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State of Maryland

Analysis of Merging Markets for the State of Maryland

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Introduction

The State of Maryland's Department of Legislative Services ("Maryland") retained Wakely Consulting Group, LLC ("Wakely"), through Bolton Partners, to analyze the potential effects of merging the individual and small group Affordable Care Act (ACA) markets. In recent years, Maryland's individual (also referred to as non-group) ACA market has experienced double-digit premium increases and a reduction in the number of issuers offering coverage. To address instability in the individual market, Maryland implemented a reinsurance based 1332 waiver. This has had a significantly positive impact on the market for the 2019 benefit year. However, Maryland is interested in exploring other ways of improving stability in the individual market. One of those ideas is the merging of the individual and small group markets.

The following discusses various forms of merging the two markets, related policy trade-offs, and implications for how the policies may interact with the 1332 reinsurance program.[1] This document has been prepared for the sole use of Maryland. This document satisfies the Actuarial Standard of Practice (ASOP) 41 reporting requirements. Using the information in this report for other purposes may not be appropriate.

Merging Markets: History and Regulations

Maryland is interested in exploring ideas that could stabilize the individual market. One idea often discussed as a method for improving individual market stability is combining the individual and small group markets. There are two potential reasons why merging markets is beneficial to the individual market. The first is that with a larger risk pool, a market (and premiums) would have greater stability. The second is that the small group is considered healthier (as measured by having a lower risk score).[2] By combining the healthier small group market with the less health individual market, premiums in the individual market would be lower.

Section 1312 (c)(3) of the Affordable Care Act (ACA) gives states the option of merging the individual and small group markets into a single risk pool. The regulation promulgated by the Department of Health and Human Services (HHS) to implement this requirement (45 CFR 156.80) provides specific requirements for a market to be merged. In particular, for a market to be merged under the Federal definition:

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[1] This paper will not include specific estimates on the effects of merging markets. This may be completed in a second phase of the project.

[2] CMS's Summary Report on Permanent Risk Adjustment Transfers for the 2017 benefit year. https://downloads.cms.gov/cciio/Summary-Report-Risk-Adjustment-2017.pdf

"...Issuers in a merged individual and small group market must offer the same plans at the same rates to all applicants in the merged market, must offer coverage on a calendar year basis, and may not make quarterly rate adjustments to rates for small group market plans."[3]

This is not the only method to merge the two markets. In the 2018 Payment Notice[4] HHS allowed states that combine individual and small group experience in developing the index rate (shared experience in setting rates) to also risk adjust across markets, even if they aren't merged according to the Federal definition. In essence, HHS allows for state flexibility in how they define merged markets. This change in policy was implemented due to a wide variety of potential ways to merge markets beyond the Federal definition and HHS wanted to accommodate those differences.

In fact, of the three states/districts that have "merged markets" each has slightly different types of merged markets.

- **Vermont**: Vermont has a fully merged market in which issuers must operate in both markets, premiums are the same for the two markets, and benefit years are aligned (calendar year).
- **Massachusetts**: While Massachusetts risk adjusts across both of its markets (i.e., small group issuers on average transfer funds to individual market issuers), Massachusetts allows small groups to enroll and renew on a rolling basis, have certain rating factors specific to the small group (that is, the premiums may not be the same in the two markets), and issuers can offer new products and update rates on a quarterly basis for small group only.
- **District of Columbia**: The District of Columbia requires issuers that operate in both the individual and small group markets to use the combined experience (i.e., index rate) in setting premiums for their plans. In other words, the markets are merged for the issuers that operate in both markets, but not for issuers that only operate in a market. Premiums can differ between the two markets for all issuers. Furthermore, all small group issuers can update small group premiums quarterly. This would not be allowed if DC followed the Federal definition of merged market.

The variation exhibited currently by these states highlights the options policymakers have in implementing a merged market. States can implement policies along a spectrum of merging.

[3] 2018 Notice of Benefit and Payment Parameters pg. 94070

[4] https://www.gpo.gov/fdsys/pkg/FR-2016-12-22/pdf/2016-30433.pdf

There are four distinct policy configurations that could be considered in merging the individual and small group markets. Each of the following options includes the previous policy choices (in other words, each option builds/incorporates the previous policy choice as each option shifts farther to an option that meets the Federal definition).

