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Individual Insurance Market Performance in Early 2018

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Despite concerns about the stability of the individual insurance market under the Affordable Care Act (ACA) raised in the past year, insurers saw better financial results in 2017 than they did in earlier years of the ACA, suggesting insurer performance was returning to levels before 2014, when new ACA insurance market rules took effect. While the market on average was stabilizing, recent policy changes have the potential to destabilize the individual market generally. As of October 12, 2017, the Trump Administration ceased payments for cost-sharing subsidies, which led some insurers to exit the market or request larger premium increases than they would otherwise. Open enrollment for 2018 was shorter than in previous years, and the Administration reduced funding for advertising and outreach.

In this brief, we look at recently released financial data from the first quarter of 2018 to examine how the individual insurance market has responded to recent changes. These new data from 2018 offer further evidence that insurers in the individual market are regaining profitability, though the repeal of the individual mandate penalty as part of tax reform legislation and the likely proliferation of loosely-regulated short-term insurance plans cloud expectations for the future.

First quarter financial data reflects insurer performance through March 31, 2018. Insurers saw better financial performance in the first quarter of 2018 than in all the earlier years of the ACA, and are returning to pre-ACA levels of profitability. Markets in some parts of the country remain fragile, with little competition and an insufficient number of healthy enrollees to balance those who are sick. Even so, absent any policy changes, it is likely that insurers would generally have required only modest premium increases in 2018 and in 2019 as well. Insurers are now beginning to file proposed rates for 2019.

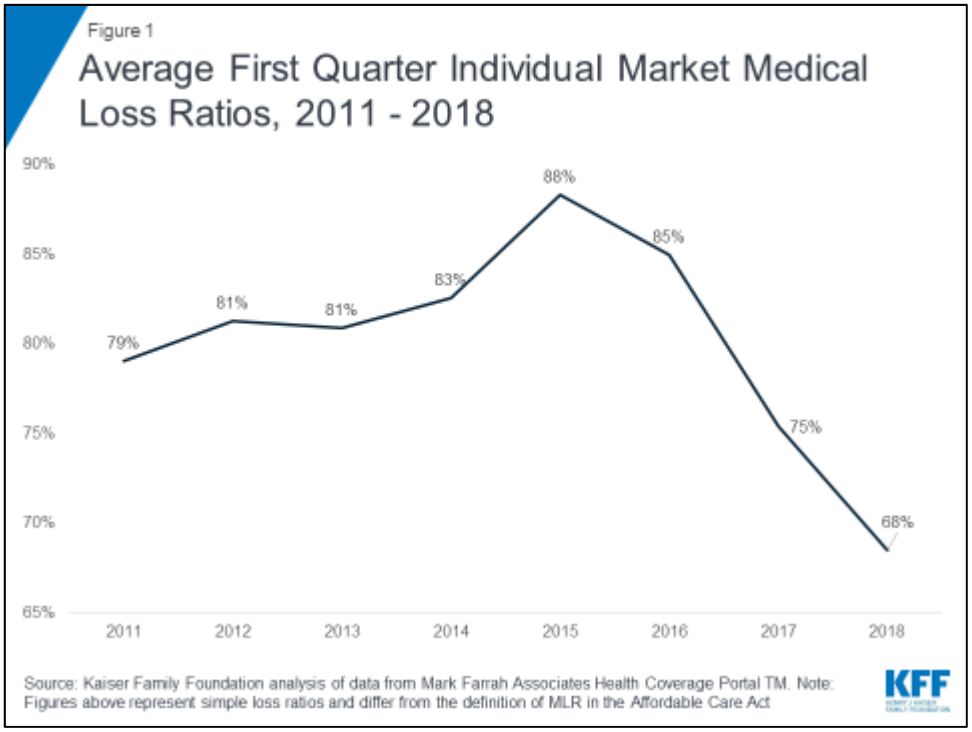
We use financial data reported by insurance companies to the National Association of Insurance Commissioners and compiled by Mark Farrah Associates to look at the average premiums, claims, medical loss ratios, gross margins, and enrollee utilization from first quarter 2011 through first quarter 2018 in the individual insurance market.[1] These figures include coverage purchased through the ACA's exchange marketplaces and ACA-compliant plans purchased directly from insurers outside the marketplaces (which are part of the same risk pool), as well as individual plans originally purchased before the ACA went into effect.

