

# Small Group Rating and Risk Adjustment Issues

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# Small Group Health Insurance Status Quo

- 33 million insured by small employers
- Guaranteed issue (GI) (required by HIPAA)
- States and DC apply (with some exceptions) rating restrictions as follows:
  - 37 have rate bands
    - Based on medical needs, industry, employer's size, age, gender, and/or other factors (some states allow wide variation in bands)
  - 9 have adjusted community rating
    - Based on region, family composition, and age
  - 1 has pure community rating
  - 4 have no rating restrictions

# SG Health Insurance Underwriting Data

- Underwriting for New Policies Uses:
  - List of employees and dependents with age, location
  - Industry type (using SIC codes)
  - Health status, if available
  - Length of time in business
  - Product chosen
    - PPO vs. HMO
    - Size of deductible, copay
    - Rx benefit

# SG Health Insurance New Policy Premiums

- Rates determined within allowable range within a rate band:
  - Age/gender/industry/location start the calculation
  - List billing for smallest groups (2-10)
    - Each new employee/dependent is billed at age-specific rate
- SG market is very competitive
  - Premiums drive most of the competition
    - Large local insurers get the best provider discounts
    - Innovative benefit plans can reduce premiums
  - Network consideration is a distant second factor
- SG risk pools determine overall reference premium for a state/region

# SG Health Insurance Renewal Policy Premiums

- First, enrollment changes evaluated
  - Guaranteed renewable, so can't be canceled
  - Smallest employers have list billing, so new employees have own rates, not average rates
- Second, claims experience evaluated
  - Some pooling of catastrophic claims
  - High claims drive premiums to upper end of band
  - Low claims keep premiums flat
- Third, most small employers “buy down” benefits almost every year by increasing cost-sharing to reduce premium increases

# Combining Non-Group and Small Group Markets

- Creates a larger risk pool
- May create new cross-subsidies
  - In Massachusetts, high existing premiums under GI in the non-group market raised small group premiums slightly, while non-group were lowered
  - In non-guaranteed issue states, likely that non-group premiums would increase significantly when combined with the small group risk pool
- Risk status of the combined pool may change

# Options for Managing Risk Variation Across Insurers

- Risk Adjustment
- Reinsurance

# Why is Risk Adjustment Needed?

- Reduces incentives to compete on selection; rewards efficiency
- Reduces incentives for insurers to have restricted/limited provider networks
- Makes sicker people more attractive enrollees due to higher payments and possibly **very** attractive enrollees if the condition can be managed for less than the risk adjustment payment
- Restrictions on underwriting and limits on rate variation may result in unequal distribution of enrollee risk across insurers/payors

# Predicting an Enrollee's Likely Cost

- Data on individuals' expenditures and characteristics are analyzed to create groups of individuals with similar expenditures and characteristics
- Characteristics typically used to assign individuals to a group include:
  - Demographics (age, gender, region) from enrollment info
  - Status (e.g. disabled or institutionalized) from enrollment info
  - Diagnoses (generally non-acute) from claims/encounter data
  - Service utilization from claims/encounter data

# How Would Risk Adjustment Work in an Exchange?

- Data on each plan's enrollee characteristics would be collected to assign individual and plan risk scores
- Each plan's score would be compared to the average risk score for all plans combined
- Each plan's payments (or contributions) to the risk pool would be determined
  - Plans with above average risk scores receive a payment
  - Plans with below average risk scores make a contribution to the risk adjustment pool

# Timing of Adjustment

- Prospective application
  - Most users apply today, predicting next year's costs
- Retrospective application
  - Certain big incidents can't be predicted (e.g. neonatal episodes)
  - May be used in start-up period, then converted to prospective when data are collected
- Can be combined

# Challenges

- Methods work well for insurance groups of 5,000 or more, not as well for smaller groups
- Administrative costs are significant
- Difficult to use with capitated delivery systems if encounter data are not fully recorded
- No system is perfect in scoring individuals
- Possible upcoding at the provider level

# Reinsurance

## Alternative to Risk Adjustment

- Retrospectively determined payment for high cost individuals
- Requires less data/simpler to administer
- May affect insurer's incentive to manage high cost cases
- Could be designed to compensate for skewed enrollment (disproportionate share of expensive persons)
  - Would require more data

# Reinsurance Options

- Commercial reinsurance—insurers purchase coverage from a “reinsurer”
- Publicly sponsored---insurers contribute to pool that shares losses for individual insurers’ high cost cases
  - Voluntary or mandatory
  - Distinct from high risk pool—insurers retain high risk persons
- Publicly subsidized/offered---aimed at lowering cost of primary insurance