Single Geographic Rating Area Not the Solution

Study Finds No Easy Answers to Reduce Insurance Premiums in Rural Colorado

AUGUST 5, 2016

Residents of Colorado's mountain counties have expressed alarm and anger at the dramatically higher insurance premiums they face compared with the rest of Colorado.

A newly released study conducted for the state Division of Insurance (DOI) examined what would happen if Colorado prohibited insurers from charging higher insurance premiums based on where their policyholders live, an idea known as a single geographic rating area.[1]

The study concluded that this policy could lead to insurers leaving some markets. This could in turn lead to less insurer competition and eventually higher insurance premiums — an unraveling of the insurance market.

Insurance Commissioner Marguerite Salazar, with that finding in mind, said her office does not intend to consolidate geographic rating areas. Instead, the DOI will look for ways to address the underlying causes of high health care costs and control rising insurance prices.

Background

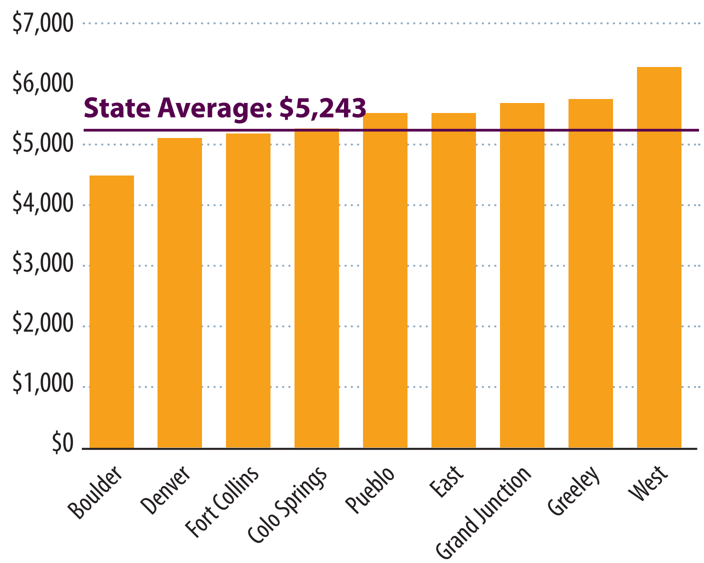
Living in the mountain and rural areas of Colorado can come with a higher price tag for health care — differences that translate into higher insurance premiums.

In the western counties, for example, the DOI study reported annual spending on health care among residents with individual and group plans, including costs paid by insurance companies and out-of-pocket costs paid by policyholders, is $1,000 higher than the state average. Health care spending in the urban areas of Boulder, Denver, Fort Collins and Colorado Springs is at or below the state average.

The Colorado Legislature asked the DOI to investigate these differences and examine whether eliminating "geographic rating" in the individual insurance market could offer a solution to the high price of insurance premiums in certain regions. (See Box.)

Cost of Care Per Person Varies Across Colorado

Payments made to health care providers by insurance companies and patients, excluding insurance premiums. Data come from commercial fully insured individual or group plans, not including Medicare and Medicaid.



Lowest Cost Region: **Boulder** ($767 below state average)
Highest Cost Region: **West** ($1,015 above state average)
Source: Lewis & Ellis, Inc. DOI study

The DOI regulates the individual and small group markets but has less regulatory authority over the large group market. Price increases in the individual market have been dramatically higher on the Western Slope in recent years, while the small group market has seen more stable prices.

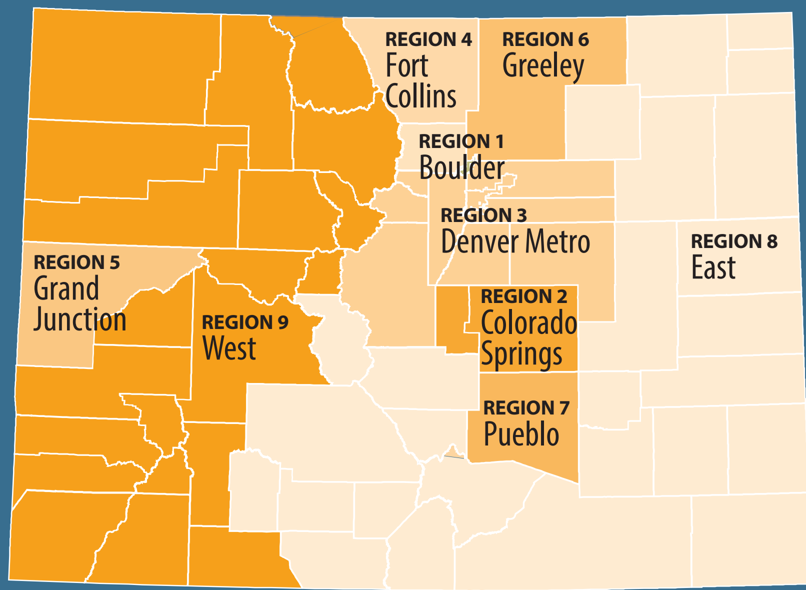
Geographic Rating: What It Is and Why It Is Used

The price of health insurance varies by region because of differences in how much people use health care services, such as visits to the doctor and diagnostic tests, as well as the price that hospitals and physicians charge.

