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MEMO

TO:	Blue Cross and Blue Shield Association
DATE:	January 27, 2015
FROM:	Kurt Giesa, FSA, MAAA
SUBJECT:	Impact of Including Employers with 51 to 100 Employees in the Small Group Market in 2016

Blue Cross and Blue Shield Association:

At your request, we have undertaken an analysis of the impact of the inclusion of employers with 51 to 100 employees (mid-sized groups) in the small group market in 2016. As you know, this analysis is based on actual underwriting data from a number of health insurance issuers. While we show results in aggregate across these sources, the results for each source on its own are similar to the results across the sources. In total, we believe these data are representative of the market at large, but it is likely that actual results will be different for particular issuers or in a particular state, depending on a number of factors, such as prevailing benefit levels and the availability of self-funded products.

Our primary findings are that expanding the definition of small group to 51 to 100 employees would have the following impacts:

- Roughly two-thirds (64%) of members in groups with 51-100 employees would receive a premium increase in 2016 as a result of changes in rating rules and expanding the market, with these groups receiving an 18% increase on average.

- Application of Essential Health Benefit (EHB) requirements would increase premiums by 3% to 5% for mid-sized groups on top of the impact from changes in rating rules and expanding the market.

- Premiums in the expanded market (1-100 employees) would increase. Premiums would increase by as much as 5% in 2016 in states that allowed the transitional policy.

- Cumulative rate increases could be much higher as a result of adverse selection. As rates increase, more mid-sized groups may drop coverage or self-fund. We estimate that this would increase rates by an additional 6-18% for mid-sized groups in 2016. The additional relatively low-cost mid-sized and small groups leaving the expanded single risk pool in 2017 and beyond could lead to a rate assessment spiral in the 1-100 market.

Background

Beginning in 2016, the definition of small employer will be expanded to include employers with one to 100 employees. This will subject groups with 51 to 100 employees to the insurance market reforms that are currently in place for ACA-compliant small group policies where premiums may vary only according to the following factors:

- age, according to a 3:1 rate schedule for adults,
- the number of covered members, subject to the restriction that no more than three dependent children under age 21 may be counted in developing the premium for a given subscriber,
- rating area,
- tobacco use, and
- benefit plan.

Issuers will not be allowed to reflect the group's actual claims experience in setting premiums, to vary administrative expenses or risk charges based on group size, or make any of the other adjustments that are currently common in the mid-sized group market to a given group's premiums. In addition, policies sold to mid-sized employers will have to include the Essential Health Benefit (EHB) package.

There are at least four ways the change in the definition of small employer will impact rates for mid-sized groups:

- The restriction on age rating will mean that groups with older covered members will see premiums decrease, and groups with younger members will see premiums increase, all else equal.
- The restriction on underwriting based on claims or varying administrative costs or risk charges by group size will mean that larger mid-sized groups and those with lower expected claims will see premiums increase, while smaller mid-sized groups and those with higher expected claims will see premiums decrease, again, all else equal.

These changes will result in subsidies among insured groups where premiums for lower cost, lower risk groups will increase, and premiums for higher cost, higher risk groups will decrease.

