Small Insurers and Large Insurers Make Their Way in the New ACA Landscape
August 10, 2013

2014 promises to be a year of profound change for health insurance entities. Large insurers are going to expand their presence, taking full control of the fully insured marketplace, pressing the inherent advantages they enjoy under the new ACA regulations. Small insurers have taken stock of the situation, clearly see the downside of staying in the sanctioned marketplace, and are moving quickly in a variety of alternative directions, in many cases taking their business partners into new territory.

Voluntary private insurance systems are dependent upon adherence to two principles:

Achieving a spread of risk in a portfolio

Making case premiums match case risk

Large insurers generally approach the market from the former, and small insurers generally approach the market from the latter. Both approaches are principled, valid, and stable. Emphasize too much on achieving a spread of risk, and anti-selection will rear its head for a given carrier. Emphasize too much on making premiums match risk, and the market will fail by not having viable premium rates for too many cases. In a voluntary private insurance system, a balanced approach is essential.

Large insurers generally compete by:
- Being “even-handed” in rates
- Fostering an image of empathy and caring
- Using economies of scale in provider contracting
- Using economies of scale in unit expense management, including distribution costs
- Enjoying a symbiotic relationship with regulatory authorities

Small insurers generally compete by:
- Charging appropriately smaller, “below market” premiums to cases with low risk profiles
- Using distribution sources to help identify these cases, paying them accordingly
- Achieving economies of scale only in geographically local situations
- Pursuing niche opportunities

The ACA legislation, and its subsequent regulatory framework, is changing the market dynamics substantially. The ACA includes, in part, provision for:
- Rebates if “economies of scale driven” minimum loss ratios are not achieved
- Risk adjusters so that insurers with healthier enrollments will pay those with sicklier enrollments
- Community rates so that premiums will be very “even-handed”

- A non-voluntary insurance system with penalty "taxes" so that premiums need not match risk, and so that a wide spread of risk becomes the dominant principle at hand
- Exchanges so that subsidies can be provided, especially to younger people who will be subsidizing older people

In the coming years, the large insurers will dominate the ACA sanctioned marketplace while the smaller insurers will retreat to various forms of niche non-ACA sanctioned efforts. The advantages for these large companies are just too numerous and powerful. Smaller insurers will not have a significant sanctioned market presence until such time as the ACA is substantially dismantled.

The ACA may fail because:

- It may do little to control future cost increases, as such increases are driven by the underlying force of the third party payer system, which becomes even more institutionalized.
- The penalty "tax" may not be enforced well, turning what is supposed to be a non-voluntary insurance system into a voluntary one, with resultant anti-selection that comes from too little emphasis on matching premium to risk.
- The ACA sanctioned risk pool may bifurcate as insureds find ways to defeat the forced premium subsidization and penalty "tax" by opting out of the ACA sanctioned marketplace.
- Federal and state governments may fail to adequately fund the exchange premium subsidies due to political forces related to deficit reduction.

In the face of these potentialities, the ACA may yet succeed for many years due to its imposition of premium subsidies that result in institutionalized entitlements.

The next couple of years will be interesting. Already:

- Insurers are competing for the expected plum business that is expected to change hands through the balance of this year, as agents seek to secure low rates for their low risk cases, while telling their high risk cases to wait until 2014, when low rates will be available under community rating.
- Insurers are relaxing underwriting standards, confident that, on average, low risk cases will be the ones being shopped.
- Insurers are rolling out alternative funding ERISA vehicles like "aggregate only" for groups as small as five lives, essentially planning to operate outside of the "reformed" marketplace.
- Insured MEWAs are exploring capital sources so that they can operate under the ACA exception for self-funded MEWAs, reducing the role of the insurer to one of portfolio excess.
- Federal and state authorities are posturing that the potential coming risk pool bifurcation ought to be stopped by force of regulation or law.
- Insurers and plan sponsors are adjusting plan year timing dates, so that plan years beginning on or after January 1, 2014, are set as far into the future as practical.

Possible strategic directions for smaller insurers and their business partners are:

- Self-Funded MEWAs – Currently, these have a full exemption from the insurance carrier provisions. They will not need to community rate, pay premium tax, pay the HIT tax, participate in the risk adjuster program, and pay rebates. Small employer portfolios may move into these vehicles in droves.
- PEOs – Currently, these must use a fully insured contract, but they are treated like single large employers, subject to rebates at the 85% level not the 80% level. They will not have to use the carrier's community rates, and they will be able to vary rates internally among co-employers. Small employer portfolios may move into these vehicles in droves.
- CO-Ops – These have been federally de-funded, but are viable due to the lack of enforcement of community rating and rebating. CO-Ops appear to be able to set their own premium and enrollment structures.
- Small Group Fully Funded, Fully Underwritten, Self-Insurance – Both aggregate only and specific and aggregate can be appropriately used in a fully funded way, provided full medical underwriting is undertaken. The premium gets cut roughly in half for the insurer, but the insurer operates under a stop loss policy, while the employer must deal with the ACA as a plan sponsor. Employers with low risk profiles will flock to this alternative.
- "Less Than Bronze" Comprehensive Plans – Insurers may be able to sell plans that do not meet the minimum standards for compliance with the ACA, so long as the employer makes up the difference with other contributions of sanctioned value. Employer self-selection into these plans may drive good underwriting results.
- Limited Medical Plans – Many individuals and groups will be purchasing these plans as an alternative to purchasing the much more expensive ACA sanctioned benefits.
- Community Health Plans – This is essentially the only way that smaller insurers can compete directly with the large insurers. They can achieve reasonable economies of scale only in very local areas.

Shorter term tactics for smaller insurers are possibly:

- Lower rates and underwriting standards for the remainder of 2013 in order to bring on quality new business, given the unique market conditions.
- Write underwritten business on December 31, 2013, with a one day pro rata 2013 premium adjustment.
- Encourage certain grandfathered cases to voluntarily give up their grandfather status, so that they will convert to community rates sometime after January 1, 2014.
- Encourage certain grandfathered cases remain in grandfathered status so that they do not convert to community rates.
- Move plan year commencement dates that begin in 2014 as far into the future as practical, especially for certain cases only, as much as practical.
- File ACA sanctioned rates, aiming for the highest feasible rates, with the objective of a long runout block with little to no new business.

The next couple of years will be pivotal for the health insurance industry. Fully insured marketplaces will come to be dominated by a small number of very large carriers, carriers working symbiotically with regulators. Smaller insurers, with their business partners, will have moved into various niche opportunities. The extent and viability of these alternative markets will be determined quickly over the next few years.