1) Merging the experience of issuers that participate in both markets
2) Incorporating #1 but also risk adjusting across both markets
3) Incorporating #2 but require issuers participating in both markets to offer the same plans to both markets (e.g., product standardization/guaranteed issue apply to both markets for the same product)
4) Full merger/Federal definition (benefit periods coincide, end of small group quarterly updates, broker agreements the same, etc.)

Table 1: Summary of Merged Market Policy Options by State/District

Policy	District of Columbia	Massachusetts	Vermont
Merged Experience for Issuers that Operate in Both Markets	✓	✓	✓
Risk Adjustment Occurs Across Both Market		✓	✓
Guaranteed Issue for All Products		✓	✓
Quarterly Updates for Small Group Disallowed and Benefit Year Aligned			✓

For each of the options, further legal analysis is likely necessary. Federal regulations on merged markets, risk adjustment, and other areas would need to be explored with CMS for approval. Furthermore, Wakely has not investigated the extent to which Maryland state law may need to be changed to accommodate any of the policy options.

Policy Options

Before examining the policy options for Maryland, it is helpful to provide context on the two markets. According to Maryland's Department of Insurance, the individual market had approximately 212,000 members as of February 2018 while the small group market had enrollment of approximately 265,000 enrollees as of February 2018.[5] In 2017, the average plan liability risk score in the non-group non-catastrophic market was 1.58 while the average plan liability risk score in the small group market was 1.25.[6] While further analysis is needed, the individual market risk score, which measures health risk, is more than 25% higher than the small group market. This implies that the individual market is significantly less healthy than the small group market.[7]

Merge Experience in Developing Index Rates

The first option, which represents the least amount of integration, would be to mimic the current DC requirements. Under this approach, issuers that participate in both the individual and small group markets merge their historical experience when setting rates. Specifically, allowed claims and enrollment for the individual and small group markets for issuers that offer products in both markets are combined in setting the issuer's index rate, or the rate that is the basis for premium rates for all of the issuers' ACA plans. However, the rates for individual and small group vary, even for the same plan design, because the risk adjustment remains distinct. Also, issuers in both markets are not required to offer the same plans in both markets.

The advantage of this proposal is that it has the least market disruption since it only effects the issuers that participate in both markets and would not require any Federal approval. Additionally, while further analysis is needed to confirm, this requirement may decrease premiums for those affected issuer's individual market premiums (since the individual market has higher morbidity than the small group). On the negative side, such a requirement would likely increase small group premiums for those issuers in both markets. This will likely reduce their competitiveness with issuers that only operate in the small group market.

Risk Adjustment Across Markets

Under a second option, all issuers in the individual and small group markets are in the same risk pool for risk adjustment purposes (individual catastrophic plans excepted). ACA risk adjustment transfers a portion of plan premiums from issuers with relatively healthy members to issuers with less healthy members. The greater the extent to which the individual market has relatively less

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[5] https://insurance.maryland.gov/Documents/newscenter/newsreleases/2019-ACA_PressRelease_Exhibits_OCA_05.04.18.pdf

[6] CMS's Summary Report on Permanent Risk Adjustment Transfers for the 2017 benefit year. https://downloads.cms.gov/cciio/Summary-Report-Risk-Adjustment-2017.pdf

[7] Maryland's non-group non-catastrophic risk scores are still higher than the small group market controlling for factors like age or actuarial value. Summary Report on Permanent Risk Adjustment Transfers for the 2017 Benefit Year.

healthy members compared to small group members, the greater the amount of transfers from the small group market to the individual market. HHS allows states to request all of their ACA individual and small group plans to be included in a single risk pool for risk adjustment purposes, provided the state requires issuers to use combined individual and small group experience to establish the combined market index rate.

The advantage of such a proposal is that all issuers, whether they participate in the individual market or not, would effectively be part of a single risk pool. All issuers, regardless of market, would be risk adjusted together. While modeling is needed to estimate the impact, this would likely mean that the individual market would have lower premiums, while the small group market would have higher premiums, relative to if the risk adjustment was not combined for the two markets. Furthermore, this option does provide some pricing flexibility for issuers. Plan level adjustments to the index rate would still be allowed. This includes differences at a plan level for provider network, delivery system characteristics, utilization management, additional benefits, and administrative expenses, excluding exchange user fees. For example, if all of the plan factors are favorable to small group, it is possible that the small group rates could still be lower than individual.

