

Risk Pooling: Is It *Really* the Key to Health Care Reform?

Cori E. Uccello, MAAA, FSA, FCA, MPP
Senior Health Fellow
American Academy of Actuaries

David A. Shea, Jr., MAAA, FSA
Chairperson, Federal Health Committee
American Academy of Actuaries

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Briefing Agenda - Background

- Risk pooling fundamentals
- Issue and rating rules
- Benefit package considerations



Briefing Agenda – Risk Pooling in Practice

- Risk pooling mechanics
- Rating variables
- Risk pooling/rating variable example
- Issues unique to the individual market
- Issues unique to the small group market



Risk Pooling Fundamentals

- Risk pools are large groups of individuals (or groups) whose medical costs are combined to calculate premiums.
- Pooling risks together allows the costs of the less healthy to be subsidized by the healthy.
- In general, the larger the risk pool, the more predictable and stable the premiums can be.



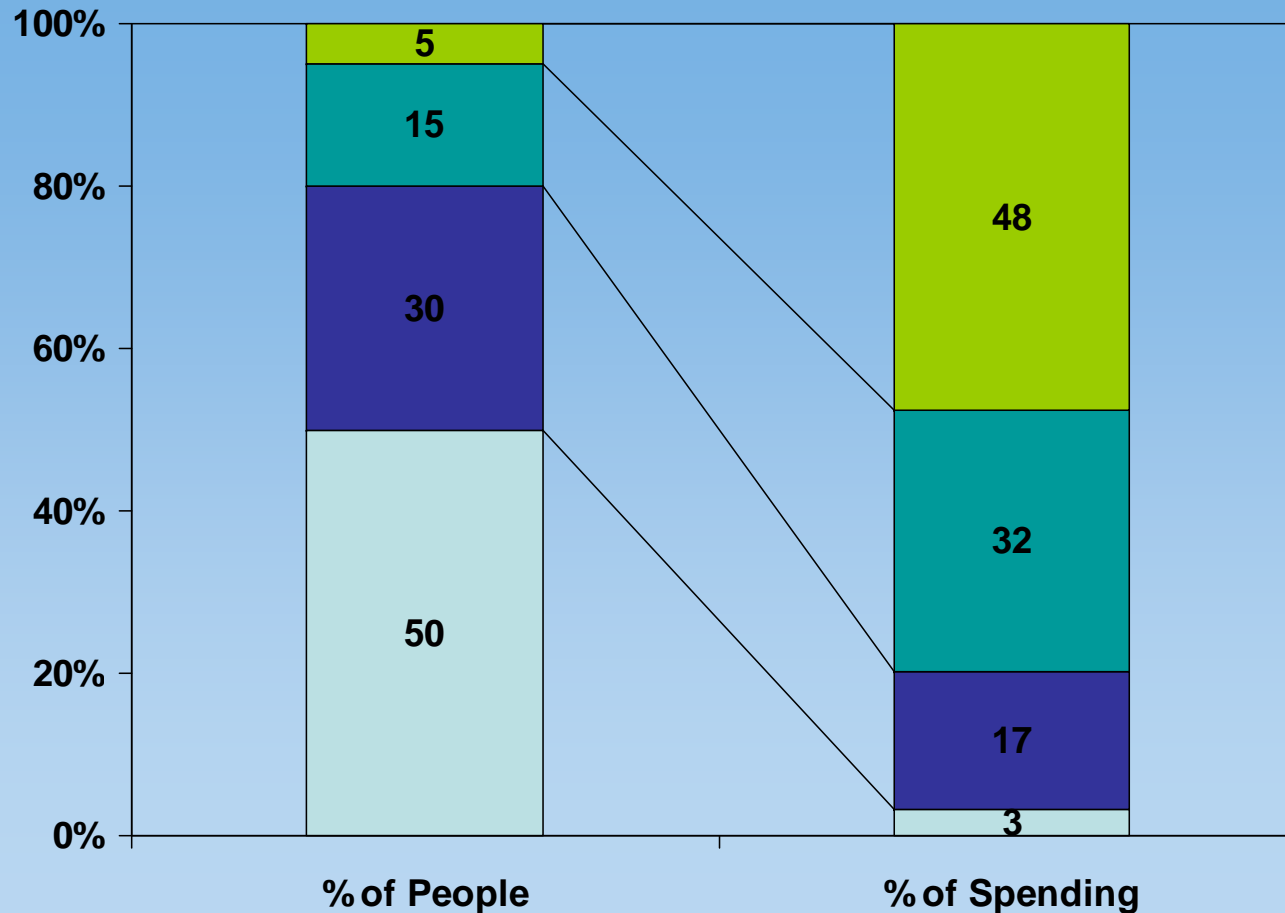
Risk Pooling Fundamentals (cont.)

