FOCUS on Health Reform

THE HENRY J. KAISER FAMILY FOUNDATION

JUNE 2012

Health Insurance Market Reforms: Rate Restrictions

Overview

What are rate restrictions?

Rate restrictions limit how much insurance companies can vary premiums charged to individuals and businesses based on factors such as health status, age, tobacco use and gender.

How do insurance companies set premiums?

Currently, each insurance company has its own way of determining premiums, and each state has different laws to regulate these practices. As a result, two individuals buying the same health insurance policy might pay different premiums depending on which insurance company they choose or which state they live in. For example, many health insurance companies set premiums based on the health conditions and risk status of the people they cover. They consider things like how old people are, what kind of jobs they have, their gender, and whether they have been sick before. This assessment helps insurance companies predict how much money they will spend on medical care for those people in the year ahead. Insurance companies use a variety of methods to set their premiums so they do not lose money on people who are sick or disabled and need a lot of care. Sometimes these methods, called rating practices, can encourage healthier people to buy coverage while discouraging sicker people from doing so by making premiums too expensive for them. Common rating practices include:

- ***Health status rating.*** Some insurance companies charge higher premiums to people who have medical conditions, or a history of such conditions, that could increase the chances that they will need health care. This is known as health status rating. For example, an insurance company might charge a person who has asthma more for insurance than a person who does not. Companies usually set the rate for an individual or group at the time of initial enrollment. This is called the *new issue rate.* When it is time for a policy to be renewed at the end of a year, insurance companies may also adjust the premium for changes in a person's health status during the prior year. This is called *experience rating.* Adjusting rates through experience rating is most common in group health insurance policies, but it also happens in individual coverage sold through associations.
- ***Demographic rating.*** Most insurance companies charge higher premiums to people based on their age, gender, or where they live. Typically, insurance companies charge more for older individuals than for younger ones, known as age rating. Insurers also charge higher premiums to women of child-bearing age, known as gender rating, because they tend to use more health care services than men. Insurers also charge more for people who live in areas where medical costs are high,

called geographic rating. These kinds of rating practices are used when a policy is first issued and when it is renewed.

- ***Industry rating.*** Some insurance companies charge higher premiums to people who work in industries and professions that tend to have higher health care costs. For example, premiums can be higher for loggers, miners, construction workers, crop dusters, bartenders, taxi drivers, parking lot attendants, hairdressers, and hospital workers. Industry rating is typically applied in the group market, although premiums for individual plans can also vary based on a person's occupation.
- ***Durational rating.*** Some insurance companies, particularly in the individual market, raise premiums for people who have been in a plan for a year or longer. This is typically due to the expiration of preexisting condition exclusion periods, where the insurance company does not have to provide coverage for a specified preexisting condition, or the effect of initial medical underwriting wearing off. In other words, the careful screening that people went through to buy the health coverage was a reliable predictor of their health care costs in the first year, but is viewed as a less reliable indicator of what costs may be in future years. Therefore, insurance companies may raise premiums to adjust for health changes in the time since the group or individual signed on to the policy. As a result, if two otherwise identical people are buying the same health insurance policy, but one is buying it for the first time while the other is renewing the policy after one year, the renewing customer would pay more for the same coverage due to durational rating.

How do rate restrictions work?

Each state has different laws to regulate how insurance companies set their premiums, and these laws vary widely by state and by insurance market. In states that have adopted rate restrictions, there are typically two types of restrictions. The first type of rate restriction is **rate bands**, which prohibit insurance companies from varying their premiums beyond a certain range from their average premium. For example, a rate band restriction could limit an individual's overall premium to no more than 125 percent of the insurance company's average premium rate. Rate bands may apply just to health status factors, or also to other individual rating factors. For example, a state may limit premium variation based on age to a ratio of 5-to-1 for older to younger individuals. Thus, a small group with all older workers could pay up to 5 times the premium charged to a small group with all younger workers. The insurance company could then further adjust the rate for health status, up to the limits of the rating band.