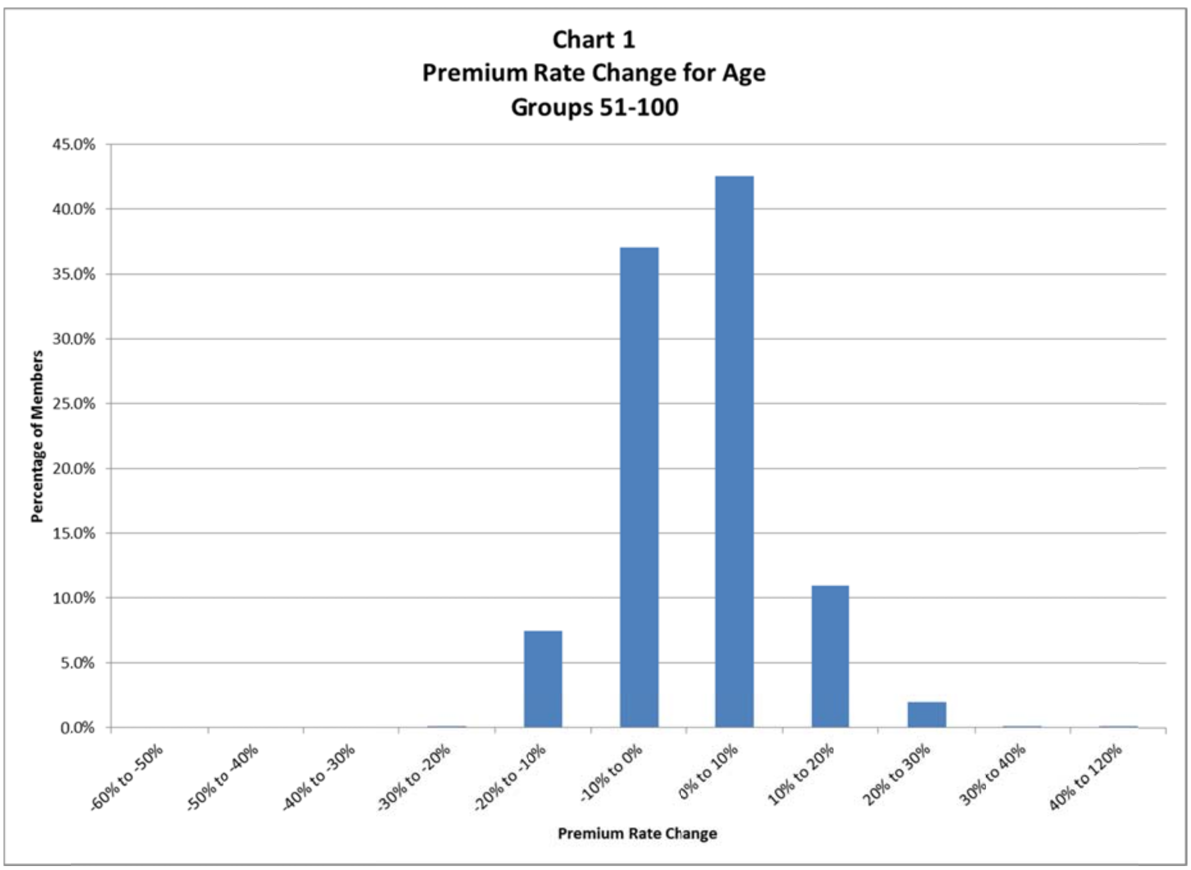
- The introduction of these subsidies into the expanded market will likely lead to some of the mid-sized groups leaving the market, either dropping coverage entirely, self-insuring, or taking advantage of the transitional policy discussed below.

- Covering the EHBs will mean that some mid-sized employers will have to increase both the scope and level of the benefits they are currently providing to their employees. We estimate that this will increase the average premiums that mid-sized groups will pay in 2016 by 3% to 5%, though this will vary considerably by group.

In order to understand the impact of these factors on the mid-sized employer market, we analyzed actual underwriting decisions from several health insurance issuers.

