THE STATEWIDE RISK ADJUSTER & HB294 MYTH VERSUS FACT

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"Government is instituted for the common good; for the protection, safety, prosperity, and happiness of the people; and not for profit, honor, or private interest of any one man, family, or class of men; therefore, the people alone have an incontestable, unalienable, and indefeasible right to institute government; and to reform, alter, or totally change the same, when their protection, safety, prosperity, and happiness require it."

John Adams: *Thoughts on Government*, 1776

Background

There has been a lot of confusion and misunderstanding around a part of HB294, Speaker David Clark's health system reform legislation, the statewide risk adjuster. UHPP supports the Speaker in his efforts, especially in regards to this part of the bill, as we view it as vital to the success of the Utah Health Exchange—the new online marketplace for purchasing defined contribution policies AND to Utah's attempts to reform healthcare without mandates.

Currently, a risk adjuster is a part of the Exchange. It was created last year to maintain the financial solvency of the Exchange. Part of maintaining that solvency is making sure that no single insurance carrier has a risk load significantly greater than another. There have been a lot of questions why this redistribution of risk is necessary. If insurance companies are private businesses with a motive to make profits, why should the state penalize successful companies and help the weak ones? The answer is that the creation of the Exchange fundamentally altered the business model for insurance companies. With this alteration came a lot of uncertainty for insurers. To give these companies time to adjust their business practices to the new reality, policymakers felt it was important to have safeguards for insurers. Otherwise, there was a real risk those companies would pull out of the Exchange and maybe out of providing insurance in the small group market altogether. Thus the risk adjuster is in place to stabilize the private market so that it can serve as the main platform for state health reforms.

What is a *Risk Adjuster*?

The *risk adjuster* works by determining which insurance carriers are experiencing significant risk and the best way to mitigate that risk. Carriers fund a risk adjustment pool. Those funds are then redistributed to carriers that have attracted risk in excess of what was anticipated. The redistribution of funds must be approved by the Risk Adjuster Board, which is comprised of insurance executives and others representing the state, businesses, and consumers.

To date, the risk adjuster board has not yet redistributed any funds. The discussion among board members has centered on the operational aspects of the Exchange including how to maintain the solvency of this new market.

So what did the Exchange do to make such a big change to the insurance business model in Utah? It simply gave consumers a greater choice in the carrier and plan they selected. Prior to the Exchange, insurance companies could make the decisions about the types of businesses they targeted through marketing and product development. If an insurance company didn't want to take on a high level of risk, they could, for example, choose not to market to construction companies or other occupations that carried a high probability of accidents. If an insurance company wanted to take on a large number of young, healthy Utahns, they could focus their products and marketing strategy around high-tech start-ups or tourism-related businesses. Conversely, another insurance company could decide to take on the risk of the construction industry and design products and premiums that would cover that extra risk.

Another certainty with the pre-Exchange marketplace was that if an insurance carrier signed up a small business, it could be pretty certain that most, if not all, of the employees would be included in the policy. Premiums could be designed around that group. However, the Exchange allows small businesses and their employees to shop for their own coverage. Employees can pick a plan that best fits their needs with the carrier of their choice—no more one-size-fits-all. While this provides a great opportunity for consumers, it introduces a lot of uncertainty to insurers. An insurer may acquire customers that it has had no previous experience with and may not particularly want. Additionally, these customers no longer come in as a group of employees. Instead, the customers come like they would in the non-group market, as individuals, with nothing to offset the risk they carry. The risk-adjuster is designed to re-distribute that risk and to give insurers the opportunity to work collaboratively to address the unknowns in this new market. This at any rate was the expectation going into the limited launch of the Exchange. It was quickly discovered that even with these safeguards, insurers still felt the customers it gained through the Exchange were so much more risky that their premiums had to be significantly higher than customers outside the Exchange.

At this point, we could just chalk this finding up to market dynamics, except for one critical piece: Most of the customers in the Exchange chose policies that mirrored the insurance plan they had previously; AND most, if not all, were with the same insurance carrier they had pre-Exchange. This left Speaker Clark and other policymakers wondering how these customers became that much more risky from the simple act of moving from one market to the other. No reasonable explanation was given by the insurers when posed with this question. Thus policymakers were left to conclude that having dual markets—the Exchange and the rest of the small group market—was not feasible.

