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Washington, DC 20005

April 11, 2018

## **Potential Impact of Short-Term Limited Duration Plans**

Dear Mila:

In this letter, we provide estimates regarding the potential impact to the District of Columbia's (the District's) individual market, specifically for those members covered under Affordable Care Act (ACA) plans, which could occur as a result of the proposed rule related to short-term limited duration (STLD) plans. Please note that the estimates that follow are not based on robust actuarial micro-simulation modeling specific to the District. However, the unique characteristics of the District's ACA market have been taken into consideration, including but not limited to its distribution of membership by age, gender, and overall cost levels. In our opinion the estimates we have developed provide the District with a reasonable starting point for discussions related to the potential impact the proposed STLD rule could have on claim costs in the District's individual ACA market.

### **Results**

In general, the impact that the proposed STLD rule is expected to have on claim costs in the District's individual ACA market could vary significantly depending on both issuer and consumer interest in STLD plans in the coming years. Given that, we have developed estimates for two separate scenarios related to STLD plans: a "Low" scenario which assumes individuals would be more risk averse when evaluating whether to purchase STLD plans and a "High" scenario which assumes individuals would be less risk averse in their STLD decision making process.

Overall, we are estimating that the proposed rule related to STLD plans could be expected to have the following impacts, depending on the assumptions employed:

## Exhibit A - Estimated Impact of STLD Rule on Individual ACA Market

Scenario	Description	Increase in Average Claim Costs <sup>1,2</sup>		Change in Enrollment <sup>3</sup>	
		Low	High	Low	High
1	STLD plans fully implemented, individual mandate penalty remains	1.7%	3.1%	-500	-900
2	STLD plans fully implemented, individual mandate penalty is \$0 <sup>4</sup>	11.7%	21.4%	-3,800	-6,100

### Notes

<sup>1</sup> On a per member per month basis, excluding the portion which can be rated for through the ACA age curve

<sup>2</sup> Estimates reflect the impact of additional changes in morbidity which would be expected to occur assuming initial changes in average claim costs resulting from enrollment in STLD plans and/or the repeal of the individual mandate penalty will be passed to remaining ACA enrollees in the form of rate increases, driving additional coverage losses; at a high level, it is being assumed that the additional coverage losses would lead to further increases in average claim costs (on a per member per month basis, excluding the portion which can be rated for through the ACA age curve) equal to approximately 20% of those which were calculated solely due to enrollment in STLD plans and/or the repeal of the individual mandate penalty

<sup>3</sup> The assumed enrollment volume prior to the changes described is approximately 17,000 covered lives

<sup>4</sup> Reflects the combined impact of the repeal of the individual mandate penalty and STLD plans being fully implemented

We note that these estimates assume full implementation of STLD plans as proposed in the draft rule released by the Internal Revenue Service, Employee Benefits Security Administration, and the Health and Human Services Department<sup>1</sup>. As a result, this study does not attempt to reflect that the impact of STLD plans on the ACA markets could be lower in the initial year(s) following effectuation of the proposed rule. Additionally, we note that we did not look at the impact on employer coverage or the Medicaid program and, therefore, these estimates do not include any increase in costs resulting from loss of coverage in the employer market or to the Medicaid program.

A description of the assumptions and methodology which was utilized to develop these estimates is provided in the following section of this letter.

### Methodology

In conducting our analysis, we began with a dataset provided by the District of Columbia Health Benefit Exchange Authority (DCHBX) which includes the following key information for each member enrolled in the District's individual ACA market as of January 2018: Policy ID, Member ID, Date of Birth, and Gender. Utilizing this membership information, we created a cohort of simulated policies representative of the District's individual ACA market. That is, the simulated

<sup>1</sup> <https://www.federalregister.gov/documents/2018/02/21/2018-03208/short-term-limited-duration-insurance>

policies have a similar distribution of membership by age and gender, have corresponding claim costs which vary as would be expected in the District, and have medical conditions which are representative of those that would be expected based on the underlying demographic mix.