- BUT, creating larger risk pools will not necessarily lower premiums.
- Must consider the size of the risk pool AND how it is comprised.
- If a pool attracts those with higher expected claims (i.e., adverse selection), premiums will be higher.
- Pools created as a by-product of membership in a group (i.e., group was created for purposes other than buying insurance) tend to be less subject to adverse selection.



Concentration of Health Spending, 2006

20% of People Account for 80% of Health Spending



Source: Kaiser Family Foundation calculations using the MEPS, available at <http://facts.kff.org/chart.aspx?ch=822>



Risk Pooling Fundamentals (cont.)

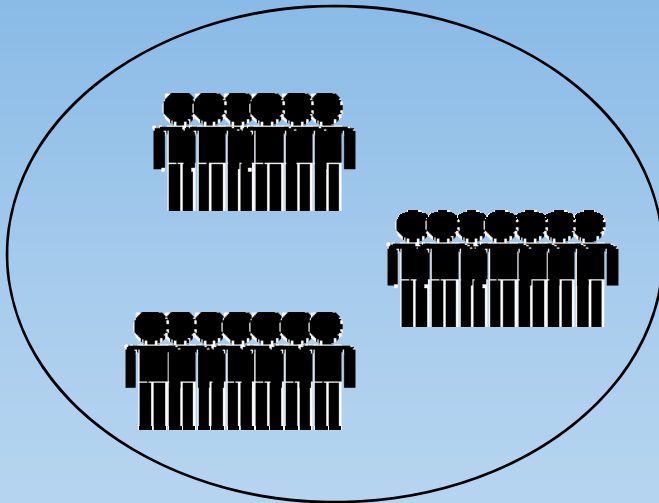
- Large employer groups
 - Workers automatically obtain coverage as a side benefit to employment.
- Small/medium size employers
 - Workers automatically obtain coverage as side benefit to employment, but employers can move into and out of the insurance market.
- Individual market
 - Individuals enter insurance market for the express purpose of obtaining health insurance.



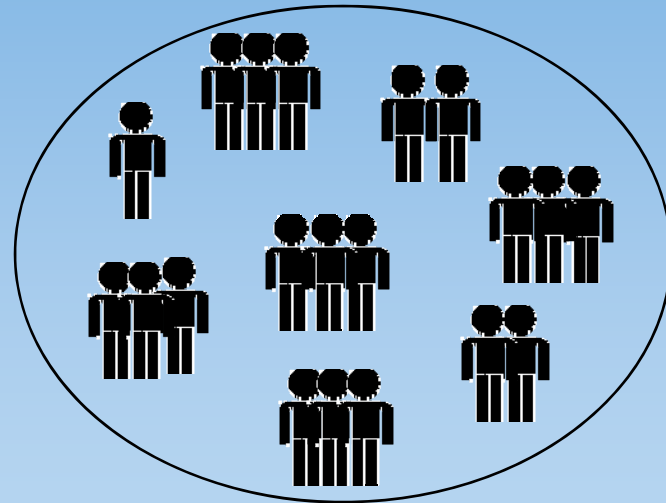
Risk Pooling Fundamentals (cont.)

- Consider two pools, with the same number of members:

Pool A: Fewer groups, more members per group



Pool B: More groups, fewer members per group



- Pool A will likely be more stable.



Issue and Rating Rules

- Address the goals of access to health insurance and premium affordability.
- Issue rule examples
 - Guaranteed issue
 - Allow underwriting



Issue and Rating Rules

- Rating rule examples
 - Pure community rating
 - Modified community rating
 - Health status rating



Alternative Pooling Arrangements

- Creating alternative pooling arrangements (e.g., regional health markets, cross-state purchasing) by state or federal initiatives to operate alongside existing arrangements, could result in adverse selection if issue and rating rules are not the same in both markets.



Benefit Package Considerations for Policymakers

- Adverse selection implications of different packages need to be considered.
- When offered a choice of plans, those at risk of higher health spending will tend toward more generous benefit packages.



