OLIVER WYMAN

Testimony before the Energy and Commerce Committee, Subcommittee on Health
September 9, 2015

Kurt Giesa, FSA, MAAA

The Effect of Expanding the Definition of Small Employer to Include Employers with 51 to 100 Employees

Introduction

Chairman Pitts and distinguished members of the Committee, thank you for allowing me to present this written testimony to you regarding the potential impact of changing the definition of the small employer as it relates to health insurance markets. My name is Kurt Giesa. I am a Fellow of the Society of Actuaries, a member of the American Academy of Actuaries, and a Partner in the firm of Oliver Wyman Actuarial Consulting.

Summary of Findings

We have undertaken an analysis of the impact of expanding the definition of "small employer" to include employers with 51 to 100 employees (mid-sized employers or groups) in the small employer market in 2016. This analysis is based on actual underwriting data from a number of health insurance issuers. While we show results in aggregate across these issuers, the results for each issuer on its own are similar to the results across the issuers. In total, we believe these data are representative of the market at large, but actual results will be different for particular issuers or in a particular state, depending on a number of factors, such as prevailing benefit levels and the availability of self-funded products, and the impact of transitional policies.

Our primary findings are that expanding the definition of small group to include mid-sized groups would increase average premiums in the expanded small group market, primarily by discouraging young, healthy groups from purchasing health insurance. Specifically:

- Roughly two-thirds (64%) of members in mid-sized groups would receive a premium increase in 2016 as a result of changes in rating rules and expanding the market, with these groups receiving an 18% increase on average. We expect that many of the groups receiving such sizeable increases would elect to drop their health insurance coverage and either self-fund or not offer any coverage at all. The departure of relatively healthy groups would increase the average expected health costs of the single risk pool, leading to premium increases to cover the costs of the remaining, older and less healthy groups.

- Application of Essential Health Benefit (EHB) requirements and the requirement to offer coverage at the metals would increase premiums by 3% to 5% for mid-sized groups on top of the impact from changes in rating rules and expanding the market.

- Premiums in the expanded market (1-100 employees) would increase. Premiums would increase by as much as 5% in 2016 in states that allowed the transitional policy.

- Cumulative rate increases over time could be much higher as a result of adverse selection. As rates increase, more mid-sized and small groups may drop coverage or self-fund, and this, in turn could lead to a rate assessment spiral in the 1-100 market.

Background

Beginning in 2016, the definition of small employer will be expanded to include employers with one to 100 employees. This will subject groups with 51 to 100 employees to the insurance rules that are currently in place for ACA-compliant small group policies, where premiums may vary only according to the following factors:

- age, according to a 3:1 rate schedule for adults,
- the number of covered members, subject to the restriction that no more than three dependent children under age 21 may be counted in developing the premium for a given subscriber,
- rating area,
- tobacco use, and
- benefit plan.

Issuers will not be allowed to reflect the group's actual claims experience in setting premiums, to vary administrative expenses or risk charges based on group size, participation rates or industry, or make any of the other adjustments to a given group's premium rate that are currently used in the mid-sized group market. In addition, policies sold to mid-sized employers will have to include the EHB package, which includes providing benefits that meet one of the metal actuarial values.

There are at least four ways the change in the definition of small employer will impact rates for mid-sized groups:

- The restriction on age rating will mean that groups with older covered members will see premiums decrease, and groups with younger members will see premiums increase, all else equal.
- The elimination of adjustment for claims experience or otherwise adjusting a group's premiums to reflect expected costs will mean that those with lower expected claims will see premiums increase, while those with higher expected claims will see premiums decrease, again, all else equal.
- Premium increases in the expanded market will likely lead some of the mid-sized groups to leave the market, either dropping coverage entirely, self-insuring, or taking advantage of the transitional policy discussed below.
- Covering the EHB package, which requires providing coverage with an actuarial value consistent with the metals, will mean that some mid-sized employers will have to increase both the scope and level of the benefits they are currently providing to their employees. We estimate that this could increase the average premiums that mid-sized groups will pay in 2016 by 3% to 5%, though this will vary considerably by group.