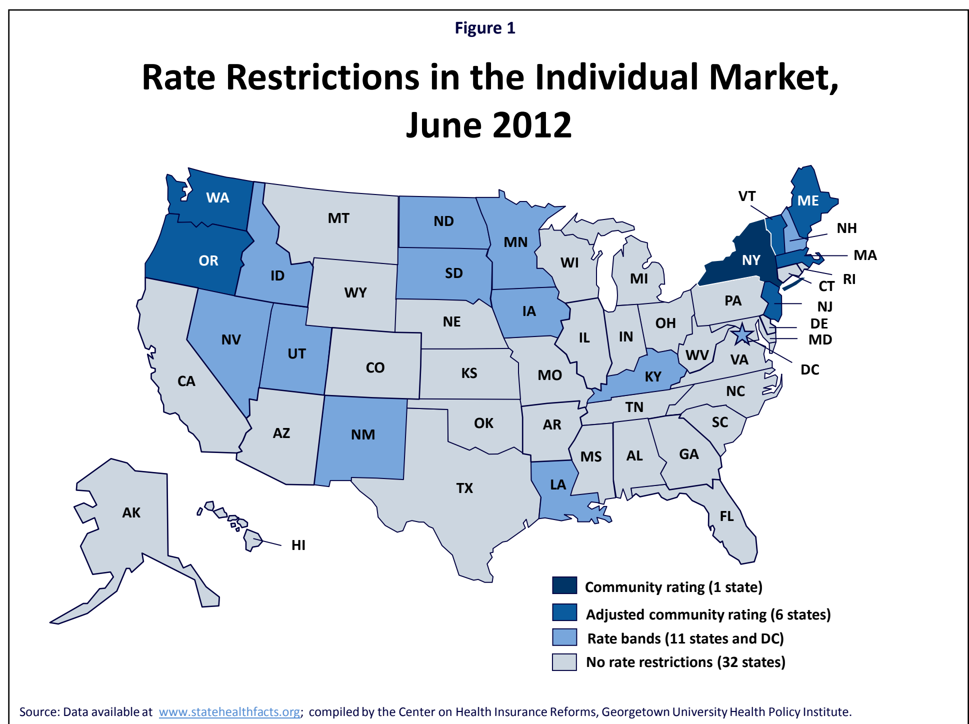
The second type of rate restriction is **community rating**, which is a method of setting premiums so that risk is spread evenly across the community, with all individuals paying the same rate regardless of their health status and other factors such as age, gender, and lifestyle characteristics. A variation of community rating is **adjusted community rating** where insurance companies cannot vary their rates based health status but can use other factors.

How does the Affordable Care Act (ACA) affect rate restrictions?

Currently, federal law does not place any limits on the ways that insurance companies set their premium rates. However, beginning January 1, 2014, insurance companies must meet the ACA's minimum premium rating rules for health plans for individuals and small businesses. Under the ACA, health plans will be allowed to adjust premiums based only on the following factors:

- **Individual vs. family enrollment.** Insurance companies will be allowed to vary rates based on who is enrolled in the plan. Thus, different rates can be charged based on whether the plan covers only an individual or a family (i.e., individual + spouse, individual + dependents).
- **Geographic area.** Insurance companies will be allowed to charge more for people who live in areas where medical costs are high.
- **Age**. Insurance companies will be allowed to vary rates based on age. However, the ACA limits this variation by not allowing insurance companies to charge an older adult more than 3 times the rate of a younger person.
- **Tobacco use.** Insurance companies will be allowed to charge more for people that use tobacco products. However, the ACA limits this variation by not allowing insurance companies to charge those that use tobacco products more than 1.5 times the non-tobacco user's rate.

Thus, the major factors that insurance companies traditionally use to charge higher premiums – such as health status, the use of health services, and gender – will no longer be allowed under the ACA. However, the ACA does permit employment-based health plans to charge employees up to 30 percent more on their premiums (and potentially up to 50 percent more) if they fail to participate in a wellness program or meet specified health goals.



The rating restrictions in the ACA set a minimum floor, not a ceiling, so states can retain or enact more stringent standards than federal law.