The disadvantage of such a proposal is that some small group issuers could see a significant increase in their risk adjustment payable and therefore lead to significant premium impacts for small group. In particular, issuers that are healthier on average relative to other small group issuers, could see very large risk adjustment charges. This could result in some small group only issuers deciding to exit the market if they feel they can no longer be competitive. Furthermore, large increases in morbidity in the individual market (for example, because of the repeal of the individual market) could result in premium increases in the small group market. Given that Maryland's individual and small group market size are not that dissimilar, the effect could be significant for the small group market. Specific analysis would be needed to understand the actual potential impact.

Product Alignment

In this model, issuers must offer the same products and plans to both individuals and small group employers. This means that the same plan (as defined by benefits/cost-sharing) will be available and priced the same for any consumer eligible to purchase the plan in the individual or small group market. Issuers could not specifically target plans to employers as any plan offered would be subject to guaranteed issue for all individuals. This effectively means that any issuer that operates in either the individual or small group market would need to participate in BOTH markets.

One potential benefit of this option is that the small group market could further subsidize the individual market. For example, plan level adjustments like administrative costs, that may result in cheaper small group plans, would be equalized across the entire market. This could also potentially expand the number of issuers offering coverage in the individual market.

Conversely, this could decrease the number of small group issuers/total issuers in both markets. Issuers that, to date, have avoided offering coverage in the individual market may be unwilling to offer plans to individual market consumers and instead choose to exit both markets. Additionally, issuers may be less able to tailor plans to different market segments. It is possible that plans that may be more appealing to only one segment may not be offered. Consequently, fewer niche or innovative products may be offered.

Full Merger (Federal Definition)

A final policy option would be for a full merger, such that the merged markets meet the Federal definition. This policy is similar to the product alignment option but the policy goes further to align the two markets. All aspects of marketing, enrollment, and premiums would be the same for individuals purchasing plans and employers purchasing plans.

Currently small group premium rates can be updated on a quarterly basis. This practice would be disallowed in this scenario. Furthermore, today the benefit year is staggered for the small group market (i.e., it does not have to coincide with the start of the calendar year). In a fully merged market the small group benefit year would need to align with the individual market. Typically, a significant portion of the small group market has a benefit year that is not the calendar year. In a full merger, all small group plans would need renew at the same time (on the calendar year). Renewing all small groups at the same time could cause resource constraints for issuers. The process and investment to transition all small groups to a calendar year benefit plan would also need to be considered. The above are potential outcomes and further discussions are needed with stakeholders.

This option may be severely disruptive to small employers or to issuers currently only in the small group market. This may have the largest potential to reduce issuer participation, specifically among the issuers that currently only operate in the small group market, relative to other options. It also may produce a market in which small employers and individuals have the most equal opportunity at purchasing similar coverage. However, there may be some efficiencies to issuers as they would only have to file one set of rates.

Summary

There are multiple policy approaches for merging the individual and small group markets that Maryland could enact. The options differ in terms of who is affected, how much they are affected, and how much variation is allowed between the two markets. It is likely that the greater the integration between the two markets, in the short term the premiums will be lower for the individual market and the premiums will be higher in the small group market, all else equal.

Analysis is needed to quantify the exact effects of the policy options on both the individual and small group markets. Equally important is discussions with stakeholders as to the expected impact. If the premium impact is a significant increase to small group premiums then it is possible that over the long term, small employers and/or small group issuers may exit the market. In that environment, the benefits of the merged market may be reduced (i.e., premiums for the individual market may not end up lower than in a non-merged market). This could also be true if the recent regulation increasing flexibilities for small employers to join association health plans has a significant effect on Maryland's small group market (it bares noting that if there is extreme disruption to the small group market then merging of the two markets may reduce uncertainty on the small group market). Additionally, the proposed HRA rule may also alter the small group risk pool. Finally, brokers may be affected by the changes and alter behavior as a result. Given the potential reactions, decisions on merging the markets should consider both the short term impact and the longer effects on both markets.

Timing

One key policy decision on merging the markets would be timing on when the policy would go into effect. If there are significant changes to the market, issuers, brokers, and employers may need ample time to adjust. For example, issuers may need additional time to appropriately price for a new market or new policy environments. Consumers may also need time to adjust to large changes. For example, if employers need to have a new benefit year then having significant time to adjust to that reality may be necessary.

