RAND HEALTH

RESEARCH HIGHLIGHTS

# Consumer Decisionmaking in the Insurance Market



Approximately 45 million Americans are currently uninsured. Most people without health insurance are employed but work for firms that don't offer insurance. Individual insurance is a potential solution for the needs of this group. However, to date, interest in such plans has been quite limited. Only a small fraction of consumers purchase individual insurance, and that fraction has been declining steadily for the past 15 years.

Policymakers and analysts want to expand this market, arguing that it gives consumers a choice of products and has the potential to reduce the number of the uninsured. However, many experts warn of inherent weaknesses in the market, including rising premiums, limited access, and higher prices for consumers in poor health. Would current policy proposals address these issues and reduce the number of uninsured?

**Key findings:**

- **Only about 7 percent of the nonelderly purchase individual insurance.**
- **People in poor health pay about 10 percent more for insurance than their healthy counterparts.**
- **It would take very large price subsidies to attract new purchasers.**
- **Reducing nonprice barriers, such as the effort required to get information about insurance products, would spur purchase about as much as modest subsidies.**
- **Consumers are willing to pay higher premiums to have lower deductibles.**
- **Maintaining an individual insurance market will probably require controlling premium costs.**

**This Highlight summarizes RAND Health research reported in the following publications:**

Buntin MB, Escarce JJ, Kapur K, Yegian JM, Marquis MS. Trends and Variability in Individual Insurance Products in California, *Health Affairs*, September 24, 2003; available at http://content.healthaffairs.org/cgi/reprint/hlthaff.w3.449v1.

Marquis MS, Buntin MB, Escarce JJ, Kapur K, Yegian JM. Subsidies and the Demand for Individual Health Insurance in California, *Health Services Research*, Vol. 39, No. 5, 2004, pp. 1547–1570.

Buntin MB, Marquis MS, Yegian JM. The Role of the Individual Health Insurance Market and Prospects for Change, *Health Affairs*, Vol. 23, No. 6, 2004, pp. 79–90.

Marquis MS, Buntin MB, Escarce JJ, Kapur K. Is the Individual Market More Than a Bridge Market? An Analysis of Disenrollment Decisions, *Inquiry*, Winter 2005/2006, pp. 381–396.

Marquis MS, Buntin MB, Escarce JJ, Kapur K, Louis TA, Yegian JM. Consumer Decision Making in the Individual Health Insurance Market, *Health Affairs*, Web Exclusive, May 2, 2006.

Marquis MS, Buntin MB. 2006. How Much Risk Pooling Is There in the Individual Insurance Market? *Health Services Research*, in press.

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To answer this question, RAND Corporation economist Susan Marquis led a team in a multiyear examination of consumer decisionmaking in the individual insurance market in California. Findings from this work are relevant to policymakers working in this area. The team concluded that:

- Only about 7 percent of the nonelderly purchase individual insurance.
- People in poor health pay more for insurance than their healthy counterparts, but not a lot more—about 10 percent.
- Modest price subsidies are not enough to increase the percentage of consumers who purchase individual insurance. It would take very large subsidies to attract new purchasers.
- Reducing nonprice barriers such as the perceived difficulty of locating information about insurance products would spur purchase about as much as modest subsidies would.
- Consumers are risk averse and are willing to pay higher premiums to have lower deductibles.
- Over the long run, the future of the individual insurance market may depend on finding a way to rein in premium costs.

## The Individual Insurance Market in California

RAND's study used detailed information about insurance products and enrollees from the three carriers that provide more than 80 percent of the individual insurance products sold in California. The research team also conducted interviews with nearly 4,000 subscribers and 400 uninsured people in California and drew on data about Californians from two large national surveys. The team analyzed consumer decisions to purchase coverage, the kind of insurance products chosen, the extent to which premiums paid by the healthy subsidize the higher prices of those in poor health, and the amount of turnover in this market.

The analyses focused only on California. However, California's trends in premiums, rates of uninsured, and rates of employer-sponsored coverage mirror those of the rest of the country. As a result, the study findings are applicable to the nation as a whole.

**Who Buys Individual Insurance?** Individual insurance is the only option for the approximately 25 percent of the nonelderly U.S. population who are not eligible for group or public health insurance (about 60 million people). In California, the fraction is closer to 30 percent. But despite the erosion of employer-provided health care, the percentage of consumers who are candidates for individual insurance and who actually purchase it has fallen.

Nationwide, the fraction of the nonelderly who purchased coverage fell from about 8 percent in 1996 to 7 percent in 2003. In California, about 7 percent of the nonelderly purchased coverage in 2003.

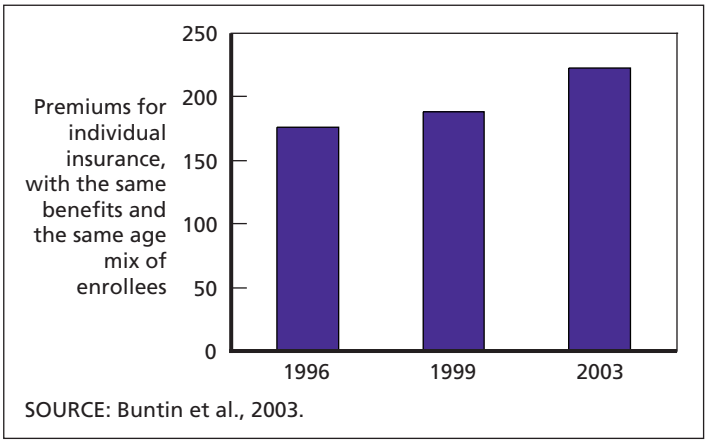
Why are purchase rates falling? One reason is cost. Premiums for individual insurance have risen rapidly in California—about 25 percent between 1996 and 2003, adjusted for inflation (see Figure 1).