Current Status and Trends

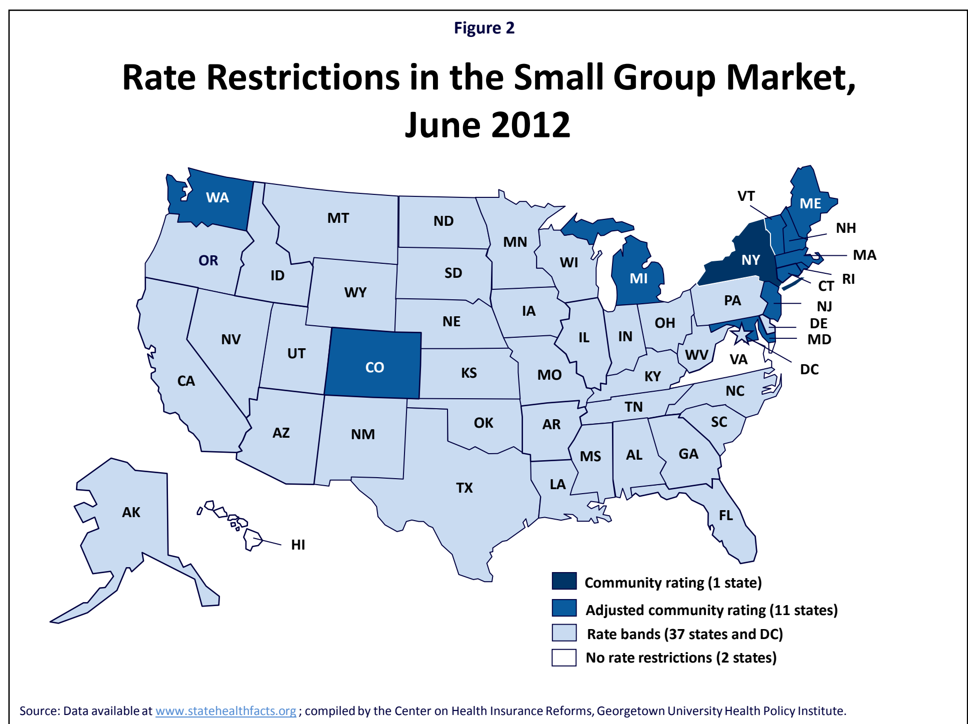
Individual Market

There are currently 18 states and the District of Columbia that have adopted some sort of rate restriction on insurance companies in the individual market (Figure 1). Of these 18 states, 11 states and the District of Columbia have adopted rate bands while seven states have adopted community rating. Of the seven states that have adopted community rating, New York allows rating based only on geographic area, while the other six states use adjusted community rating. The majority of states – 32 states – have not adopted any rate restrictions in the individual market.

As noted above, the Affordable Care Act limits insurers from varying premiums based on certain factors such as age, gender, tobacco use, or occupation. Some states have already implemented such limits in their individual market. As of the end of 2011, 14 states prohibited insurance companies from using a person's gender as a factor in establishing premiums rates. Five states did not allow companies to vary rates based on tobacco use, and two states had banned rating on the basis of age. A person's occupation is prohibited as a rating factor in 13 states.[1]

Small Group Market

Rate restrictions are far more common in the small group market than in the individual market. In the small group market, 48 states and the District of Columbia have adopted some form of rate restrictions (Figure 2). Currently, 36 of these states and the District of Columbia require insurance companies to adhere to rate bands while the other 12 states have adopted community rating. Of those states with community rating restrictions, 11 states have adopted adjusted community rating, while New York allows only geographic rating. Only two states, Virginia and Hawaii, do not impose any sort of rate restrictions.



[1] More detailed information on state individual market rate restrictions is available at www.statehealthfacts.org.

Many states also bar companies from using certain rating factors in varying small group premium rates. As of the end of 2011, 15 states prohibited companies from varying premium rates on the basis of gender. Sixteen had banned rating based on tobacco use, and two states prohibited rating based on age. Thirteen did not allow insurers to vary premiums based on the type of industry the business was in.[2]

Transition to 2014

Individual Market

The ACA's rate restrictions will result in greater changes for the individual market than for the small group market. Currently, there are 18 states that limit how much insurance companies can impose in premiums on individuals and small businesses based on factors such as health status, age, tobacco use, and gender. By January 1, 2014, the states must enforce the federal rating standard or allow the federal government to do so. To have standards in place that meet the ACA's rate requirements may require changes to state law by 2013.

Small Group Market

Although nearly all 50 states have adopted some form of rate restrictions in the small group market, the ACA introduces minimum rating restrictions that limit rating variation to only the four factors discussed above: type of enrollment (individual or family); geography; age; and tobacco use. Because many states have rate restrictions that do not meet the federal rating standard, these states will have to adjust their small group market rating laws by 2013 to comply with the rate restriction provisions in the ACA.

This fact sheet was prepared for the Kaiser Family Foundation by the Center on Health Insurance Reforms, Georgetown University Health Policy Institute.

[2] More detailed information on state small group market rate restrictions is available at www.statehealthfacts.org.

This publication (#8328) is available on the Kaiser Family Foundation's website at www.kff.org.

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