Medical Loss Ratios

As we found in our previous analysis, insurer financial performance as measured by loss ratios (the share of health premiums paid out as claims) worsened in the earliest years of the Affordable Care Act, but began to improve more recently. This is to be expected as the market had just undergone significant regulatory changes in 2014 and insurers had very little information to work with in setting their premiums, even going into the second year of the exchange markets.

Loss ratios began to decline in 2016, suggesting improved financial performance. In 2017, following relatively large premium increases, individual market insurers saw significant improvement in loss ratios, a sign that individual market insurers on average were beginning to stabilize, better matching premium revenues to claims costs. Though the federal government terminated cost-sharing subsidy payments in late 2017, loss ratios have continued to decline, averaging 68% in the first quarter of 2018. This suggests insurers were able to build in the loss of payments into their premiums, and some insurers may have even over-corrected.

First quarter loss ratios tend to follow the same pattern as annual loss ratios, but in recent years have been 10 to 15 percentage points lower than annual loss ratios.[2] Though 2018 annual loss ratios are therefore likely to end up higher than 68%, this is nevertheless a sign that individual market insurers on average are on a continuing path towards significantly improved profitability.



Margins

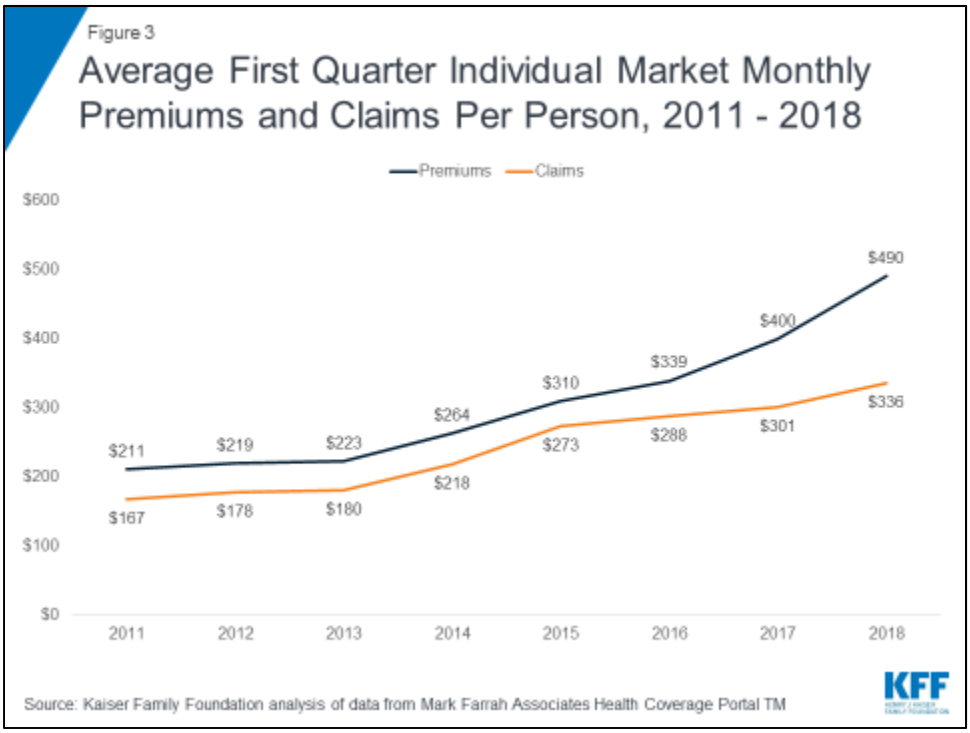
Another way to look at individual market financial performance is to examine average gross margins per member per month, or the average amount by which premium income exceeds claims costs per enrollee in a given month. Gross margins are an indicator of performance, but positive margins do not necessarily translate into profitability since they do not account for administrative expenses.