The DOI illustrated these points in its study. It found that the total annual cost for lab and pathology procedures per person is $195 in the West region, about three times higher than the statewide average of $66. The reason is that even though the cost of each procedure is slightly lower in the West region, residents there get those procedures nearly three times more frequently than the average Coloradan. For other procedures, such as outpatient surgery, the rate of use is similar, but the cost per surgery is noticeably higher in the West.

Under the Affordable Care Act, insurance companies are allowed to set their premiums on a limited set of factors, including age, family size, tobacco use, and where policyholders live ("geographic rating"). Pre-existing conditions can no longer be considered when setting rates.

Colorado's Nine Geographic Ratings Regions



In Colorado, geographic rating allows insurance companies to vary premiums across nine different geographic areas.

These nine regions were defined by the DOI in 2015 after a consolidation from 11 regions. In that consolidation, high-cost mountain counties were combined with surrounding lower-cost counties in an effort to even out the insurance premiums.

Single Geographic Rating

The DOI commissioned the actuarial firm of Lewis & Ellis, Inc. to examine the potential impact on premiums if Colorado eliminated the ability of insurers to set insurance rates based on where policyholders live.

The study found that the most immediate effect would be to reduce insurance premiums in high-cost regions while increasing premiums in low-cost regions.

In this scenario, residents in the Boulder, Denver and Colorado Springs regions — where some 70 percent of the state's population lives — could experience eight to nine percent increases in their premiums. The other regions would enjoy modest decreases, while the West region could see a dramatic drop of more than 20 percent. (See table on next page.)

At first glance, changing to a single geographic rating area mitigates large disparities in premiums at the cost of raising premiums for a majority of the state's residents. Five northeastern states and Hawaii have adopted a similar approach of not allowing geographic rating in setting health insurance premiums, according to a 2014 Commonwealth Fund report.[2]

However, this change creates incentives that could lead to adverse effects in the insurance market. For example, with no ability to set prices based on where policyholders live, premiums in the formerly high-cost areas might not cover the cost of care. Unless insurers are able to offset those losses by higher premiums in lower cost areas or by controlling costs, they may leave the market in the high-cost areas. This could cause the market to unravel and result in even higher premiums.

As Salazar noted, this "could harm the very citizens" who were targeted for relief.

Premium Price Changes Under Two Scenarios

Region	Convert to Single Region	Keep Nine Regions with Rating Band
Boulder	▲ 8.1%	▲ 1.3%
Denver	▲ 8.3%	▲ 1.3%
Colorado Springs	▲ 9.0%	▲ 1.3%
Fort Collins	▼ -1.6%	▲ 1.3%
Pueblo	▼ -1.0%	▲ 1.3%
East	▼ -6.2%	▲ 1.3%
Grand Junction	▼ -4.7%	▲ 1.3%
Greeley	▼ -2.2%	▲ 1.3%
West	▼ -21.3%	▼ -5.2%

Source: Lewis & Ellis, Inc. DOI study

A Compromise: Using Rating Bands

An alternative approach suggested in the DOI study could modestly reduce the disparities in premiums with a lower likelihood of disrupting the insurance market. DOI could institute "rating bands" so that insurance premiums could only vary within a set limit.

Currently, the relative difference between the geographic rating factor for the lowest and highest regions is as high as 61.5 percent in the individual market. The DOI study considered one proposal that caps the difference at 40 percent.

The potential effects of this 40 percent band is also shown in the table. Premiums would increase by 1.3 percent in every region except the West region, which would see a 5.2 percent decline, according to the study.

Looking outside of Colorado, five states use rating bands to limit geographic rating. In addition, rating bands are the norm when it comes to rating for age differences.[3]

Is This a Real Solution?

The DOI study points out that neither of these approaches — moving to a single geographic region or using rating bands — addresses the real problem of affordable insurance premiums across the state.

That's because the underlying cost of health care is influenced by a number of factors that would not be altered simply by a change in the geographic rating system.

For example, are the high costs of care in certain areas driven by the lack of competitive markets? If there are few providers in a certain area, they might be in a good bargaining position and demand high reimbursement rates from insurers. Similarly, lack of competition among insurers could lead to higher premiums. Health care costs might also be driven up by practice patterns: providers or their patients may seek more procedures or diagnostic tests than in other areas.

Western Slope legislators and residents had hoped the DOI study would present a clear solution to the high costs of insurance in their area, and they are likely to be disappointed by the conclusions.

However, Commissioner Salazar stressed that the issue was a top priority for her and said the governor's office had directed her to convene a group of key stakeholders to look at the issue. She plans to have that group's recommendations ready by the end of the year — in time for the 2017 legislative session.

End Notes

1 Lewis & Ellis, Inc. Actuaries & Consultants (Brown MA, Huckaba A, Louden S). Colorado Total Health Cost and Geographic Areas 2016 Study. Prepared for the Colorado Department of Regulatory Agencies: Division of Insurance. July 28, 2016.

2 Giovannelli J, Lucia KW, Corlette S. Implementing the Affordable Care Act: State Approaches to Premium Rate Reforms in the Individual Health Insurance Market. Commonwealth Fund publication 1795 Vol. 34. December 2014.

3 Giovannelli, et.al.

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