To assess the impact of the proposed rule, we first estimated what each enrollee's projected cost would be if they were to enroll in an STLD plan, including their out-of-pocket costs for both covered and non-covered services, the annual premium rate for the STLD plan and, in the scenario where the individual mandate penalty is assumed to remain in place, the penalty owed as a result of not purchasing ACA-compliant coverage. Several assumptions were incorporated into the development of these cost estimates and we have outlined the key assumptions we have made related to STLD plans below:

- *Underwriting* - Coverage can be denied to individuals who do not meet a carrier's underwriting requirements
- *Pre-Existing Conditions* - Services associated with treating a pre-existing condition will not be covered
- *Pricing Assumptions*
  - i. STLD carriers will utilize all rating factors which existed prior to the ACA (e.g. full age curve)
  - ii. STLD carriers will target an overall loss ratio equal to 50%
  - iii. STLD rates will be adjusted to account for the morbidity of the individuals projected to enroll in the plans
  - iv. Allowed cost levels for services commonly covered by STLD plans and ACA plans will be the same (i.e., similar provider discounts will be available to insurers offering STLD plans as are available to insurers offering ACA plans)
- *Policy Limits* – A lifetime policy limit of \$1,000,000 will be in force
- *Renewability* – STLD plans will be available for up to 364 days and will be “optionally renewable” (i.e. renewable at the option of the insurer)
- *Essential Health Benefits* – Coverage for the ten essential health benefits, excluding services associated with pre-existing conditions, will be as follows:
  - i. Ambulatory Patient Services (i.e. outpatient services) – Covered
  - ii. Prescription Drugs – NOT Covered
  - iii. Emergency Services – Covered
  - iv. Mental Health Services – NOT Covered
  - v. Hospitalization (i.e. inpatient services) - Covered
  - vi. Rehabilitative and Habilitative Services – NOT Covered
  - vii. Preventive and Wellness Services – NOT Covered
  - viii. Lab – Covered
  - ix. Pediatric Care (i.e. pediatric dental and vision services)– NOT Covered
  - x. Maternity Care – NOT Covered
- *STLD Plan Design*<sup>2</sup> - For the purpose of this analysis, the STLD plan is assumed to have a \$1,000 deductible (per person), 70% coinsurance rate (insurer responsibility), and a \$5,000 out-of-pocket maximum (per person, in addition to the deductible)

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<sup>2</sup> These assumptions related to plan design were chosen based on a review of short-term limited duration products which are currently available in the individual market

- *Cost Levels of Not Covered Services* - For services not covered by STLD plans (e.g. maternity), it is assumed that the “allowed charges” for those services will be approximately 45% higher under the STLD plans than under ACA plans, due to a lack of provider discounts being available for those services.

Next, we estimated each enrollee’s projected cost assuming they were to enroll in a silver level ACA plan. Similar to the approach used when assessing each enrollee’s projected costs if they were to enroll in a STLD plan, we developed estimates for what each enrollee’s expected out-of-pocket costs for covered services would be as well as what each enrollee’s annual premium rate would be expected to be if enrolled in an ACA plan.

After developing projected costs at the enrollee level for both STLD and ACA coverage, in order to determine which ACA policyholders would potentially shift to an STLD plan, the assumptions outlined below were applied:

- If an individual had an occurrence of a Hierarchical Condition Category (HCC) over the past five years, that individual would be declined for STLD coverage
- If an individual is in the top quartile of ACA enrollees with respect to total claim costs in the prior year, that enrollee would choose not to enroll in STLD coverage due to the expectation that they would be more risk averse
- If an individual incurred a high volume of annual claim costs at some point over the past five years such that it would have been in the enrollee’s best interest to remain in the ACA market in that year:
  - *More Risk Averse Scenario*: 100% of those individual will not purchase STLD coverage
  - *Less Risk Averse Scenario*: 100% of the individuals where this result occurred in the most recent year will not purchase STLD coverage, 80% of the individuals where this result occurred two years ago will not purchase STLD coverage, 60% of the individuals where this occurred three years ago will not purchase STLD coverage, 40% of the individuals where this result occurred four years ago will not purchase STLD coverage, and 20% of the individuals where this result occurred five years ago will not purchase STLD coverage
- For all other policyholders (i.e. after removing the enrollees identified in the three bullet points above), we compare their projected annual costs under both the STLD plan and the ACA plan. If the net cost to purchase the ACA plan is cheaper, it is assumed that the individual will remain in the ACA market. If the net cost to purchase the STLD plan is cheaper, it is assumed the individual will leave the ACA market to purchase an STLD plan
- Decisions to keep or change coverage are made at the policy/household level

After applying the criteria outlined above and ensuring that the projected STLD rates adequately reflect the morbidity of the membership expected to enroll in those plans, the average projected allowed claim costs of the enrollees expected to remain in the ACA market after the STLD plans are fully implemented was compared to the overall average allowed claim costs of the ACA market prior to the implementation of STLD plans. This comparison provides the expected change in average allowed claim costs in the individual ACA market (on a per member per month basis), and was then adjusted to exclude the portion of the change which can be rated for through the existing ACA age curve.

