



THE AFFORDABLE CARE ACT IN 2014 Significant Insurer Losses despite Substantial Subsidies

The Affordable Care Act (ACA) significantly altered the individual insurance market through a host of new rules and requirements. Among its central changes, the ACA required insurers to offer coverage to any applicant but restricted insurers from charging premiums that properly reflect health status and age. This made health insurance relatively more attractive to older and less healthy people and relatively less attractive to younger and healthier people. For insurers offering Qualified Health Plans (QHPs)—plans certified to be sold on the new ACA exchanges—in the individual market, a key question was whether enough young and healthy people would enroll to create a stable risk pool. Achieving this balance is also the key determinant as to whether the law’s changes are sustainable, or whether they will lead to the deterioration of the individual market for insurance.

This study is the first in a series from the Mercatus Center at George Mason University that is intended to provide a comprehensive analysis of the impact of the ACA on the individual and small group insurance markets in 2014. This study presents an overview of insurers’ performance selling QHPs in the individual market and discusses how insurer performance varied across carriers and states. In sum, it finds that insurers incurred sizeable losses on a per-enrollee basis—despite much higher government support through the law’s reinsurance program than they expected when they set premiums. It also finds that insurers would have needed to increase premiums by at least 26 percent, on average, to have avoided losses in 2014 without the reinsurance program.

The subsequent studies in this series will focus on contrasting insurers’ performance selling individual QHPs and small group QHPs, analyzing the key factors that explain the variation in insurers’ performance, and assessing the overall function of the ACA’s three premium stabilization programs. Together, these analyses of the first-year performance of QHPs provide a comprehensive review of the law’s past performance and critical information in considering the law’s future, especially since reports indicate that insurers’ performance in 2015 was generally similar to their performance in 2014.

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KEY POINTS

- *Insurers suffered significant losses selling individual market QHPs in 2014.* These losses were well in excess of \$2.2 billion despite these insurers receiving net reinsurance payments of \$6.7 billion or \$833 per enrollee. These payments were at least 40 percent more per enrollee than insurers had expected through the reinsurance program when setting premiums.
- *Premiums in 2014 would have needed to be more than 25 percent higher to cover insurers’ cost of offering individual market QHPs in the absence of the reinsurance program (which is set to expire this year) and assuming the same enrollment.* The premium increase would need to be much higher than that, however, to account for selection effects as relatively healthier people would be more deterred from the higher premiums than relatively less healthy people.
- *There was wide variation in insurer performance selling QHPs in 2014.* Insurers with narrow provider networks appear to have done relatively well, while the health insurance cooperatives (co-ops), established with government funding, incurred the greatest losses.

BACKGROUND ON REINSURANCE PROGRAM

To assist insurers in adjusting to the ACA’s new requirements and to mitigate their risk, the law contained three premium stabilization programs—risk adjustment, reinsurance, and risk corridors. The reinsurance program, a three-year program to compensate insurers for large claims incurred by “high risk individuals in the individual market,” is an explicit subsidy of individual market plans. When insurers set premiums for 2014, they expected that they would receive payment for 80 percent of per-enrollee claims between \$60,000 and \$250,000 through the reinsurance program. The Congressional Budget Office estimates that the reinsurance program lowered premiums by 10 percent in 2014.

LARGE INSURER LOSSES DESPITE LARGER THAN EXPECTED REINSURANCE PAYMENTS

Insurers suffered substantial losses in 2014 despite receiving much larger reinsurance payments per enrollee than they expected when setting premiums. Largely as a result of having fewer enrollees than expected, the reinsurance program was eventually made about 40 percent more generous than originally announced, paying 100 percent of the cost of per-enrollee claims between \$45,000 and \$250,000. The net reinsurance payments totaled \$6.72 billion, or \$833 per QHP enrollee in the individual market in 2014.

In aggregate, the 289 individual market QHPs collected \$35.76 billion in premium income and paid claims of nearly \$37.30 billion in 2014. This does not account for administrative costs—additional expenses that typically amount to about 15 percent of premiums. The risk corridor program, which was intended to transfer money from generally profitable insurers selling QHPs to generally unprofitable ones, ran a deficit of nearly \$2.2 billion for individual market QHPs in 2014. However, the risk corridor program was designed to reimburse only a portion of insurer losses, which means overall losses were substantially greater than \$2.2 billion.

PROJECTING PREMIUMS WITHOUT THE REINSURANCE PROGRAM

Insurers incurred large losses in 2014 despite receiving \$6.72 billion in net reinsurance payments for their individual market QHPs. The average loss ratio (medical claims paid divided by premium income) for the 289 QHPs equaled 1.110 when weighting QHPs by claims. This loss ratio suggests that premiums for individual market QHPs will have to rise significantly when the reinsurance program ends. Assuming that insurers generally need at least 15 percent of premiums to cover administrative expenses, premiums in 2014 were roughly 26 percent too low, on average, to cover insurers' full costs of offering individual market QHPs.

If average premiums had been 26 percent higher, however, that would have lowered total enrollment and increased selection effects. Relatively healthy people and higher income enrollees, who qualify for little or no subsidies that make the insurance more attractive, would have been deterred to a greater degree than people who expected to use more healthcare services. As a result of this dynamic effect, the average premium increase would likely have needed to be substantially greater than 26 percent for insurers to break even on their QHPs in 2014.

INSURER PERFORMANCE VARIED SIGNIFICANTLY

Although the evidence is not conclusive, differences in insurer performance in 2014 indicate that carriers with narrower networks were more successful in controlling claim costs. Kaiser was the insurer with a sizeable market share that performed the best in 2014. Blue Shield of California, which made the highest amount of payments into the risk corridor program, offered narrow network exchange plans in 2014. Moreover, QHPs offered by carriers whose principal pre-ACA business in the state was Medicaid managed care also performed relatively well in 2014.

The insurance co-ops set up through the ACA were the worst performing group of insurers. The co-ops' average per-enrollee medical claims equaled \$6,120—more than 22 percent above the average for all insurers. The third paper in the series will offer a more detailed analysis of insurer performance in 2014, including an examination of the effects of state decisions to expand Medicaid and adopt the transition policy allowing non-ACA-compliant coverage to continue.

CONCLUSION

The 2014 data used in this study is the most recent available since the deadline for carriers to file 2015 plan year data is June 30, 2016. The findings are important and relevant because insurers' performance in 2015, at least in the aggregate, has reportedly been comparable to 2014. Once the 2015 data is available and analyzed, we are likely to be left with a similar conclusion—QHPs have not yet attracted a broad enough risk pool for the individual market to stabilize despite the premium stabilization programs enabling carriers to set premiums significantly lower than they would absent those programs.

It appears that QHPs with narrow provider networks performed better than QHPs with broader networks in 2014. That may suggest that healthier people disproportionately gravitated to plans with broader networks. This result may also have occurred because of more aggressive utilization management by insurers with more restrictive networks. As the end of the reinsurance and risk corridor programs approaches, and insurers face the reality that premiums for the first time must cover expenses, a key question emerges. Can insurers that continue offering QHPs reverse their losses through some combination of higher premiums and plan redesign, or are the ACA's provisions unsustainable and in need of change?