Looking at gross margins, we see a similar pattern as with loss ratios. Insurer financial performance has improved dramatically through the first quarter of 2018 (increasing to $155 per enrollee, from a recent annual low of $36 in 2015). These data suggest that on average insurers in this market have met or exceeded pre-ACA individual market performance levels, and that insurers are generally now earning a profit in the individual market. Again, first quarter data tend to indicate the general direction of the annual trend, and while annual 2018 margins are unlikely to end as high as they are in the first quarter, these data suggest that insurers in this market are now on average financially healthy.

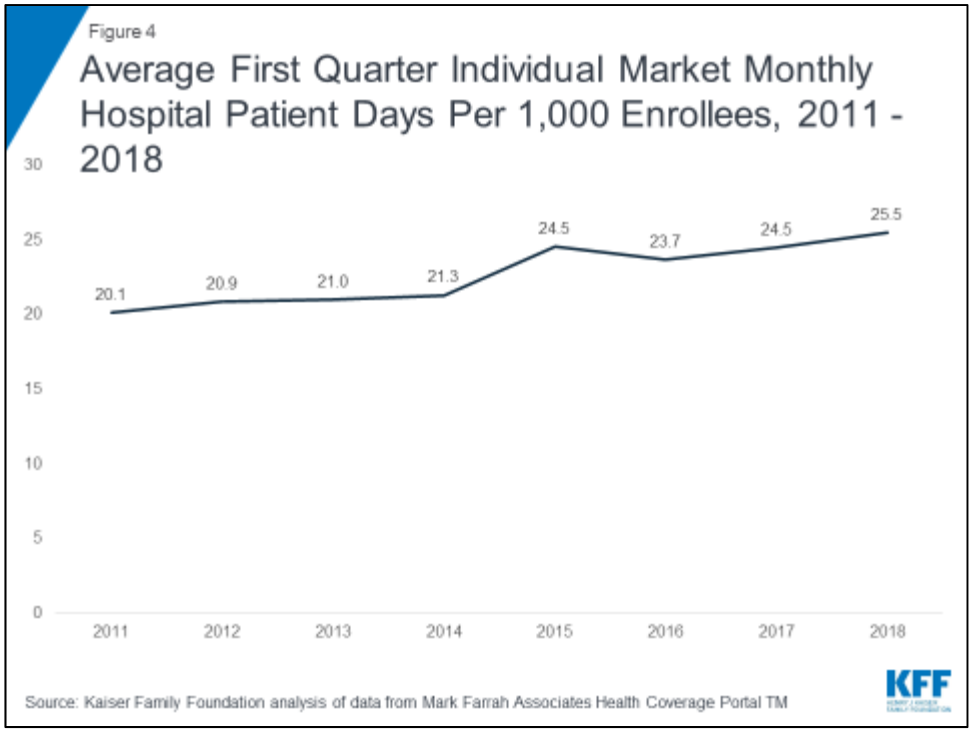
Underlying Trends

Driving recent improvements in individual market insurer financial performance are the premium increases in 2018 and simultaneous relatively slow growth in claims for medical expenses. On average, first quarter premiums per enrollee grew 23% from 2017 to 2018, while per person claims grew 11%. This growth in claims is in part due to the loss of cost-sharing subsidy payments; insurers are required by law to provide cost-sharing subsidies to eligible enrollees, but are no longer being reimbursed by the federal government. A major factor in 2018 premium increases was rate hikes to offset the termination of federal

cost-sharing subsidy payments. Claims costs will increase throughout the year as enrollees meet their deductibles.



One concern about rising premiums in the individual market was whether healthy enrollees would drop out of the market in large numbers rather than pay higher rates. While the vast majority of exchange enrollees are subsidized and sheltered from paying premium increases, those enrolling off-exchange have to pay the full increase. On average, the number of days individual market enrollees spent in a hospital in the first quarter of 2018 was higher than in the previous three years, which could be a sign of a modestly worsening risk pool. (The first quarter of 2014 is not necessarily representative of the full year because open enrollment was longer that year and a number of exchange enrollees did not begin their coverage until mid-year 2014).