Finally, the calculated difference in average allowed claim costs was increased by a factor of 20% (e.g. if the initial estimated change in average claim costs was 1.0%, the estimate was increased to 1.2%) to reflect the additional impact which would be expected to occur in the individual ACA market assuming the changes in average claim costs due to shifts in enrollment to STLD plans will be passed to remaining ACA enrollees in the form of a rate increase, driving additional coverage losses.

### **Combined Effect of STLD Plans, the Repeal of the Individual Mandate, and AHPs**

In a prior letter dated February 6, 2018, we provided an estimate that the repeal of the individual mandate penalty is expected to result in an increase in average claim costs in the individual ACA market equal to approximately +7.2% (on a per member per month basis, excluding the portion which can be rated for through the ACA age curve). In an additional letter dated February 21, 2018, we provided an estimate that the combined effect of the proposed AHP rule being fully implemented and the repeal of the individual mandate penalty would be expected to have an impact on average claim costs in the individual ACA market equal to approximately +7.9% to +16.4%

To the extent STLD plans are fully implemented at the same time as the repeal of the individual mandate and the full implementation of AHPs, we would not expect the net impact to average claim costs in the individual ACA market to simply be the sum of the estimates referenced above and the STLD estimates provided earlier in the letter in Exhibit A. We would expect that a number of the policyholders who would exit the ACA market as a result of the full implementation of the STLD rule would also be those policyholders who would exit due to the repeal of the individual mandate penalty and/or the implementation of the AHP rule.

Overall, to the extent all three items are fully implemented at the same time, we would expect the combined impact on average claim costs in the individual ACA market to be equal to approximately +13.3% to +19.9% in the scenario where consumers are assumed to be more risk averse in determining whether to purchase STLD plans (i.e., the “Low” scenario) and +22.8% to +31.3% in the scenario where consumers are assumed to be less risk averse in determining whether to purchase STLD plans (i.e., the “High” scenario). The range provided within each of the “Low” and “High” scenarios is dependent upon the assumptions that are employed for AHPs. The low end of the ranges provided assumes the following related to AHPs: Only SHOP enrollees (excluding congressional employees) and sole proprietors in the Professional, Scientific, and Technical Services industries are eligible to purchase AHPs; Differences in pricing factors exist between the AHP and ACA plans; AHPs use pre-ACA rating factors; and there are no differences in covered benefits between the ACA and AHP plans. The high end of the ranges provided assumes the following related to AHPs: AHPs do not cover maternity benefits (for employer groups with fewer than 15 employees); sole proprietors in the individual market only consider AHPs if there are no females between ages 21-40 included on their policy; employers in the small group market consider AHPs only if they have less than 15 employees and 20% or less of their membership is made up of females between ages 21-40; differences in pricing factors exist between the AHP and ACA plans; AHPs use pre-ACA rating factors; and AHP rates reflect the exclusion of maternity benefits (for employer groups with fewer than 15 employees).

### **Limitations and Considerations**

Key limitations and considerations associated with our analysis include the following:

- Estimates rely on membership information provided by DCHBX. If the information used is inaccurate or has been misinterpreted, the underlying findings and conclusions may need to be revised
- Estimates are not based on robust microsimulation modeling and therefore may not fully recognize all interactions specific to the District's ACA markets that might exist.
- Values are based on estimates of future events; therefore, actual results will vary
- Actual results are expected to vary on a carrier specific basis
- Unless specified, estimates are based on the isolated impact of the proposed rule related to STLD plans and do not consider the impact of other changes to the proposed rule or in legislation or regulation at either the District or Federal level

### **Distribution and Use**

This report was sponsored by DCHBX with the purpose of providing a reasonable starting point for discussions related to the range of the potential impact the proposed STLD rule could have on claim costs in the District's individual ACA market. Oliver Wyman's consent to any distribution of this report (whether herein or in the written agreement pursuant to which this report has been issued) to other parties does not constitute advice by Oliver Wyman to any such third parties and shall be solely for informational purposes and not for purposes of reliance by any such third parties. Oliver Wyman assumes no liability related to third party use of this report or any actions taken or decisions made as a consequence of the results, advice or recommendations set forth herein. This report should not replace the due diligence on behalf of any such third party.

Please let me know if you have any questions related to this letter.

Thank you.

Sincerely,



Ryan Schultz, FSA, MAAA

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