHPs).

This study is the second in a series examining the ACA's performance using the same dataset. To read this study in its entirety and learn more about its authors, Mercatus Senior Research Fellow Brian Blase, Galen Institute Senior Fellow Doug Badger, Heritage Foundation Senior Research Fellow Edmund F. Haislmaier, and University of Houston law professor Seth Chandler, please see "Affordable Care Act Turmoil: Large Losses in the Individual Market Portend an Uncertain Future."

KEY POINTS

- Individual QHPs had loss ratios (medical claims divided by premium income) of 110 percent. These were significantly higher than the loss ratios for group QHPs (82 percent) and

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individual non-QHPs (83 percent), both of which were well within the historic norm for health insurance plans.

- These losses came as the result of per-enrollee medical claims that were 24 percent higher for individual QHPs than for group QHPs and 93 percent higher for individual QHPs than for individual non-QHPs.
- The large losses came despite the ACA targeting the individual QHP market with significant subsidies, particularly payments through the reinsurance program equal to 20 percent of premium income. The reinsurance program is set to expire after 2016, which will undoubtedly cause premiums to rise as insurers strive to reach profitability.
- These results indicate that the ACA's regulations may be unsuitable for the individual market. This situation could pressure policymakers to revise or reverse some of the changes made by the ACA.

BACKGROUND

The ACA required that insurers participating in the individual market offer coverage to any applicant, but restricted the insurers' ability to charge premiums that reflect applicants' likely expenditures. These requirements make individual insurance significantly more expensive for relatively young and healthy people and create incentives for individuals to delay purchasing coverage until they anticipate needing medical care. To offset these incentives, the ACA provided income-related subsidies for people purchasing exchange coverage and imposed a tax penalty on those without the required coverage.

Since the ACA's changes introduced greater uncertainty into the individual market, the law established a temporary reinsurance program for insurers offering ACA-compliant plans in the individual market, in addition to the risk adjustment and temporary risk corridor programs available to insurers offering QHPs in both the individual and group markets. The reinsurance program compensates insurers for a large share of expenses incurred by "high risk individuals," financed by fees on nearly everyone with private insurance.

SUMMARY

Individual QHPs suffered significantly larger losses than both individual non-QHPs and group QHPs despite significant subsidies that boosted premium income in the individual QHP market.

- Total revenue per enrollee (before risk corridor claims) was $5,484 for individual QHPs but only $4,812 for group QHPs. This disparity was driven largely by subsidies from the reinsurance program that totaled 20 percent of individual QHP premium income.
- Insurers received average reinsurance payments of $915 per enrollee, on net, for their individual QHPs in 2014. For group QHPs, however, insurers had to pay into the reinsurance program an average of $61 per enrollee.

- Insurers would have needed roughly 31 percent higher average premiums to have covered their expenses selling individual QHPs in 2014 without the reinsurance program. This suggests that large premium increases will be necessary, because (1) enrollees are more costly than expected and (2) the reinsurance program expires at the end of 2016.

Individual QHPs had loss ratios of 110 percent, compared to loss ratios for group QHPs and individual non-QHPs of 82 percent and 83 percent, respectively. The large losses for individual QHPs were driven by high medical claims.

- Insurers' average per-enrollee medical claim for individual QHPs was $4,973, much higher than the average per-enrollee medical claim of $2,581 for individual non-QHPs and $4,007 for group QHPs.
- In proportional terms, enrollee medical claims for individual QHPs were 24 percent higher than for group QHPs and 93 percent higher than for individual non-QHPs.
- The dramatically different experiences of nearly identical plans in the two QHP markets may be explained by features of group coverage that limit adverse selection pressures resulting from the ACA's insurance market rules and premium restrictions.

The poor performance of individual QHPs relative to group QHPs was generally consistent across insurers, although overall performance varied significantly across insurers, with the new ACA-sponosored cooperatives (co-ops) performing the worst.

- The carrier with a sizeable market share that fared the best in the individual market was Kaiser Permanente, while the co-ops generally had the worst results.
- The risk adjustment program produced large losses for group QHPs offered by co-ops, because the co-ops were collectively assessed a risk adjustment payment of $975 per enrollee.

CONCLUSION

Insurers offering both individual and group QHPs fared reasonably well in the group market but generally incurred large overall losses in the individual market. These losses occurred despite large reinsurance payments overwhelmingly benefitting individual QHPs and subsidies that were only available to people purchasing individual QHPs through an exchange. The large losses on individual QHPs did not occur in the group market, suggesting that the ACA's individual market rules and regulations may be incompatible with a well-functioning insurance market because they trigger significant adverse selection pressure.

Although the reinsurance program significantly lowered individual QHP premiums in 2014, premiums were still not low enough to attract a sufficient number of younger and healthier enrollees to create a balanced risk pool. Preliminary data indicate that insurers' losses were significantly larger in 2015 than in 2014. These increased losses, coupled with the scheduled expiration of the reinsurance and risk corridor programs, will likely lead to substantially higher premiums in 2017. Yet higher premiums will further reduce the attractiveness of individual QHPs to younger and healthier enrollees, resulting in a market that will appeal primarily to lower-income individuals who receive large subsidies and to people with expensive health conditions. To avoid such an outcome, it is increasingly likely that the individual insurance market changes made by the ACA will have to be revised or reversed.