



Repealing Health Reform Would Mean Billions More in Administrative Costs

Law's Insurance Exchanges Will Help Consumers Find More Affordable Coverage

By Sonia Sekhar August 2010

Opponents of the Affordable Care Act are threatening to repeal the new health care law and all the advantages it provides the American people. If they succeed, they would essentially reinstate the individual insurance market as the primary coverage option for those who don't receive health insurance through their employer. This market has continually failed to provide Americans with affordable, quality health care coverage.

Among its many limitations, the individual insurance market is extremely inefficient. This is largely because individuals seeking coverage on their own have no market strength and are not able to purchase coverage that spreads risk across a diverse group of enrollees, which also makes these policies more expensive. Insurers sell individual policies one at a time, which increases the marketing and paperwork costs for each policy. In contrast, large employers purchasing group policies buy in bulk, have negotiating power with insurance companies, and are able to spread the risk of expensive health care needs across a large population of workers.

In addition, those who buy coverage on the individual market are usually subject to costly screening processes, which insurers use to assess an applicant's risk. Insurers look at factors such as an applicant's age and health status to determine whether to provide or deny coverage and how to price the policy based on the applicant's likely need for health care services. This underwriting process adds to the administrative cost of policies sold in the individual market, and insurers pass these costs off on consumers. Altogether, our \$2.6 trillion health care system spends over \$160 billion on administration that does not go toward paying for health care.

The Affordable Care Act will reduce these administrative costs by establishing state-based health insurance exchanges by 2014 and creating new rules for health insurance plans. The Center for American Progress estimates that when fully implemented, the Affordable Care Act will result in more than \$1.3 billion of annual savings in administrative spending and up to \$7.2 billion of savings from 2014-2019 for the 5 million individuals who will likely transition from buying coverage on the individual market to buying it in exchanges, according to the Congressional Budget Office.

If all 17.7 million individuals who are currently enrolled in the individual insurance market transition to exchanges, we estimate \$4.7 billion of annual savings in administrative spending when the law is fully implemented—and up to \$25.4 billion of savings from 2014-2019.

High administrative costs in the individual market

The majority of Americans obtain health coverage in the large group market, where employers negotiate rates with insurers to provide coverage to employees and their dependents. The large group market controls costs by streamlining administrative procedures and sharing health risk more broadly. Conversely, people buying coverage on the individual market can't take advantage of these efficiencies or avoid the costs of risk-related screenings such as underwriting.

The recently passed Affordable Care Act will allow people who currently buy coverage without the help of an employer to benefit from many of the same advantages enjoyed by those who receive coverage from their employer. The law sets up state-based insurance exchanges that will simplify enrollment processes and pool large numbers of individuals into a common marketplace. Additionally, new insurance rules within the exchanges—such as requiring health plans to provide coverage to all applicants regardless of health status at a uniform rate—will eliminate administrative costs associated with the underwriting process.

Prior to the Affordable Care Act's passage the CBO estimated that on average 29 percent of premium dollars in the individual insurance market went toward administrative costs. In contrast, employer-sponsored plans in the large group market spend less than half of this amount—12 percent of premium dollars—on administrative costs. Assuming that plans offered through insurance exchanges can mirror employer-sponsored plans' administrative spending, we estimate that annual

savings for individuals who join exchanges will amount to more than \$1.3 billion when the exchanges are fully implemented, and about \$7.2 billion from 2014-2019.

When the exchanges are in full swing the CBO estimates they will insure 24 million Americans, drawing primarily from those who currently buy on the individual market, workers in small businesses, and people who are currently uninsured. They further estimate that 80 percent of exchange participants will be eligible for subsidies to help pay for coverage.

Those seeking to repeal the Affordable Care Act are ignoring the real benefits of reform, including the increased efficiencies and consumer protections the exchanges will bring. Indeed, repealing the exchanges will continue to subject consumers to costly insurance company practices where plans use beneficiary premium dollars on underwriting, deny insurance coverage based on pre-existing conditions, and rescind coverage based on any scrap of evidence that a beneficiary had an unreported pre-existing condition. And that's just to name a few.

The Affordable Care Act guarantees quality, affordable coverage for all Americans. Insurance exchanges will provide small businesses and individuals a better, more efficient alternative to the individual market -- a key step to realizing this promise. Repealing the law will thus greatly undermine Americans' ability to buy affordable health coverage.

Methodology

Estimation of total administrative spending on employer-sponsored plans. The Kaiser/Health Research and Educational Trust 2009 Employer Benefits Survey found that the average premium in 2009 for a single plan was \$4,824 and the average family premium was \$13,375. We apply the CBO's estimate that an average of 12 percent of premium dollars spent on the group market is used for administrative costs to these premium averages. This results in an administrative cost of about \$600 for single plans in the group market and about \$1,600 for family plans. To determine 2014 administrative spending, we grow 2009 administrative spending by the projected trends in national health expenditures. We then use national enrollment data by insurance and family type to calculate the number of policies that exist.

Estimation of total administrative spending on plans bought on the individual market. The individual market premiums for single plan and family coverage in 2009 were \$2,985 and \$6,328, respectively, according to the America's Health

Insurance Plans. We then apply the CBO's estimate that an average of 29 percent of premium dollars spent on the individual market is used for administrative costs to these premiums. To determine 2014 administrative spending on the individual market we grow 2009 administrative spending by projected trends in national health expenditures. This results in an administrative cost for single plans in the group market of about \$870 and family plans of about \$1,840.

Calculation of the individual market's excessive administrative burden. We calculate the number and distribution of individual market policies using AHIP's 2009 survey on the individual insurance market. We estimate that the 17.7 million people in that market are spread across 10.9 million policies—approximately 70 percent single and 30 percent family policies. We applied this ratio to the CBO's estimate that 5 million people will leave the individual market when the exchanges are fully implemented, and determined that with 3.1 million policies moving from the individual market to the exchange there will be \$1.3 billion in annual savings on administrative costs when the new law is fully implemented. Given health care inflation, that means that repealing the exchange provisions and insurance reforms would create \$7.2 billion in unnecessary administrative spending between 2014 (the first year exchanges are implemented) and 2019 due to the additional costs in the individual market.

If everyone currently buying coverage on the individual market were to move to exchange-based coverage, administrative savings would be even greater. If all 10.9 million policies move to the exchange, we determine that there would be a \$4.7 billion annual savings in administrative costs when the new law is fully implemented. Given health care inflation, that means repealing the exchange provisions and insurance reforms would create \$25.4 billion in unnecessary administrative spending over the six years health insurance exchanges would be in place due to the additional costs in the individual market.

Notes

[1] CBO estimates that administrative costs range from 9 percent for firms with less than 100 workers to 27 percent for two-employee businesses. Using 2006 Census data on the distribution of covered workers by firm size, and assuming firms with less than 100 have administrative costs at the midpoint of CBO's range, the average for administrative costs for employer-based coverage is 12 percent.

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