

Expanding the individual health insurance market: Lessons from the state reforms of the 1990s

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SUMMARY OF KEY FINDINGS

- > **Comprehensive state reforms of the individual market increased the availability of coverage for higher-risk people.**
- > **State reforms made coverage less affordable on average, although premiums for higher-risk people decreased, at least in the short run.** Still, coverage was probably not affordable for modest-income families with health problems.
- > **There is no evidence that reforms increased coverage overall;** in fact, states with comprehensive reforms experienced a decrease in coverage rates because people with lower risks left the market due to the higher price they faced for individual insurance.

Individual health insurance market reforms: why relevant to today's policy debates?

- Many policy-makers support expanding health insurance coverage by providing tax credits to individuals with low or modest incomes to help them purchase private health insurance.

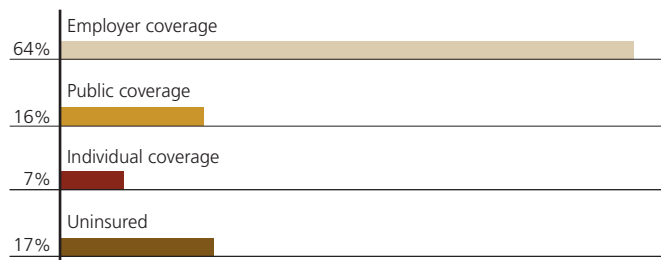
If tax credits are enacted, more people will purchase health insurance directly from insurers. How a credit is used and who benefits the most from it will be affected by how the individual insurance market operates and is regulated.

Drawing on lessons of state insurance market reforms of the 1990s, we examine whether reforms could be used to make individual insurance more available and affordable today.

What is the individual market and whom does it cover?

- The individual insurance market—also known as the nongroup market—is really 51 separate markets, regulated by the states and the District of Columbia.
- Only about seven percent of Americans under the age of 65—17 million people—have individually purchased health insurance coverage (Figure 1). This number has decreased slightly over the last ten years.

Figure 1. Health insurance coverage of nonelderly Americans, 2002



Source: Fronstin, 2003

- Individual coverage is an important source of health insurance for people without employer-sponsored insurance or public coverage through Medicaid or Medicare.
- In an unregulated market, insurers can deny or limit coverage or charge higher premiums based on the individual's risk profile.

States enacted individual market reforms in the 1990s to make individual insurance coverage more available and affordable.

In general, reforms are designed to make coverage more available and spread costs across a larger number of people (risk pooling). Such reforms can result in increased premiums for people with lower risks and lower premiums for those with higher risks, making it easier for sick people to get coverage.

At the same time, reformers hope to keep healthier people in the market. If premiums increase too much, healthy people will drop coverage, driving up premiums for the sicker people remaining and causing premiums to grow more rapidly as healthier and lower-cost people drop coverage because it is too expensive (i.e., an adverse selection spiral).

This two-part reform challenge—to increase availability and spread costs among the sick and the well, but also to keep prices low enough that healthier people retain coverage—is central to the discussion of individual market reforms.

DEFINITIONS

Guaranteed Issue

Guaranteed issue requires that insurers offer insurance to anyone that applies.

Guaranteed Renewal

Guaranteed renewal prohibits insurers from dropping coverage when enrollees re-apply.