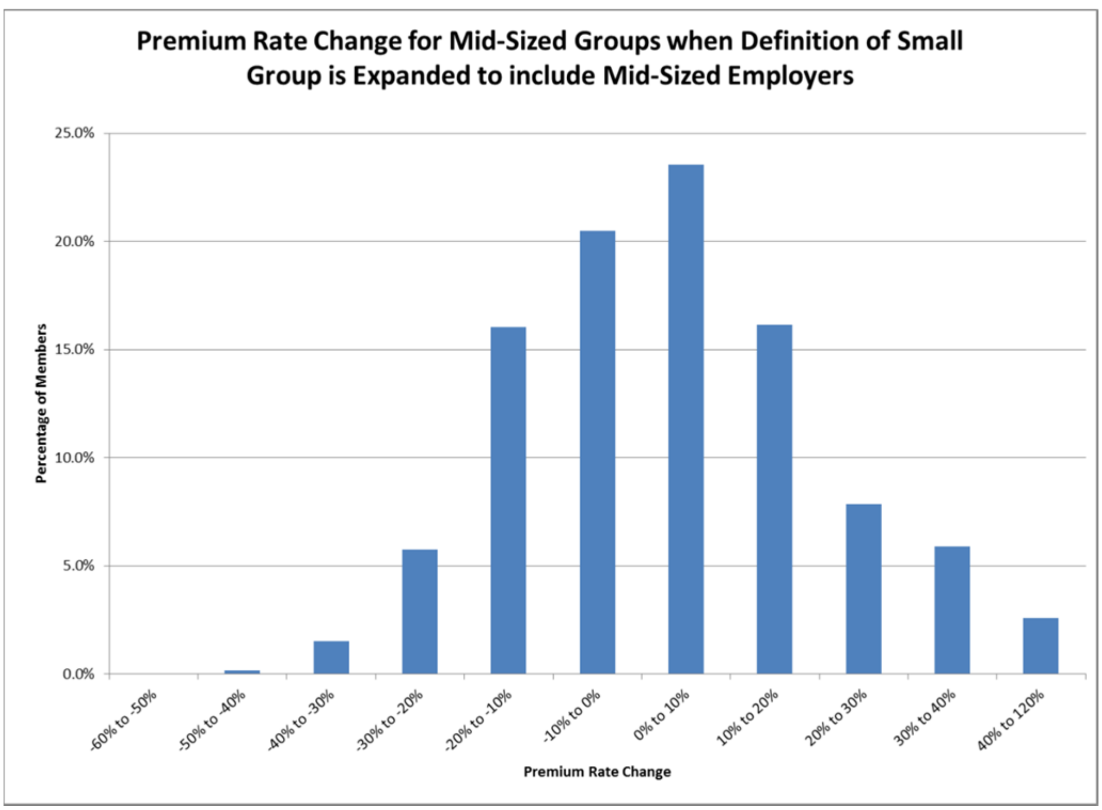
Change in Premiums for Mid-Sized Groups under Modified Community Rating

In order to understand the impact of these factors on the premiums mid-sized employers will pay, we undertook a study on behalf of the BlueCross BlueShield Association. We analyzed actual underwriting decisions from several health insurance issuers. Our starting point was the premiums the mid-sized groups were paying, and we compared those premiums to premiums that will result once the ACA's modified community rating standards are implemented.

Currently, demographic factors used to rate mid-sized groups are based on actuarial considerations, matching cost to risk. When the definition of small group is expanded to include mid-sized groups, issuers will be required to use a modified community rating approach to determine premiums for mid-sized employers. Issuers will no longer be allowed to use rating factors that are predictive of the cost of providing coverage to a group.

Absent the adverse selection that may occur as a result of the ACA rating requirements being imposed on the mid-sized group market, our data shows that roughly 30% of the new small group market membership in 2016 would be composed of what had been consider mid-sized groups. Further, in our data, the premium for current small groups is roughly 5% higher than premiums for mid-sized groups after adjusting for benefit and other differences. Again, absent adverse selection, combining the two markets will result in about a 3.5% increase for mid-sized group members and a 1.4% decrease for small group members.

In the following chart, we illustrate the range of premium changes that mid-sized groups will experience when their premiums are determined in compliance with the ACA's small group rating rules and the risk pools are merged. Note that the changes we illustrate are before medical trend or other factors that could lead to premium increases such as the wear-off of the transitional reinsurance program. In addition, the changes we illustrate assume no net change in the total premium collected from mid-sized groups, other than the 3.5% discussed above that is required to cover the increased cost of merging the two markets.



Sixty-four percent of members are in groups that would receive a premium increase, and the average increase would be 18%. Roughly 40% of members would receive premium increases averaging 10% or more, and the average increase for these members is 25%.

The Potential for Adverse Selection

Small and mid-sized groups will have options for obtaining coverage in 2016. They may choose fully insured, ACA-compliant products either on or off the exchanges and so become part of the expanded, single risk pool. They may offer employees and their dependents health benefits on a self-insured basis, purchasing reinsurance to mitigate the risk of self-insuring. All other things equal, self-funding may provide a group a cost advantage of roughly 6% to 8% relative to being fully insured by avoiding health insurer taxes and the requirement to provide EHBs. This is in addition to the potential advantage of avoiding the new rating rules. As the small group market is expanded to include mid-sized groups, we expect to see an increase in the number of mid-sized groups choosing to self-insure, particularly among those groups that would otherwise see a large increase in costs from purchasing adjusted community rated, ACA-compliant coverage.

