CRITICAL ISSUES IN HEALTH REFORM
Individual Mandate

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Some reform proposals aiming to increase access to affordable health insurance coverage and reduce the number of uninsured include requirements that individuals obtain coverage. The implications of such a requirement depend on many factors, but especially on its ability to reduce adverse selection.

Adverse selection occurs in a voluntary market.

In a voluntary market, individuals at greater risk of high health care spending are more likely to desire coverage, while low-risk individuals are more likely to opt out. This phenomenon, typically referred to as adverse selection, increases the average insured risk and results in higher average premiums.

Certain issue and rating rules exacerbate adverse selection.

How the various rules and regulations that apply to health insurance markets are defined can affect the degree of adverse selection. For instance, guaranteed-issue provisions can exacerbate adverse selection concerns, by giving individuals the ability as well as the incentive to delay purchasing insurance until they have health care needs. Likewise, by limiting or prohibiting the use of health status and age as premium rating factors, pure community rating and adjusted community rating rules can raise the premiums for younger and healthier individuals relative to what they would pay if age and health status could be used as rating factors. This can cause younger and healthier individuals to opt out of coverage, leaving a higher-risk insured population. Allowing insurers to charge higher premiums or to deny coverage to high-risk individuals can help reduce adverse selection by making insurance more attractive to healthier individuals, but at the cost of reduced access to coverage and higher premiums for the high-risk population.

An individual mandate can reduce adverse selection.

Increasing overall participation in health insurance plans could be an effective way to minimize adverse selection. Requiring individuals to have insurance coverage is one way to increase participation rates, especially among low-risk individuals, and thereby reduce adverse selection risk. Other types of incentives are also available to increase participation, including: limiting open enrollment periods with penalties for delayed enrollment, subsidizing premiums, and instituting automatic enrollment (i.e., opt-out rather than opt-in provisions). Medicare Parts B and D include some of these incentives. Nevertheless, an effective and enforceable individual mandate would likely achieve even higher participation rates than these types of voluntary incentives.

In the absence of universal coverage, some degree of adverse selection is inevitable.

Even with an individual mandate that dramatically increases participation rates, some degree of adverse selection is inevitable. And even with universal coverage, some insurance plans may end up with a disproportionate share of high-risk individuals, due to benefit design differences, for example. If plan premiums are not allowed to vary to reflect health status or demographic characteristics, plans could be at risk for large losses as a result of this selection. To protect their financial viability, plans could develop strategies to avoid enrolling less-healthy individuals,

The Individual Medical Insurance Market: A Guide for Policymakers (October 2008)
http://www.actuary.org/pdf/health/med_market_1008.pdf

Risk Classification in the Voluntary Individual Health Insurance Market (March 2009)
http://www.actuary.org/pdf/health/risk_mar09.pdf

Wading Through Medical Insurance Pools: A Primer (September 2006)
http://www.actuary.org/pdf/health/pools_sep06.pdf

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such as dropping the types of benefits that are most attractive to those who are less healthy. Risk adjustment could be used to adjust plan payments to take into account the health status of plan participants. This would reduce the incentive an insurer might have to avoid enrolling high-risk individuals. In addition, some type of reinsurance mechanism could limit insurers' potential losses by protecting against unexpected high-cost claims.

The impact of an individual mandate and other market reforms will vary across states.

The impact of an individual mandate and market reforms will vary across states, depending on their current market rules. In states that allow underwriting and premium variations by health status, the uninsured population may be less healthy, on average, than the uninsured population in states with guaranteed issue and community rating. High-risk individuals are less likely to be able to obtain affordable coverage in the underwritten states, and low-risk individuals are less likely to be willing to pay the premiums in guaranteed issue states. Therefore, instituting an individual mandate and moving to guaranteed issue/modified community rating in a currently underwritten state will likely increase participation rates by higher-risk individuals, and average premiums will increase as a result. The opposite is true in the guaranteed issue states, where the newly insured will more likely be low-risk individuals. The effect of reform options on states with high-risk pools can be more complicated, depending on whether the high-risk pool enrollees are incorporated into the individual market or whether the high-risk pools remain in place, even temporarily.

The impact of an individual mandate can vary by when it is implemented, compared with other market reforms.

Efforts to increase access to coverage through guaranteed issue and modified community rating rules will typically result in the high-risk individuals being the first to enroll. This is confirmed by preliminary evidence from the Massachusetts health reform program—before the state's individual mandate was fully implemented, the people who enrolled first were the least healthy among the uninsured. Bringing in the low-risk individuals, through an individual mandate or other incentives, is key to reducing adverse selection and keeping the program viable. In other words, if a mandate is to be implemented, it should be in conjunction with, or at least not too long after, any move to stricter issue and rating rules.

The impact of an individual mandate on the individual market will vary by what coverage options are available.

The impact of an individual mandate on the individual market will depend on what other coverage options people have and whether that coverage is subsidized. If low-risk individuals have access to subsidized coverage through an employer, they might obtain coverage there, rather than in the individual market. However, if federal premium subsidies are available only in the individual market, this could increase individual market participation by people with lower risk factors. Although this could increase the viability of the individual market, this could lead to fewer employers offering coverage if an employer mandate is not imposed as well.

Other considerations

Imposing an individual mandate would require that several other issues be addressed, including:

- Whether and how to define minimum creditable coverage,
- Whether and how to define affordability,
- How to set premium subsidies,
- How best to set and enforce penalties for noncompliance,
- Whether to also impose an employer mandate, and
- What type of enrollment methodology to use.

How each of these issues is addressed will impact not only the effectiveness of the individual mandate, but also the costs to individuals and to the federal government.