Statewide Risk Adjuster and the Precedent for Legislative Action

What the statewide risk adjuster will do is eliminate the uncertainty for insurers around this new marketplace. It is simply an insurance policy for insurance companies. When policymakers discovered that segmenting the market would not work, it was felt the best way to eliminate that segmentation without mandating businesses participate in the Exchange was to roll the market back together through the risk adjuster mechanism. What policymakers are saying to insurance companies is "we want you to take a risk and help develop this new concept in the insurance market—the Exchange. If you are willing to do so, we will provide a safety net so you are not unduly harmed by taking the risk."While some may see this as government meddling in private markets—there is precedence for government acting as an incubator for innovation when the private sector can't or won't. These examples range from the agriculture extension services, in which the government nudged farmers to try new farming methods to the relaxing of regulations around retirement and pension programs that

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gave rise to the creation of IRAs, 401(k) plans and other products that are now part and parcel of our retirement lexicon. Here in Utah, government has acted as an innovation incubator in many different areas. For example, USTAR (the Utah Science, Technology and Research initiative) is a program in which state funds and resources are used to turn academic research into marketable products. The state's decision to foster charter schools as an alternative to traditional public education is another example. There are other myths and misconceptions about the statewide risk adjuster. Some were outlined in an article authored by Alexis Thread and circulated to Utah legislators. Below we address a few of the most fallacious arguments.

Myth vs. Fact on the Statewide Risk Adjuster

Myth: The State Risk Adjuster and other provisions in HB294 are a zero-sum game between freedom and government particularly in the form of mandates. If government wins, everyone else loses.

FACT: There are no mandates in HB294. Utahns will not be mandated to purchase health insurance, nor will businesses be mandated to provide it. Insurance companies, for their part, will not be mandated to provide universal coverage. The State Risk Adjuster (SRA) in the simplest terms is insurance for insurers. If government wins in this case, everyone else wins. Insurers will have a safeguard against catastrophic losses as they develop this new market. Only by innovation can the private market be strengthened, and only by having government support can the insurers innovate successfully.

Myth: The SRA is the first step towards pooling of private property or the government getting involved in trying to provide equal distribution of "things."

FACT: Again, there is no pooling of risk in Utah's approach to reform—if risk can even be considered private property in the first place. Businesses in the small group market and those participating in the Exchange will be rated and premiums charged based on the health status of their own employees. Companies with young, healthy employees will still see lower rates than companies with older, sicker workers. Insofar as they are tied to health status, lifestyle choices will still impact premiums.

Myth: "Ownership" of the SRA by the Department of Insurance will give state government an unacceptable amount of control over the insurance market in Utah.

FACT: First, the Department of Insurance will not "own" the SRA. It will be a non-profit entity with its own Board of Directors. Of those directors, 3 to 5 will be representatives of the insurance carriers. This is the largest voting block on the board. The Department of Insurance will have one representative who only has voting rights in the event of a tie. Finally, the charge given to the SRA in relation to insurance risk is simply to "mitigate *significant* issues of risk selection or *improve* how the Utah Statewide Risk Adjuster adjusts risk" (HB294 lines 1867 and 1868, emphasis added). There is no mandated gauge that determines for the Board what constitutes significant issues of risk selection; and, given the makeup of the Board, it will be difficult to build consensus around what that threshold is or should be. This was deliberate in Speaker Clark's design. The democratic principal of a check-and-balance system and a deliberative process will be extended into the oversight of the SRA.

Myth: The risk adjuster should only exist within the Exchange for the single purpose of lessening the adverse selection concerns of participating carriers.

FACT: This was what Speaker Clark originally designed in HB188. However, the limited launch taught us that 77.5% of the businesses that went through the process would see their premiums increase—45.2% actually said the increase was "much higher." For a number of these employers, the policies their employees selected were similar to those they had outside the Exchange (through the same insurer). Given that Utah's insurance market, both inside and outside the Exchange, is dominated by the same five large carriers, risk cannot be mitigated in one market but not the other and have any hope of success. Dual markets lead to inefficiencies, cost differentials and rent-seeking on the part of insurance companies, as the limited launch discovered.[i] The SRA is an approach to doing so that does not mandate small businesses participate in a single market.

Myth: The SRA will do very little to reduce the cost of health care services.

FACT: Since the SRA will only be dealing with insurance rates and premiums, lowering the cost of actual health care services is beyond its purview. HB294 does begin to address costs by requiring health care providers to give consumers price sheets on services, but only if the consumer asks. Beyond this, efforts to rein in health care costs are going to require the cooperation of the federal government. Medicare and Medicaid now pay 1 out of every 2 medical claims. Without cost containment within those federal programs, Utah will have very little leverage to bring costs down.

Conclusion

The statewide risk adjuster is a small step towards fostering innovation in Utah's insurance industry. The goals of this innovation are to make health insurance affordable and to bring the previously uninsured into the private market. There is precedent for government to step in and foster the right incentives *so that the private market can be the foundation for a reformed health care system*. The outcomes of this experiment in health reform are still uncertain. However, Utahns have spoken up and let policymakers know the status quo is untenable. Utah policymakers are responding in the way they see fit for the state and its residents, rather than waiting for whatever federal reform may bring. The solutions encapsulated in HB294, including the statewide risk adjuster are those that can address Utahns concerns within the current political framework. The provisions of HB294, starting with the Statewide Risk Adjuster, deserve a chance to be fully implemented.

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[i] For a discussion of these concepts and what public policy does to mitigate these issues, see Weimer, D & Aidan Vining; Policy Analysis: Concepts and Practice (4th Edition); Prentice Hall, 2004.