Adverse Selection

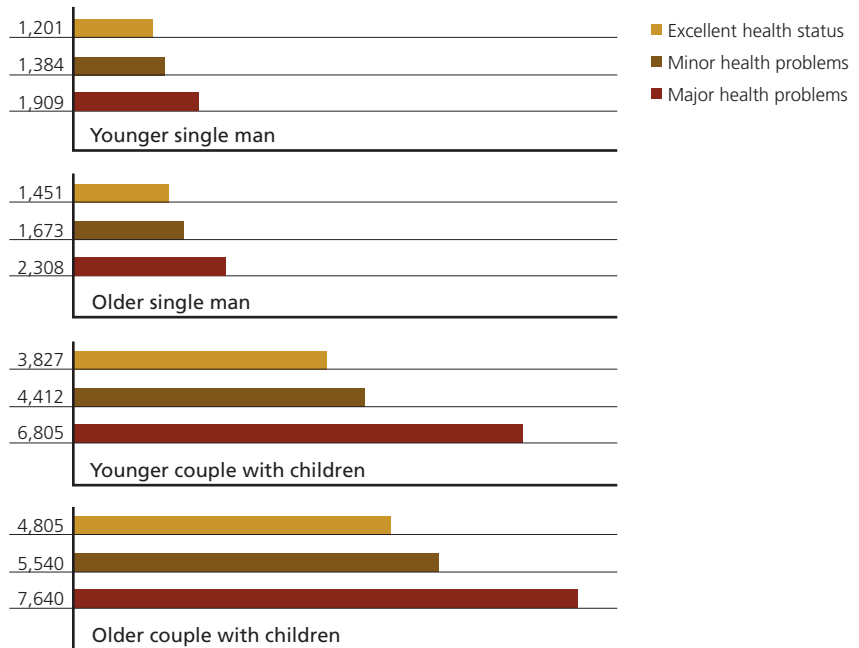
Adverse selection occurs when people with above-average expected costs are more likely to purchase insurance than people with average or below-average expected costs.

Adverse Selection Spiral

If adverse selection occurs in a market, insurers experience higher costs than anticipated. They are likely to raise premiums, causing lower-cost enrollees to drop coverage. The population remaining has even higher average costs than previously, and the cycle continues.

■ People with major health problems pay higher premiums for individual coverage than people who are healthy (Figure 2).

Figure 2. Simulated annual premiums (in dollars) for non-smokers, 1998–2001



Source: Hadley, 2003

Why did states enact individual market reforms?

- In the early 1990s, state officials were under great pressure to address rising health care costs and uninsured rates. They saw insurance market reforms as one possible solution.
- States enacted individual market reforms to make coverage more available and affordable—especially for higher-risk people—with the ultimate goal of reducing the uninsured rate or at least keeping it from growing. Some states also enacted reforms to prevent the individual market from collapsing.

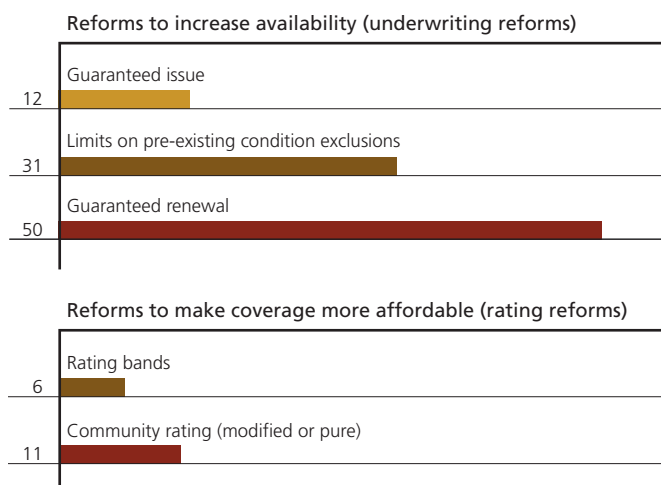
What reforms did states enact?

- States enacted underwriting reforms to increase availability of coverage. These reforms included:
 - Guaranteed issue and renewability of insurance policies
 - Limitations on exclusions for pre-existing conditions

Comprehensive reforms increased the availability of individual insurance, especially for higher-risk people.

- States also enacted rating reforms to increase affordability of coverage for higher-cost or sicker people. These reforms included:
 - Rating bands
 - Pure and modified community rating
- Finally, states enacted reforms to spread risk across insurers. These reforms included:
 - Risk adjustment
 - High-risk pools and insurer of last resort
 - Insurer pay or play mechanisms
- In the 1990s, all states enacted one or more of these reforms (Figure 3). Most common were laws to limit pre-existing condition clauses and provide guaranteed renewal (in part due to HIPAA—Health Insurance Portability and Accountability Act—requirements).

Figure 3. Number of states with individual market reforms, 2000



Source: Pauly, 2000

Did underwriting reforms make policies more available, especially for higher-risk people?

