Article from:

The Actuary

November 1994 – Volume 28, No. 9

Risk adjustment necessary element of health care reform, according to Academy monograph

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The American Academy of Actuaries released its 14th monograph in a series on health care reform issues on September 20. "Health Risk Assessment and Health Risk Adjustment: Current Initiatives" was produced by the Risk Adjustment Work Group. Work group member Geoff Sandler announced the work group's findings at a press briefing in Washington, D.C. The monograph examines the approaches of two states, New York and California, in implementing or considering risk adjustment provisions in recent legislative reforms. Following is a summary of the monograph.

Academy statement

The American Academy of Actuaries considers risk adjustment necessary to effective health care reform. Without risk adjustment methods, rating structures being considered in health reform proposals are likely to provide carriers incentives to avoid high-risk individuals in order to keep premiums down. Individuals then would continue to face premium or contribution choices that reflect risk selection, rather than medical and administrative efficiency. The Academy considers risk adjustment a necessity if restrictions on setting rates will not allow premiums and contributions to vary in relationship to the relative risk factors (e.g., age, sex, health) of the purchasers.

Benefits of risk adjustment

The risk adjustment process uses the results of risk assessment to determine carrier transfers. It can be designed to help accomplish several goals:

- Help reduce the effects of either inadvertent or intentional risk selection, so carriers in a competitive market can compete on the basis of medical and administrative efficiency and quality of service and care, rather than on the ability to select risk
- Compensate carriers fairly and equitably for the risks they assume
- Maintain consumer choice among multiple health plans based on rates or employee contributions that reflect relative medical and administrative efficiencies
- Protect the financial soundness of the system

New York's risk adjustment

On July 17, 1992, New York Governor Mario Cuomo signed into law the Community Rating and Open Enrollment Law. The law, most of which took effect April 1, 1993, contains risk adjustment provisions. Although it is too early to predict long-term effects, data since enactment of the law indicate that:

- Most carriers are still in the market.
- There appears to be movement toward managed-care plans.
- There is no evidence that the number of uninsureds has decreased.

Risk adjustment in New York state was intended to counteract existing risk differentials resulting from age, sex, and health status differences between health plan populations. It could be viewed as a financial mechanism to facilitate community rating. While the ultimate impact of this model is still to be determined, the model illustrates that a risk adjustment mechanism can be implemented fairly quickly and easily without significant additional administrative costs.

The work group suggested the process could have been improved with more industry participation and support and more actuarial input from professional organizations. It also could have allowed more time for implementation. Incremental change, such as allowing the law to take effect upon renewal rather than on a fixed date, might have smoothed, although extended, the transition.

Risk adjustment in California

On October 1, 1992, a new law in California enacted major reform of the small-group-employer health market. This law created the Health Insurance Plan of California (HIPC) and called for the consideration of prospective risk adjustment mechanisms within the HIPC.

Although it is only partial implementation of managed competition, the California HIPC will be an interesting model in the continuing discussion of health care reform. To date, there has been no agreement on a risk adjustment method or any decision on whether risk adjustment is necessary. This may indicate that the legislation needs to specifically mandate the use of a risk adjustment method. The California experience has shown that if legislation does not mandate risk adjustment, it is less likely to evolve voluntarily.

For a copy of this monograph or a list of others produced by the Academy's work groups on health care, contact the American Academy of Actuaries, 1100 17th Street, NW, 7th Floor, Washington, DC 20036, 202/223-8196.