

Insurance Brokers and the PPACA: The Potential for Field Underwriting and Other Concerns

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Introduction

Independent health insurance agents and brokers play a major role in helping small employers and individuals search for health insurance coverage. It has been estimated that at least half of small employers who provide health insurance for their employees do so through insurance brokers, and in some markets the number reaches 90 percent.¹ Because of their significant presence, brokers have the ability to significantly affect the overall functioning of these markets.

Because of this, it is vital that policymakers understand brokers' role in the marketplace. In particular, as federal and state regulators begin to implement provisions of the Patient Protection and Affordable Care Act (PPACA),² it is important that they understand the effect that brokers can have, for good or ill, on the effectiveness of the new regulations.

The Current Role of Brokers

While some brokers contract exclusively with a single insurer, most brokers contract independently with a number of insurers, who agree to pay commissions on the policies sold.³ In most states, insurers set their own commission rates. These rates can vary widely even within a single market, with one insurer offering commissions of 10 percent of the premium, another 6 percent, and some offering no commissions at all.⁴ Insurers may also pay brokers bonuses for high volume of sales or other services. The ability of insurers to set commission rates and to enter into or terminate contracts on their own terms gives them a great deal of influence over brokers.

PPACA is likely to impact the relationship between brokers, insurers, and their individual and small employer clients. Some brokers have expressed concern that the broker industry will not survive after the full provisions of PPACA go into effect in 2014. One concern is that as state-regulated exchanges make it easier for individuals and small groups to find, compare, and enroll in insurance policies,⁵ the need for brokers will be significantly lessened. Most commentators agree, however, that there will still be a demand for brokers. Even if exchanges do simplify the process, purchasing health insurance will remain a complicated undertaking, especially for small group employers.

¹ Leslie Jackson Conwell, *The Role of Health Insurance Brokers: Providing Small Employers with a Helping Hand* 1-2 (Center for Studying Health System Change, Issue Brief No. 57, 2002).

² Pub. L. 111-148 (hereinafter "PPACA").

³ Mark A. Hall, *The Role of Independent Agents in the Success of Health Insurance Market Reforms*, 78 MILBANK Q. 23, 25 (2000); Conwell, *supra* note 1, at 2.

⁴ Conwell, *supra* note 1, at 2.

⁵ See PPACA § 1311.

Of more concern to brokers than lost business is the potential effect that the PPACA could have on their **commissions**. The Act requires health insurers to maintain an **80 percent medical loss ratio**—meaning no more than 20 percent of an insurer’s expenses can go toward non-medical costs.⁶ This provision will require insurers to **cut many administrative costs**—and brokers’ commissions will likely be pinched in the process.⁷

Despite these difficulties, the **demand for brokers is unlikely to go away**. Both insurers and small employers **rely heavily on brokers in marketing and purchasing health insurance**. Furthermore, **by simplifying the application process, by answering applicant questions, and by ensuring that forms are filled out correctly, brokers can make the application process more efficient for both the client and the insurer**. Because of these **distinct advantages**, brokers will continue to be an important part of the health insurance market.⁸

Potential Policy Concerns

It is vital that policymakers understand the role that brokers could play in an exchange-driven system. Brokers could facilitate the operation of exchanges and play a helpful role in outreach programs. However, brokers could also undermine some of the basic purposes of the exchanges. Regulators must understand this in order to shape policy that **utilizes brokers as a friend, not a foe**.

Field Underwriting

The most significant concern is the potential for insurers to use brokers to **cherry-pick applicants**—influencing brokers to send healthy, low-risk individuals and groups to the insurer, while sending high-risk, high-cost business elsewhere. This process has been referred to as “field underwriting” or “street underwriting.”⁹

Insurers have always had a strong incentive to separate applicants into different risk pools, placing high-risk, high-cost individuals in one pool and low-risk, low-cost individuals in another. The plans that are offered, the services covered, and the premiums charged will differ with each pool. Currently, this separation is carried on openly, through questions on insurance applications about age, health status, and other factors relevant to determining the risk involved in insuring an individual or group.

This separation into pools certainly has negative consequences for those with **pre-existing health problems**. However, it is expected and even essential in an unregulated market.

⁶ PPACA § 10101(f).