- In states with comprehensive underwriting reforms (guaranteed issue combined with guaranteed renewability and strict limits on pre-existing condition exclusions), individual insurance became more available for purchase.
- Comprehensive reforms resulted in some carriers leaving the individual market—especially where guaranteed issue was paired with community rating—and possibly fueled faster HMO penetration.

DEFINITIONS

Rating Bands

Rating bands limit the allowable price range for a given policy.

Community Rating

Under community rating all applicants for a given insurer are charged the same premium for the same coverage. In pure form, rates can vary only by where the enrollee lives, benefit package and family size. In modified form, rates can vary by age and gender, but not health status.

Risk Adjustment

Under risk adjustment, payments to an insurer are increased for above-average-risk enrollees and lowered for below-average-risk enrollees.

High-Risk Pools

High-risk pools are a mechanism by which insurers can pass on high-risk individuals to a centralized pool, subsidized by insurers and sometimes government.

Insurer Pay or Play

Under pay or play mechanisms, insurers selling in the group market must also sell in the individual market or pay a share of the losses for insurers selling in this market.

The average cost of policies went up and overall coverage rates decreased in states with comprehensive reforms.

States risked creating adverse selection spirals through their insurance reform efforts. The limited data on this issue suggest that adverse selection occurred, but not to the degree anticipated.

Premium increases were more moderate and adverse selection was less of a problem when:

- Rating restrictions were phased in over time.
- Risk was spread across many insurers in the individual market through risk adjustment or reinsurance.
- Insurers were permitted to use pre-existing condition exclusions or waiting periods.
- Insurers offering group coverage were required to sell in the individual market.

- Even in states with guaranteed issue, coverage was not necessarily available to everyone. Most states did not require guaranteed issue of every policy an insurer offered and some permitted insurers to impose a prior coverage requirement.
- Research findings are inconclusive on the impact of more modest reform packages (those not including guaranteed issue).

How did rating reforms affect the cost of coverage?

- Average premiums and premiums paid by healthier people rose in states with comprehensive reforms (community rating combined with guaranteed issue), while premiums paid by sicker or higher-risk people fell. Premium increases were more modest when reforms were phased in. Less aggressive reforms (e.g., rating bands) had no clear effect on premiums.

Did adverse selection occur?

- Reforms that make insurance more available and affordable for higher-risk people can increase adverse selection problems for insurers.
- Adverse selection did occur after community rating was introduced, but not as much as expected, in part due to risk-spreading mechanisms and because many sicker people still could not afford coverage.

How did reforms affect coverage?

- Although policies were more available for purchase, more people did not necessarily buy them. States with comprehensive reforms (including a combination of guaranteed issue, community rating and other rating restrictions) experienced a decrease, not an increase, in overall coverage rates.
- States with less comprehensive reforms experienced modest or no changes in coverage rates.
- Limited evidence suggests that high-risk people were somewhat more likely to obtain coverage in states with reforms.

Policy Implications

- > **Without other policy measures, individual market reforms cannot provide a solution to meet the needs of both low-risk and high-risk individuals.** A largely unregulated market may be best suited to offer inexpensive individual policies to uninsured people who are younger and healthier. However, people who are older or high-risk will be unable to find affordable coverage in such a market. Reforms of the type implemented in the 1990s make coverage somewhat more available and affordable for this group.
- > **Tax credits may expand options, but may not produce viable coverage alternatives for high-risk uninsured people.** Some policy-makers argue that subsidies for purchasing individual coverage such as tax credits might help resolve current affordability problems by lowering premiums and increasing the size of the individual market without the need for reforms. The experience with the health insurance component of the Earned Income Tax Credit suggests that an unreformed market will produce policies with premiums reflecting tax credit amounts, but these policies are likely to offer limited benefits or significant cost-sharing.
- > **For tax credits to achieve significant reductions in the uninsured, they may need to be combined with comprehensive market reforms or other measures to assure access to health insurance for credit-eligible people.** While the individual market reforms of the 1990s had only a modest impact on coverage rates of higher-risk people, it is possible that similar reforms, if combined with substantial subsidies (through tax credits), would have a greater impact.

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