Change in Mid-Sized Group Premiums Due to 3:1 for Age

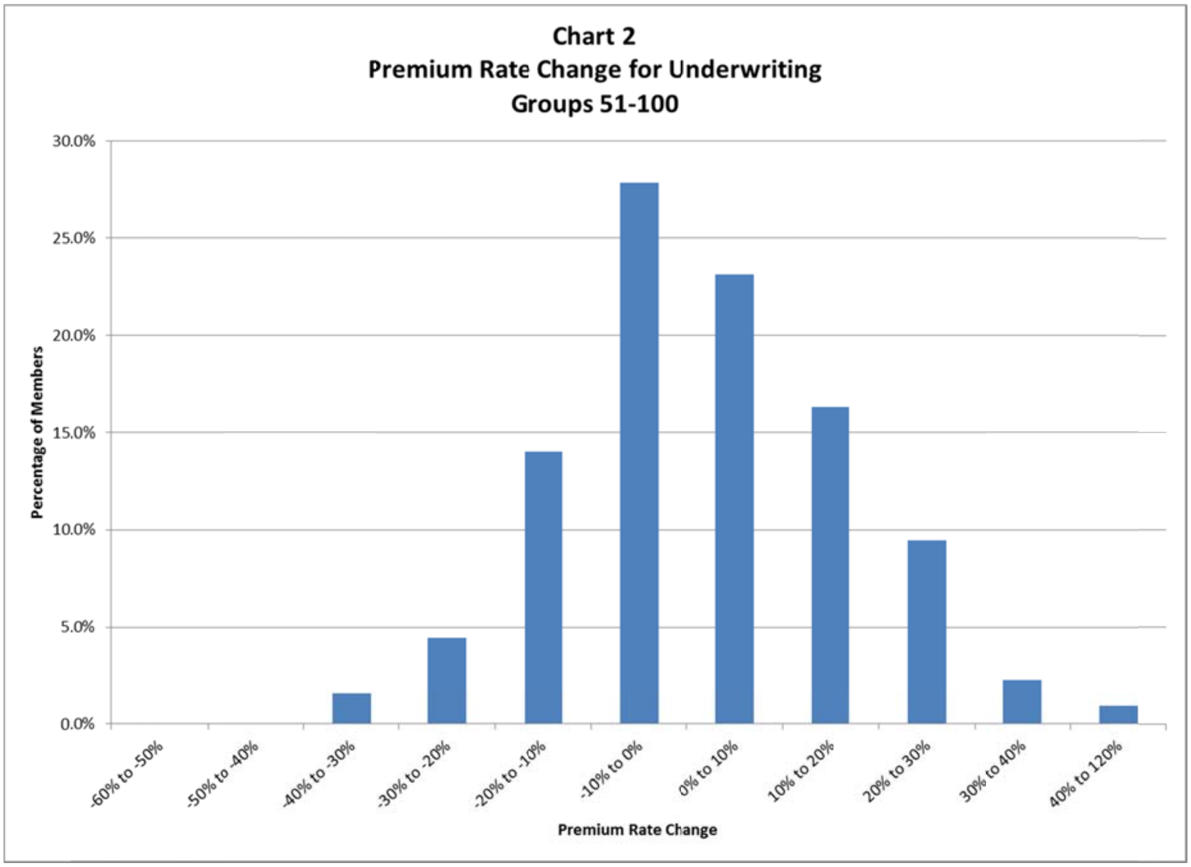
In Chart 1, we show the impact of the change in age rating on mid-sized groups. Currently, demographic factors used to rate mid-sized groups are based on actuarial considerations, matching cost to risk. When the definition of small group is expanded to include groups with up to 100 employees, demographic factors will be restricted so that the factor for the oldest member is no more than three times the factor for the youngest adult member. Absent any other changes, this change alone will produce the rate changes we illustrate in Chart 1, below.



In developing the percentages in Chart 1, we have assumed that there will be no change in overall mid-sized group premiums as a result of moving to a 3:1 age rating scheme. Fifty-six percent of members are in groups that will see a rate increase due to the move to a 3:1 age rating scheme coupled with the elimination of gender, and the average rate increase for those groups will be 7%.