⁷ See Steve Davis, *Brokers Wonder if Health Insurance Exchanges Will Help or Hinder Their Client Base, Commission Rate* AIS’S HEALTH BUSINESS DAILY, May 14, 2010, available at <http://www.aishealth.com/Bnow/hbd051410.html>.

⁸ See Timothy Stoltzfus Jost, *Health Care Insurance Exchanges and the Affordable Care Act: Eight Difficult Issues* 52 (Commonwealth Fund Report, Sept., 2010), available at <http://www.commonwealthfund.org/Content/Publications/Fund-Reports/2010/Sep/Health-Insurance-Exchanges-and-the-Affordable-Care-Act.aspx>.

⁹ See generally Conwell, *supra* note 1, at 35-43.

Without such separation, healthy individuals—faced with relatively high premiums caused by being pooled together with high-risk individuals—may choose to forego insurance altogether. This leaves only high-risk individuals in the market.

Although such separation may be “actuarially fair”—ensuring that each applicant pays a premium based on the risk he or she imposes—it makes it difficult or impossible for small groups or individuals with preexisting conditions to purchase insurance. PPACA represents a policy decision to bring an end to such risk pooling, instead bringing all applicants into a single risk pool. The Act seeks to do this by limiting both a healthy individual’s ability to forego insurance (through the individual mandate provision)¹⁰ and an insurer’s ability to divide applicants into separate pools. The Act uses a number of tools to do this. Insurers must accept any individual or employer who applies for coverage under any plan it offers. They are limited in the factors they can consider in setting premiums for individuals or groups and are specifically prohibited from considering the health status of the enrollees in issuing coverage.¹¹

Even with these provisions, however, insurers have a number of more subtle methods by which they can divide applicants into multiple pools. Although they cannot deny an applicant who applies for a specific plan, they may be able, through selective marketing and other methods, to encourage low-risk applicants to apply for certain plans, and high-risk applicants to apply for other plans (or, better yet, to other insurers). For example, an insurer may try to maintain a “low profile” by not advertising its products openly, instead only informing potential applicants via brokers.¹² If an insurer has enough influence over its brokers, it can encourage them to steer applicants where the insurer wants them.

There are a number of ways that insurers can encourage brokers to engage in this “field underwriting.” Setting commission schedules is one such method. In its most blatant form, insurers may vary commissions based on the health status of the group or provide bonuses to brokers whose clients prove to have low loss ratios.¹³ More subtly, insurers may vary the commissions they offer based on the size of the group, offering lower commissions for very small groups, which tend to be more risky for insurers.¹⁴

Insurers may also use informal methods for influencing brokers to steer unprofitable business to other insurers. For example, after insurance reform in Florida required insurers in the state to offer policies to all applicants, regardless of risk, one broker described how insurers would pressure brokers:

It’s their sales reps.... They become who you depend on and they pull strings for you. They get things accomplished for you and in return they unsubtly or subtly ask you to be careful what you send them....¹⁵

¹⁰ PPACA § 1501(b).

¹¹ PPACA § 1201(4).

¹² See, e.g. Conwell, *supra* note 1, at 34 (describing an insurer using this tactic.)

¹³ See Hall, *supra* note 3, at 34.

¹⁴ See Conwell, *supra* note 1, at 2-3.

¹⁵ Hall, *supra* note 3, at 38.

Exchanges are designed, in part, to limit an insurer's ability to do this. A plan participating in the exchange cannot easily maintain a low profile and thus cannot as easily control who applies. However, no insurer is required to participate in the exchange, and no individual is required to use the exchange to purchase insurance.¹⁶ There is a potential, then, for a "gray market" to arise, where low-risk, low-cost plans are sold outside of the exchange via brokers, leaving the exchange to handle primarily high-risk, high-cost applicants.¹⁷

Participation in a Health Insurance Exchange

A related concern is the potential for brokers to steer applicants away from exchanges altogether. For exchanges to function properly, it is important that they attract a significant number of applicants. Exchanges are designed to provide insurers with a large, stable risk pool. Just as a large employer provides more predictability and is more attractive to an insurer, so a large exchange will be more attractive. Additionally, if a large portion of the population obtains insurance through an exchange, insurers will have an incentive to forego the "gray market" described above and instead offer a variety of plans through the exchange in order to maintain its market share.