Maryland may also have unique timing considerations because of its reinsurance based 1332 waiver. As currently constructed, Maryland's reinsurance program provides funds to the individual market. It is Wakely's understanding that if the individual and small group markets were merged, under all options and while the program was on-going, then some of the reinsurance funds would be spread across both the individual and small group market. The result is that individual market premiums could increase (i.e., because the effect of reinsurance would be spread across both markets, thereby reducing the effect on only the individual market). Federal pass-through dollars, which helps fund the reinsurance program, could be reduced, since Federal savings could be less.[8] This could result in significantly reducing the size and effectiveness of the reinsurance program (which again would lead to premium increases in the individual market). Discussion with CMS on the intersection of rating rules and the 1332 waiver may be necessary to determine if policy flexibilities exist that would allow reinsurance to be focused only on the individual market.

[8] As part of the 1332 waiver considerations, Maryland must report any significant legal changes to its markets. Merger of the markets is likely to require updates to the Federal government and potential requirements for public comments as part of updating the waiver.

Unless reinsurance can be targeted only to individual market plans, Wakely recommends that if a merged market policy is implemented, it be implemented after the current 1332 waiver expires.

Conclusion

Merging the individual and small group markets is one way of increasing the size and stability of the risk pool for both markets. The theory is that, by using a larger number of individuals in a shared claims experience, the premiums will be more stable. In particular, the inclusion of healthier enrollees in the small group market in the same risk pool as individual market enrollees is thought to decrease premiums for individual market enrollees. However, such a policy choice would have distributional implications in that premium decreases in the individual market is likely to result in premium increases in the small group market. A detailed analysis would need to be completed to understand the expected premium impact to each market.

Furthermore, the type of merger matters. Depending on the exact policy configuration, the impact on individual and small group rates could be different, the type of products available to consumers could be different, and the willingness for issuers to participate could be different. Wakely has outlined different policy configurations ranging from merging experience of some issuers, to risk adjusting across markets, to product standardization, and finally to full market merger. Each option further equalizes premiums between the two markets. However, each option does feature risks to the existing small group market. Instability in the small group market could lead to issuers and small employers exiting the market. Consequently, policy makers need to weigh the advantages brought to the individual market with the potential disruption merging markets could cause.

This discussion has focused on general trends of the impact of merging markets. However, each state may have slightly different experiences. Wakely recommends discussing with all stakeholders the potential ramifications for the policy options. In particular, understanding the impact of options #3 and #4 on issuers that currently do not operate in the individual market will be key.

Finally, policy makers should consider the timing of implementing a policy. Giving stakeholders sufficient time to react to the new policy environment will be necessary. Furthermore, given the current importance of a reinsurance program for the individual market it may be beneficial to ensure that a merging market policy timeline does not disrupt the positive benefits of the reinsurance program/1332 waiver.

Appendix A

Disclosures and Limitations

Responsible Actuaries. Julie Peper and Al Bingham are the actuaries responsible for this communication. They are Members of the American Academy of Actuaries and Fellows of the Society of Actuaries. They meet the Qualification Standards of the American Academy of Actuaries to issue this report. Michael Cohen contributed significantly to the memo.

Intended Users. This information has been prepared for the sole use of the Maryland. Distribution to parties should be made in its entirety and should be evaluated only by qualified users. The parties receiving this report should retain their own actuarial experts in interpreting results.

Risks and Uncertainties. This document is a discussion of policy alternatives and does not present results of any actuarial analysis or projection. Thus, there are no actuarial risks. There are risks with regard to policy and regulation. For example, some variations of merged markets outlined in this paper may be affected by future regulation or CMS approvals.

Conflict of Interest. The responsible actuaries are financially independent and free from conflict concerning all matters related to performing the actuarial services underlying these analyses. In addition, Wakely is organizationally and financially independent of the state of Maryland.

Contents of Actuarial Report. This document constitutes the entirety of actuarial report and supersede any previous communications on the project.

Deviations from ASOPs. To the best of our knowledge, the report and methods used in the analyses are in compliance with the appropriate ASOPs with no known deviations. A summary of ASOP compliance is listed below:

ASOP No. 41, Actuarial Communication