AMERICAN ACADEMY *of* ACTUARIES

April 5, 2011

The Honorable Michael T. McRaith
Co-Chair, Exchanges (B) Subgroup
Director, Illinois Department of Insurance

The Honorable Sandy Praeger
Co-Chair, Exchanges (B) Subgroup
Commissioner, Kansas Insurance Department

Re: NAIC White Paper on Adverse Selection

Dear Director McRaith and Commissioner Praeger:

On behalf of the American Academy of Actuaries'[1] Exchanges Work Group, I am pleased to offer the following comments on the National Association of Insurance Commissioners (NAIC) Exchanges (B) Subgroup's white paper on adverse selection. The white paper overall represents a good, high-level description of adverse selection and the potential for selection as it relates to the exchanges created through the Affordable Care Act (ACA). We do, however, have a number of comments and suggestions that we believe could enhance the white paper. Our comments are presented by section of the white paper.

**Background**

In general, we would recommend revising the *Background* section to better differentiate between the types/causes of adverse selection, which also would help frame the discussion for the remainder of the white paper. For example, the *Background* could outline the three basic types of adverse selection discussed in the paper: adverse selection as it relates to the tendency of consumers to defer purchase of insurance until it is needed; adverse selection inside versus outside the exchange; and adverse selection among plans within the exchange. As is, the remainder of the white paper is specific to the potential for adverse selection in those categories, so providing additional description in the *Background* section would better frame those references in the rest of the paper.

**Adverse Selection Issues in Exchanges**

Many of the eight issues identified in this section apply both inside and outside the exchanges, as well as between plans within an exchange. That is not always clearly indicated, however, in the descriptions provided. For example, in the first issue there is a description of the potential for selection if one market (an exchange or the traditional market) is required to offer plans with more comprehensive benefits. The potential for selection not only exists between the traditional

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

market and exchange, but also among plans within an exchange. It could help to differentiate and discuss both types of adverse selection potential.

*Example 4: Although the number of participants in grandfathered plans may be minimal by 2014, the removal of these members from the risk pool may also result in adverse selection.* Depending on a state's current issue and rating rules, selection could occur in grandfathered plans as higher-cost individuals opt for less expensive coverage offered through the exchange, leaving grandfathered plans primarily with lower-cost individuals. Given the lack of new entrants, grandfathered plans (as noted in the example) slowly will disappear over time. As this example is written, it is unclear if the subgroup is suggesting that the loss of grandfathered plans would be a concern. We recommend the subgroup revise this example to explain more clearly the potential selection concern.

*Example 7: If Exchanges are structured so that employers may only offer their employees a defined contribution arrangement whereby the employee/dependent makes the choice of insurer and plan option through the exchange while the outside market allows the employer to make the choice of plan or plans available to covered employees/dependents, adverse selection may occur. Additionally, if an employer may offer employees multiple products through a variety of carriers inside the exchange, while the employee choice is limited outside to only one carrier and one plan, adverse selection in the outside market may occur.*
Another concern the subgroup should consider is that the potential for selection between plans within an exchange is greater if employees have the choice of any plan within the exchange as opposed to the employer making the choice of plan within the exchange.

In addition to the examples that the subgroup has included in this section, we suggest a separate discussion of the selection potential if the number of carriers in an exchange is limited. If there are a limited number of carriers allowed in the exchange, some individuals then could find greater flexibility and more competitive rates outside the exchange.

**Key ACA Provisions Addressing Adverse Selection**
This is a comprehensive list and discussion of the provisions that have some effect on adverse selection. Some of these provisions, however, mitigate adverse selection (e.g., the premium for plans offered inside and outside an exchange must be the same, and the same rating factors must be used inside and outside the exchange) while others exacerbate the potential for adverse selection (e.g., issuers must offer at least one silver and one gold level plan to participate in an exchange, with no similar requirement outside of it, and small groups up to 100 members must be allowed to experience rate outside of the exchange.) It would be helpful to differentiate within this section those provisions that exacerbate from those that mitigate adverse selection.

Under Section 1201, adding PHSA Section 2707, we recommend that the subgroup clarify what is meant by "skew the benefits offered." As we read the description, we believe the subgroup's concern is that large groups may provide less generous coverage that still meets the minimum required coverage, which has the potential to drive higher-risk employees to the exchanges to get more comprehensive coverage.

**State Options to Minimize Adverse Selection Effects**

It is our understanding that this subgroup also plans to prepare a separate white paper related to reinsurance and risk adjustment. Since risk adjustment is one of the most significant methods for mitigating adverse selection, it might be appropriate to include a brief discussion of the ACA risk-sharing mechanisms in this paper as well. As part of that discussion, we believe it would be appropriate to recognize the factors that affect health spending (and therefore, potential adverse selection), including health status, income, gender and age (to the extent that age is not already allowed as a rating factor).

In addition to our general suggestion of including some discussion of the risk adjustment mechanisms, we have the following specific comments and requests for clarification:

Under *Additional Mechanisms to Consider – State Mandated Benefits*, is the subgroup suggesting that states pick up the cost of mandated benefits outside of the exchanges? The subgroup should clarify exactly what is intended when making the requirements the same inside and outside the exchange.

Under *Additional Mechanisms to Consider – Qualified Health Plan (QHP) Description*, the subgroup may want to specify what additional requirements a QHP would have to meet that would make it more expensive than plans outside an exchange.

Under *Additional Mechanisms to Consider – Penalties for Non-Enrollment*, we recommend the subgroup consider including a more robust discussion of an appropriate enrollment process that would mitigate some of the adverse selection concerns and result in a more stable rating pool. For example, state exchanges may limit the number of times an individual can change coverage to once a year to limit the adverse selection associated with switching coverage. This also would help lower the administrative burden of tracking membership. In addition to an annual open-enrollment period and late-enrollment penalties, other mechanisms to help limit adverse selection could include increasing the time allowed between open-enrollment periods and limiting the ability to upgrade to more generous benefit plans during open enrollment

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Thank you for the opportunity to comment. If you have any questions or would like to discuss any of our comments in more detail, please contact Heather Jerbi, the Academy's senior health policy analyst (jerbi@actuary.org; 202.785.7869).

Sincerely,

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American Academy of Actuaries

Cc: Jolie H. Matthews, Senior Health & Life Policy Advisor & Counsel, NAIC