Vermont Legislative Joint Fiscal Office

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ISSUE BRIEF

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Community Rating: The Basics

There are two basic approaches to setting any insurance premium – basing it on the characteristics of the individual purchaser or basing it on the characteristics of a larger pool of which the purchaser is a member. Most often, premiums are based on a combination of the two factors. For example, a company that sells fire insurance may set a standard premium for coverage of a one-family home, but modify that premium based on factors such as the age of the home, the presence of smoke detectors, or the distance from the nearest fire department.

Under the first approach, the goal of the insurer is to set a premium that is adequate given the risk presented by the individual purchaser. Under the second, the goal is to set a premium that is adequate given the risk presented by the aggregated pool, but not necessarily for each individual purchaser.

In health insurance, these two approaches are referred to as experience rating (where premiums are based on the characteristics of the individual purchaser, most often a large employer) and community rating (where premiums are based on the aggregate experience of many different individuals or small employers).

There are two common variations on community rating – pure and adjusted (or modified). Under pure community rating, premiums for the same product are identical[1] regardless of the characteristics of the purchaser (age, health status, etc.). Under adjusted community rating, premiums are permitted to vary within set limits, based on selected purchaser characteristics.

One of the policy consequences of requiring community rating is that there are subsidies among pool members. Younger purchasers (who typically use less health care) will subsidize older purchasers and healthy purchasers will subsidize purchasers with serious illnesses.

Community Rating in Vermont

Vermont reformed its health insurance markets in the early 1990s. It required community rating and guaranteed issue[2] in its individual and small group markets. As part of the reforms, the legislature gave the Commissioner of Banking, Insurance, Securities and Health Care Administration some latitude in exactly how community rating would operate.

[1] Premiums are most often permitted to vary based on family structure. Coverage for an individual will cost less than coverage for a family.

[2] Guaranteed issue may or may not be required in conjunction with community rating. Under guaranteed issue, an insurer must offer coverage to any purchaser. In the absence of guaranteed issue, insurers may decline to offer coverage at their discretion.

The Commissioner may require pure community rating or allow adjusted community rating in each of these markets. The law identifies several factors which may be permitted under adjusted community rating and establishes a maximum range within which the community rate is allowed to vary (plus or minus 20 percent).

Currently, BISHCA requires pure community rating in the small group market and in the individual market IF the insurer is a non-profit. For-profit insurers in the individual market are permitted to use adjusted community rating.
As part of those reform efforts, the state also created a new insurance market for certain associations. In this market, a qualified association is treated as though it was a single large employer, even if all the members of the association are small groups. The association is experience-rated, but it is required to use adjusted community rating when setting premiums for individual members.

According to BISHCA, in 2009, there were about 17,000 Vermonters in the individual market (including about 12,000 in Catamount), about 19,000 in the small group market, and about 85,000 Vermonters in the association market.

How PPACA Will Change Things
Community rating is not currently required in most states. Seven states require community rating in both their individual and small group markets and only one, New York, requires that both markets use pure community rating.

PPACA will require all states to use adjusted community rating in both markets and to have guaranteed issue in the individual market. It will permit deviation from the community rate of 3:1 (highest rate is 3 times the lowest rate[3]). Adjustment factors may include age, geography, family composition, and tobacco use.

While this will require substantial changes in most states, PPACA does not preempt state regulations that offer a higher level of consumer protection. Vermont will not be required to change its regulation of either the individual or small group markets.

It is unclear at this time how PPACA will affect the association market.

Additional Reading
BISHCA has an excellent guide to how the individual and small group markets currently operate in Vermont. It can be found at:
http://www.bishca.state.vt.us/sites/default/files/JAN%202011%20FINAL.pdf

The American Academy of Actuaries has a good national review of state-level reform issues. It can be found at: http://www.actuary.org/pdf/health/state_level_nov09.pdf

[3] For example, if the community rate for a product is $200, rates could range from $100 to $300.