Finally, small and mid-sized groups may choose to stop offering health benefits.

We expect that this range of available options will result in adverse selection in the expanded single risk pool in 2016 and beyond.

This dynamic, where small and mid-sized groups forum shop for the best price for coverage will lead to adverse selection that health plans will incorporate into their small group pricing for 2016, and the addition of mid-sized groups into the mix may exacerbate this problem.

Premium Rate Change Considering the Effects of Adverse Selection

The impact of adverse selection by mid-sized groups on the expanded market depends primarily on the size of the small group market relative to the mid-sized group market, and also on the morbidity of the small group market relative to the mid-sized group market. Among the companies whose data we are using for this analysis, the mid-sized group market represented roughly 30% of the total of the small group and mid-sized group markets, combined. However, there are indications that this is changing, that the relative size of the small group market is shrinking as small groups drop coverage to allow employees access to premium subsidies.[1,2]

We illustrate the effect of adverse selection among mid-sized groups on the expanded market by postulating that at some level of rate increase, mid-sized groups will choose one of the following: to self-fund, to take advantage of the transitional policy, if allowed, or to stop offering coverage, and so remain outside of the expanded single risk pool, and that groups

[1] http://kaiserhealthnews.org/news/small-businesses-drop-coverage-as-health-law-offers-alternatives/

[2] http://www.jsonline.com/business/more-small-businesses-dropping-insurance-helping-workers-buy-health-plans-b99358644z1-277383331.html

with smaller increases, or rate decreases, will choose to purchase ACA-compliant coverage in the expanded single risk pool.

In Table 1, below, we show the consequences of this adverse selection on the premiums for mid-sized groups.

Table 1
Impact of Adverse Selection on Mid-Sized Groups Lapsing
Results for 2016

Rate Increase above Which Mid-Sized Group Lapse	Percentage of Mid-Sized Group Members Lapsing	Increase in Mid-Sized Group Premiums as a Result of Lapses
0%	64%	18%
10%	41%	12%
20%	23%	8%
30%	12%	6%

Table 1 shows, for example, that if all mid-sized groups that will receive a rate increase as a result of the ACA rating rules were to lapse (the first line of the table), this would mean that 64% of the mid-sized group members would leave the fully insured market, and this would require an 18% increase in premiums for those mid-sized groups remaining in the market. If only those mid-sized groups receiving more than a 10% rate increase as a result of the merging of markets were to lapse, 41% of mid-sized group members would lapse, and the premium increase for the remaining members would be 12%. Again, this analysis ignores the impact of the requirement that mid-sized groups provide EHBs, which could add 3% to 5% to the average premiums mid-sized employers will pay in 2016. These increases would be in addition to medical trend.

Table 1 reflects the results for 2016 only. Increases like the 18% rate increase we illustrate in Table 1 would likely result in additional relatively low-cost, mid-sized and small groups leaving the single risk pool for self-funding or dropping coverage in 2017 and later, potentially leading to a rate assessment spiral in the single risk pool.

The impact of this adverse selection on the expanded single risk pool will depend, in part, on the extent to which the selection can be spread over the small group market. As we noted, small employers comprised roughly 70% of what would be the expanded market if all fully insured small and mid-sized employers were in the expanded market. However, in some states where the transitional policy was implemented, rather than 70% of the potential expanded single risk pool being made up of small employers, one-half or less of the potential expanded single risk pool could be comprised of small group employers in 2016.

In Table 2, we show estimates of the impact of this selection assuming the small groups comprise 50% of the potential expanded single risk pool, roughly representative of states where the transitional policy was implemented and again, assuming small groups comprise 70% of the expanded single risk pool, roughly representative of states where the transitional policy was not implemented. We further vary the impact based on the assumption that mid-sized groups with rate increases over a certain amount choose not to participate in the expanded market.

Table 2
Impact of Selection on Premiums in the Expanded Market

Rate Increase at which Mid-Sized Groups Lapse	Small Employer Share of the Potential Expanded Market	
	50%	70%
0%	5%	3%
10%	4%	2%
20%	2%	1%
30%	1%	1%

Table 2 shows, for example, that assuming mid-sized groups would lapse if they see any rate increase as a result of the imposition of the ACA rating rules, and if small groups comprise 50% of the potential expanded market, then premiums for the expanded market as a whole would increase by 5% if the small and mid-sized markets are combined and the sort of adverse selection we anticipate were to occur. Similarly, if mid-sized groups only lapse if premiums increase by more than 30% as a result of the ACA rating rule, and small employers make up 70% of the potential expanded market, then the rate increase due to adverse selection among mid-sized groups would cause premiums for the market as a whole to increase by 1%. Again, these increases would be in addition to medical trend.

I welcome the opportunity to address any questions you may have related to this analysis.