Adverse Selection

- As noted earlier, when medical insurance is voluntary, it is subject to adverse selection based on asymmetric knowledge of health conditions.
- Ways to minimize it or its effects:
 - Mandate coverage
 - Provide premium subsidies
 - “Default” enrollment
 - Penalty for delayed enrollment
 - Risk adjustment



Risk Pooling in Practice



Briefing Agenda – Risk Pooling in Practice

- Risk pooling mechanics
- Rating variables
- Risk pooling/rating variable examples
- Issues unique to the individual market
- Issues unique to the small group market



Risk Pooling Mechanics

- Generally, insurance carriers pool the revenue and claims experience based on “market segment” (individual, small group or large group) to determine rate increases.
- There are no hard and fast rules regarding risk pooling in the determination of premiums, outside of the state regulatory constraints.
- Carriers prefer larger pools to smaller pools because they increase the predictability of projected claims; increasing predictability should not be interpreted as “lower cost.”



Risk Pooling Mechanics

- Within a market segment (e.g., individual), carriers sometimes segment the experience based on:
 - Insured's state of residence
 - Network differences (HMO versus PPO), since provider contracting differences drive unit cost
 - Benefit design (actively marketed versus not actively marketed)
- Again, there is a delicate balance in determining the appropriate level of risk pooling, to avoid disaggregating experience in such a way that sacrifices predictability.



Rating Variables

- Outside of the large employer market, there are a considerable number of ways in which premiums vary where allowed by law.
- These exist to minimize adverse selection in a voluntary market.
- A carrier must consider the variables in each state to also avoid adverse selection as much as possible.



Rating Variables

- Differences in benefit design, network and family status (to a degree) are generally acceptable rating variables everywhere.
- Outside of these, all bets are off.
- When allowed (or not specifically disallowed) by regulation, the following rating variables can be found in the individual and small group market:
 - Age (either individual ages or age bands)
 - Area/location (cities, counties, MSAs)
 - Gender
 - Health status



Rating Variables

- Rating variables are usually not separate risk pools.
- Factors are applied to arrive at premiums that vary by the rating variables, and experience is monitored over time, separately from the determination of overall rate levels.
- The following example will illustrate how this works.



Risk Pooling/Rating Variable Example

- A carrier has a book of individual business in one state with no restrictions on rating variables.
- There are two products, one HMO and one PPO, of equal size.
- Within each product, rates were initially established to vary by gender, area, underwriting tier and age.
- The carrier needs to update the rates for the coming year based on emerging experience.



Risk Pooling/Rating Variable Example

- The carrier analyzes two pools within the individual market: the HMO product and the PPO product.
- From that analysis, the overall rate increase is determined for each; if the carrier does no other analysis, all rates go up by the same percentage.
- Must also consider if the rates make sense from a marketing perspective.
- In this example, the HMO rates will go up 8% and the PPO rates will go up 10%.
- The carrier then decides to examine the experience within each product by area/location.



Risk Pooling/Rating Variable Example

- Each product has two rating areas within a state, of equal size.
- From the earlier analysis the carrier has determined the overall required rate increases; this additional analysis will determine how those overall rate increases are split between the rating areas.
- For the HMO product, one rating area needs to go up 10% while the other needs to go up 6%, which still achieves the overall increase of 8%.
- Since the PPO product is marketed side-by-side with the HMO product, consideration should be given to not only the experience within the PPO but the rate changes for the HMO.
- It is decided to increase one rating area by 11% and the other by 9%, achieving the overall 10%.



Issues Unique to the Individual Market

- The insured pays 100% of the premium.
- In most cases, premiums increase as the policyholder ages.
- Medical underwriting plays a huge role in determining rates for a policyholder.
- Actual rates can vary by many parameters (age, gender, area, underwriting, tier, etc.).
- Probably the most price sensitive of all market segments.



Issues Unique to the Small Group Market

- The insured usually pays a larger portion of the premium than in large groups.
- In some cases, premiums increase as the policyholder ages, but this could be obscured by the employer contribution.
- Medical underwriting plays a large role in determining rates for a group.
- The premium spread between low and high risk groups is almost always limited by state law.
- Small groups are much more price sensitive than large groups.



Questions/Comments

For more information, contact:

Heather Jerbi

Senior Health Policy Analyst, Federal

American Academy of Actuaries

1100 17th Street, NW

Washington, DC 20036

202-785-7869

jerbi@actuary.org