Change in Mid-Sized Group Premiums for Elimination of Underwriting

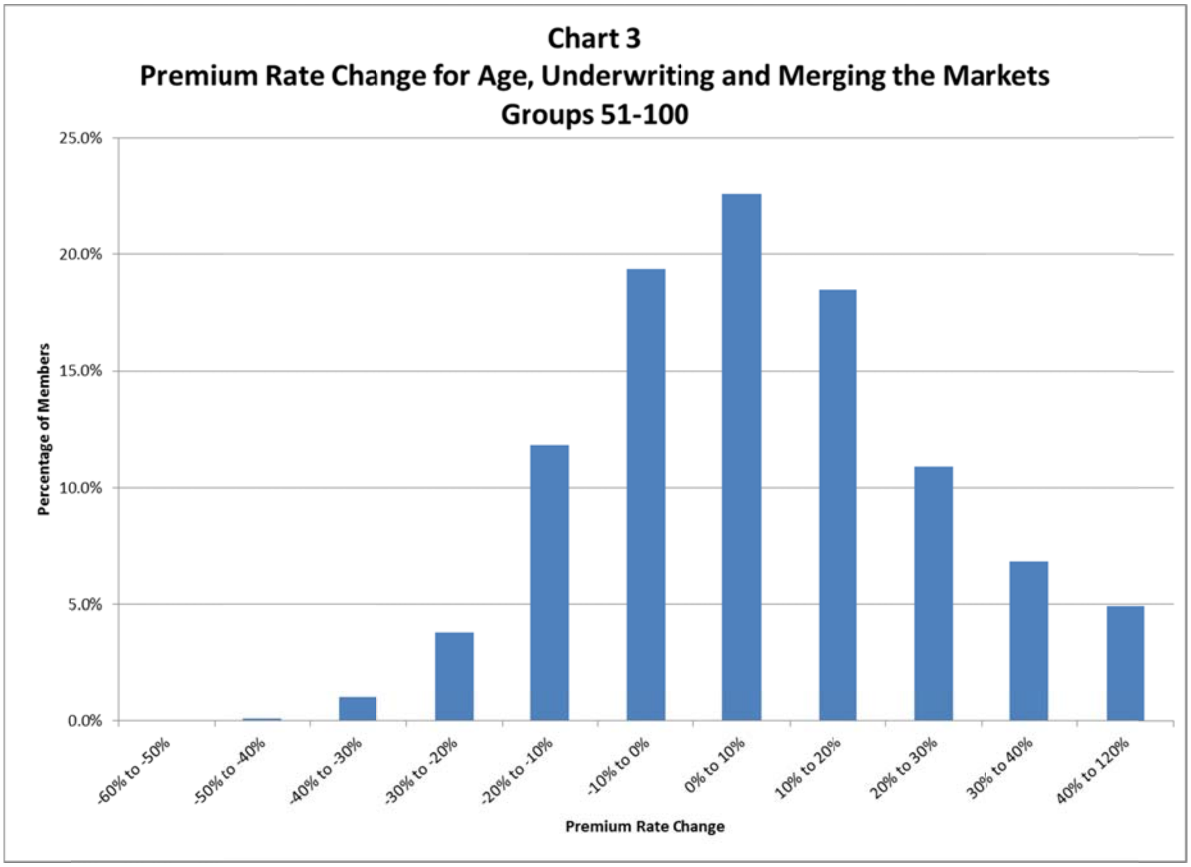
In Chart 2, we show the impact of the elimination of underwriting on mid-sized groups, holding all other rating factors constant. As was the case in Chart 1, in Chart 2 we have assumed there is no change overall to premiums for mid-sized groups.



The impact of eliminating underwriting is more significant than the move to 3:1 age factors. The elimination of underwriting causes 52% of groups to see a premium increase, and that increase will average 13%. This is independent of the change for age.

Combined Impact of 3:1 Age Rating, and Elimination of Underwriting, and Merging the Markets, Absent Adverse Selection

In Chart 3, we show the combined impact on mid-sized groups of the elimination of underwriting, 3:1 age rating, and including mid-sized employers in the expanded market, assuming no adverse selection among small or mid-sized groups and no change due to the requirement to provide EHBs.



Here, 64% of members are in groups that would receive a premium increase with these groups receiving an 18% increase on average.

The Potential for Adverse Selection

Small and mid-sized groups will have options for obtaining coverage in 2016. They may choose fully insured, ACA-compliant products either on or off the exchanges and so become part of the expanded, single risk pool. They may offer employees and their dependents health benefits on a self-insured basis, purchasing reinsurance to mitigate the risk of self-insuring. All other things equal, self-funding may provide a group a cost advantage of roughly 6% to 8% relative to being fully insured by avoiding health insurer taxes and the requirement to provide EHBs. As the small group market is expanded to include mid-sized groups, we expect to see an increase in the number of mid-sized groups choosing to self-insure, particularly among those groups that would otherwise see a large increase in costs from purchasing adjusted, community rated, ACA-compliant coverage.

In states where permitted, and where the issuer allows it, small and mid-sized groups may take advantage of the extended transitional policy and renew non-ACA-compliant coverage on or before October 1, 2016, and so remain outside of the expanded single risk pool for all of 2016 and most of 2017. Even in states that did not allow the transitional policy, mid-sized groups may be given the opportunity to renew their existing policies late in 2015 and so remain outside of the single risk pool for most of 2016.

Finally, small and mid-sized groups may choose to stop offering health benefits all together. We expect this range of available options will result in adverse selection in the expanded single risk pool.

This dynamic, where small and mid-sized groups forum shop for the best price for coverage will lead to adverse selection that health plans will incorporate into their small group pricing for 2016, and the addition of mid-sized groups into the mix may exacerbate this problem.

