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Risk Adjustment and the Patient Protection and Affordable Care Act

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With the passage of the Patient Protection and Affordable Care Act (PPACA), individuals with preexisting health conditions will be eligible for health insurance with the individual mandate. In addition, with the introduction of PPACA in January 2014, premiums for individuals and small businesses can only be based on (i) age (cannot vary by more than 3 times between the oldest and the youngest adults), (ii) tobacco use (cannot vary by more than 1.5 to 1), (iii) geographic area, and (iv) individual vs. family enrollment (e.g. individual, individual + spouse, individual + dependent(s)). As such, the resultant claims experience of such individuals will not be in concert with their premiums. As recognition of the mis-match of premiums and claims, three tools will be used to help ensure the viability of the insurance system: reinsurance, risk corridors, and risk adjustment. The first two tools are temporary, initiated to reflect that a large influx of previously uninsured persons will be entering the insurance market. The last tool, risk adjustment, is the tool that is seen as the long-term solution to balance the claims experience and premiums.

This study will provide a history and background on risk adjustment tools used. The focus of the study is to detail the fundamental assumptions of the risk adjustment tool proposed for use in January 2014 and the potential biases that could accompany its introduction.