Taken together, these data on claims and utilization suggest that the individual market risk pool was relatively stable through 2017, though sicker on average than the pre-ACA market, which is to be expected since people with pre-existing conditions have guaranteed access to coverage under the ACA. There are indications that the risk pool has become somewhat sicker in the last couple years, suggesting healthier enrollees may be dropping out of the market.

Discussion

Results from early 2018 suggest that despite significant challenges, the individual market remains stable and insurers are generally profitable. Insurer financial results from 2018 – after the Administration's decision to cease cost-sharing subsidy payments, but before the repeal of the individual mandate penalty in the tax overhaul goes into effect – showed no sign of a market collapse. Premium and claims data support the notion that 2017 premium increases were necessary as a one-time market correction to adjust for a sicker-than-expected risk pool, and premium increases in 2018 were in large part compensating for policy uncertainty and the termination of cost-sharing subsidy payments. Without these policy changes, it is likely that insurers would generally have required only modest premium increases in 2018. Low loss ratios and higher margins indicate that some insurers over-corrected in 2018, raising premiums more than was necessary to cover claims and administrative costs and earn a reasonable profit. Even though repeal of the individual mandate penalty and expansion of loosely regulated insurance options will tend to drive premiums up in 2019, increases will be mitigated by this over-correction, and in some cases, premiums will even go down. Some insurers have exited the market in recent years, but others have been successful and expanded their footprints, as would be expected in a competitive marketplace. In 2019, some insurers are reentering markets they had previously exited.

While the market on average was stabilizing, there remain some areas of the country that are more fragile. In addition, data on hospitalization in the individual market suggest that the risk pool may be worsening. Policy changes have the potential to cause further adverse selection and destabilize the individual market generally. Repeal of the individual mandate penalty as part of tax reform legislation will take effect in 2019, combined with the likely expansion of loosely regulated short-term insurance plans that could siphon off healthy enrollees from the ACA-regulated individual market. These changes will increase uncertainty for insurers and likely push premiums higher, all else being equal.

Methods

We analyzed insurer-reported financial data from Health Coverage Portal TM, a market database maintained by Mark Farrah Associates, which includes information from the National Association of Insurance Commissioners. The dataset analyzed in this report does not include NAIC plans licensed as life insurance or California HMOs regulated by California's Department of Managed Health Care; in total, the plans in this dataset represent at least 80% of the individual market. All figures in this data note are for the individual health insurance market as a whole, which includes major medical insurance plans sold both on and off exchange. We excluded some plans that filed negative enrollment, premiums, or claims and corrected for plans that did not file "member months" in first quarter 2018 but did file first quarter membership.

To calculate the weighted average loss ratio across the individual market, we divided the market-wide sum of total incurred claims by the sum of all health premiums earned. Medical loss ratios in this analysis are simple loss ratios and do not adjust for quality improvement expenses, taxes, or risk program payments. Gross margins were calculated by subtracting the sum of total incurred claims from the sum of health premiums earned and dividing by the total number of member months (average monthly enrollment) in the individual insurance market.

Endnotes

[1] The loss ratios shown in this data note differ from the definition of MLR in the ACA, which makes some adjustments for quality improvement and taxes, and do not account for reinsurance, risk corridors, or risk adjustment payments. Reinsurance payments, in particular, helped offset some losses insurers would have otherwise experienced. However, the ACA's reinsurance program was temporary, ending in 2016, so loss ratio calculations excluding reinsurance payments are a good indicator of financial stability going forward.

[2] Although first quarter loss ratios and margins generally follow a similar pattern as annual data, starting in 2014 with the move to an annual open enrollment that corresponds to the calendar year, first quarter MLRs have been about 10 – 15 percentage points lower than annual loss ratios in the same year. This is because renewing existing customers, as well as new enrollees, are starting to pay toward their deductibles in January, whereas pre-ACA, renewals would occur throughout the calendar year.