Premium Rate Change Considering the Effects of Adverse Selection

The impact of adverse selection by mid-sized groups on the expanded market depends primarily on the size of the small group market relative to the mid-sized group market, and the morbidity of the small group market relative to the mid-sized group market. Among the companies whose data we are using for this analysis, the mid-sized group market represented roughly 30% of the total of the small group and mid-sized group market at the end of 2014. However, there are indications that this is changing, that the relative size of the small group market is shrinking as small groups drop coverage to allow employees access to premium subsidies.[1,2]

We illustrate the effect of adverse selection among mid-sized groups on the expanded market by postulating that at some level of rate increase, mid-sized groups will choose one of the following: to self-fund, to take advantage of the transitional policy, if allowed, or to stop offering coverage, and so remain outside of the expanded single risk pool, and that groups with smaller increases, or rate decreases, will choose to purchase ACA-compliant coverage in the expanded single risk pool.

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[1] http://kaiserhealthnews.org/news/small-businesses-drop-coverage-as-health-law-offers-alternatives/

[2] http://www.jsonline.com/business/more-small-businesses-dropping-insurance-helping-workers-buy-health-plans-b99358644z1-277383331.html

In Table 1, below, we show the consequences of this adverse selection on the premiums for mid-sized groups.

Table 1
Impact of Adverse Selection on Mid-Sized Groups Lapsing
Results for 2016

Rate Increase above Which Mid-Sized Group Lapse	Percentage of Mid-Sized Group Members Lapsing	Increase in Mid-Sized Group Premiums as a Result of Lapses
0%	64%	18%
10%	41%	12%
20%	23%	8%
30%	12%	6%

Table 1 shows, for example, that if all mid-sized groups that will receive a rate increase as a result of the ACA rating rules were to lapse (the first line of the table), this would mean that 64% of the mid-sized group insureds would leave the fully insured market, and this would require an 18% increase in premiums for those mid-sized groups remaining in the market. If only those mid-sized groups receiving more than a 10% rate increase as a result of the merging of markets were to lapse, 41% of mid-sized groups members would lapse, and the premium increase for the remaining members would be 12%. Again, this analysis ignores the impact of the requirement that mid-sized groups provide EHBs which we estimate will add 3% to 5% to the average premiums mid-sized employers will pay in 2016. In addition, these increases would be in addition to medical trend.

Table 1 reflects the results for 2016 only. Increases like the 18% rate increase we illustrate in Table 1 would likely result in additional relatively low-cost mid-sized and small groups leaving the single risk pool for self-funding or dropping coverage in 2017 and later, potentially leading to a rate assessment spiral in the single risk pool.

The impact of this adverse selection on the expanded single risk pool will depend, in part, on the extent to which the selection can be spread over the small group market. As we noted, at the end of 2014, small employers comprised roughly 70% of what would be the expanded market if all fully insured small and mid-sized employers were in the expanded market. However, in some states where the transitional policy was implemented, rather than 70% of the potential expanded single risk pool being made up of small employers, we estimate that roughly one-half of the potential expanded single risk pool could be comprised of small group employers in 2016.

In Table 2, we show estimates of the impact of this selection assuming the small groups comprise 50% of the potential expanded single risk pool, roughly representative of states where the transitional policy was implemented and again, assuming small groups comprise 70% of the expanded single risk pool, roughly representative of states where the transitional policy was not implemented. We further vary the impact based on the assumption that mid-sized groups with rate increases over a certain amount choose not to participate in the expanded market.

Table 2
Impact of Selection on Premiums in the Expanded Market

Rate Increase at which Mid-Sized Groups Lapse	Small Employer Share of the Potential Expanded Market	
	50%	70%
0%	5%	3%
10%	4%	2%
20%	2%	1%
30%	1%	1%

Table 2 shows, for example, that assuming mid-sized groups would lapse if they see any rate increase as a result of the imposition of the ACA rating rules, and if small groups comprise 50% of the potential expanded market, then premiums for the expanded market as a whole would increase by 5% if the small and mid-sized markets are combined and the sort of adverse selection we anticipate were to occur. Similarly, if mid-sized groups only lapse if premiums increase by more than 30% as a result of the ACA rating rule, and small employers make up 70% of the potential expanded market, then the rate increase due to adverse selection among mid-sized groups would cause premiums for the market as a whole to increase by 1%. Again, these increases would be in addition to medical trend.

Please let me know if you have any questions about this analysis or any other matter where you think we might be of assistance.

Thank you.