Thus, it is important for regulators to take action to encourage applicants to enroll through an exchange. PPACA at least partially recognizes this need and has provisions designed to encourage small group employers to participate in an exchange. One program in particular anticipates that insurance brokers could play a major role in this outreach as "navigators." Navigators are individuals, such as brokers, with existing connections to either employers or individuals who are likely to enroll in a health plan. Navigators receive grants to conduct public education activities and to distribute information about and facilitate enrollment in plans.¹⁸ Thus, the PPACA recognizes the power that brokers have to encourage consumers to use the exchanges.

However, there is also some potential that, if the Act is not implemented properly, brokers will have incentives to steer applicants to insurers who operate outside of the exchange.¹⁹ For example, if a state chooses to limit or regulate commissions inside the exchange but not outside, as some states have already done,²⁰ brokers may simply steer applicants to plans outside of the exchange.

Potential Regulatory Responses

The primary purpose of this paper is to describe the potential concerns that regulators and other policymakers must address in dealing with brokers, and is not to recommend

¹⁶ PPACA § 1312(d).

¹⁷ See Jost, *supra* note 8, at 9 (discussing the "possibility for healthy individuals or small employers to purchase ... coverage outside the exchange, threatening adverse selection against it").

¹⁸ PPACA § 1311(i).

¹⁹ See Jost, *supra* note 8, at 52-53.

²⁰ See Davis, *supra* note 7 (describing how the Utah Health Exchange pays commissions based on a flat rate).

specific actions. What sort of regulation is appropriate will vary according to the nature of the exchange that a state elects to create as well as the political feasibility of various interventions. Therefore, this section only briefly discusses the benefits and costs of some possible regulations.

Regulation of Commissions and Bonuses

Insurers' ability to set commissions plays a major role in their ability to influence brokers. As discussed above, insurers have been known to offer bonuses to brokers whose clients have low loss ratios or to vary commissions based on the desirability of the business. Regulators could limit this practice by either setting commission rates directly or requiring that commission rates only vary according to certain factors. Unlike many of the forms of regulation discussed here, commissions are relatively easy to monitor and regulate. This, therefore, provides an area where regulators can decrease field underwriting at relatively low cost.

Another important consideration with regard to commissions is whether to regulate commissions equally both inside and outside of the exchange. Because insurers who advertise through the exchange have already elected to use a semi-public forum, it is more politically feasible to regulate commissions within the exchange than without.²¹ However, as discussed above, it is important that brokers have an incentive to bring business into the exchange. Regulating commissions within the exchange but not outside could make that difficult.²²

Reporting to deter field underwriting

The informal methods used by insurers to influence brokers are likely to be more difficult to detect than commission-setting. For example, an unstated practice of simplifying the application process for brokers who send good business, while making it more difficult for brokers who send bad business, would be difficult to detect. One possible method for deterring such activity would be a reporting program whereby brokers who feel they are being pressured can report insurers. The system could also allow employers who feel that their brokers treated them differently based on the health status of their employees to report those brokers. While such reporting is always incomplete, and a weak solution at best, it does provide some deterrence and ability to detect offenders.

Limiting broker participation

In considering the ways in which brokers can be utilized by insurance companies to undermine important aspects of health insurance exchanges, it might seem tempting to regulate brokers out of the picture altogether. It is important to note, however, that brokers can play many positive roles in this process. They can educate consumers, provide outreach for the exchanges, simplify the application process, and act as

²¹ This may be one reason Utah, for example, has set rates within its exchange but not outside of it. See Davis, *supra* note 7.

²² See Jost, *supra* note 8, at 12-13.

advocates for consumers with insurance companies. Furthermore, if they are sufficiently independent, brokers may actually decrease insurers' ability to engage in illicit underwriting. Brokers who see their loyalty as being to their clients are more likely to detect and avert attempts to steer clients away from plans that may benefit them. Therefore, regulations that put an undue burden on brokers may prove to be unwise.

Conclusion

Insurance brokers can play a valuable and positive role in health insurance exchanges set up under PPACA. If properly regulated, brokers can increase participation in and understanding of the exchanges and health insurance in general. However, if not properly regulated, brokers could undermine many of the basic purposes of PPACA. Both federal and state policymakers assigned with implementing the Act should understand this potential influence and attempt to craft regulations that allow brokers to play a positive role.

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