Potential purchasers of individual insurance are predominantly low income, so premium increases of this magnitude may make individual insurance unaffordable. In California in 2003, families with incomes greater than 400 percent of the federal poverty level (FPL) ($18,400 in 2003 for a family of four) were more than five times as likely to purchase individual insurance as those with incomes less than 200 percent of FPL. Even a healthy family in the latter group would have to spend nearly 15 percent of its income to purchase individual coverage.

The behavior of the self-employed also underscores the importance of affordability: The self-employed purchase individual insurance at a rate more than twice that of those who are not self-employed, in part because their premiums are tax deductible.

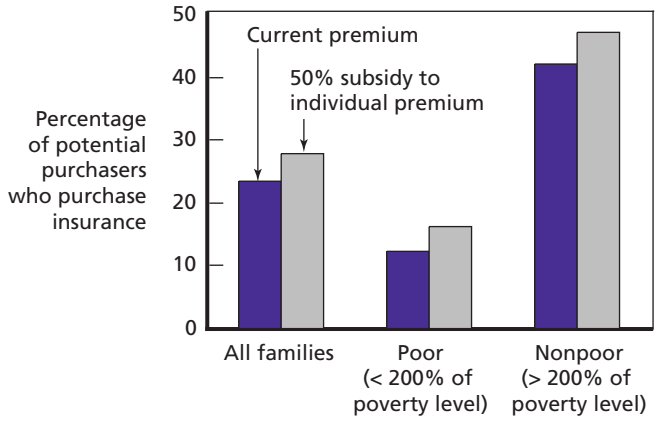
**How Do Consumers Respond to Price Changes?** How much consumers respond to prices depends on the decision they are making. The decision to purchase insurance is not greatly affected by price: It requires very large changes in price to attract new purchasers. For example, even subsidizing half of premium costs would increase the purchase rate by only about 20 percent—in California, this would mean an increase of 200,000 families. This is a decrease of about 6 percent in the number of uninsured. Purchase rates are very different for the poor and nonpoor, but their response to price changes does not differ markedly (see Figure 2). However, the young,

**Figure 1**
**25 Percent Increase in Premiums for Individual Insurance in California, from 1996 to 2003**



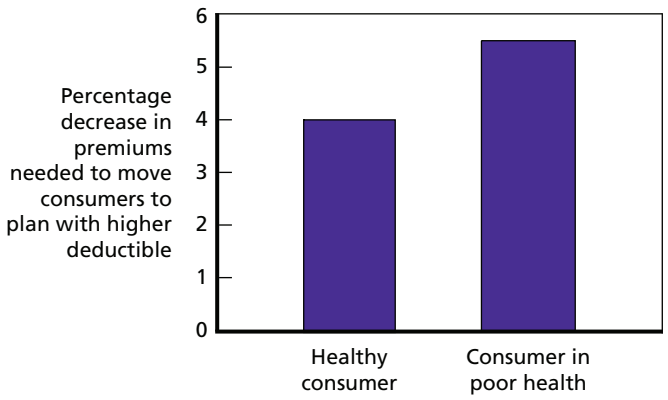

SOURCE: Buntin et al., 2003.

**Figure 2**
**Subsidies Have Only a Small Effect on the Decision to Purchase Individual Insurance**




SOURCE: Marquis et al., 2004.
NOTE: Data are from 2001.

**Figure 3**
**Consumers in Poor Health Want More-Generous Coverage**




SOURCE: Marquis, Buntin, Escarce, Kapur, Louis, and Yegian, 2006.

who are more likely to be uninsured, are more responsive to price changes than are their older counterparts.

Consumers who have already purchased insurance are more sensitive to price changes—a 20 percent decrease in a product's premium will lead to an almost 40 percent increase in that product's market share. However, most of the switching occurs between plans offered by the same insurer—consumers appear to have some brand loyalty.

Changes in premiums also affect other consumer decisions—for example, a 20 percent decrease in premiums reduces the likelihood that a consumer will drop coverage at any given point in time by about 15 percent.

**Does Benefit Design Affect the Demand for Insurance?** The decision to purchase individual insurance is also determined by whether the products on the market meet consumers' needs. Marquis and her colleagues found that people prefer more-generous benefits, but overall demand for insurance is not very responsive to changes in policy benefits. For example, a 50 percent decrease in deductibles would increase demand for insurance by about 0.5 percent and a 50 percent decrease in out-of-pocket maximums would increase demand by 1 percent.[1]

Consumers in poor health are more likely to demand generous benefits than are healthier consumers (see Figure 3). It would take a 4 percent decrease in price to induce a healthy consumer to switch to a plan with a 50 percent higher deductible. However, for a consumer in poor health, it would take a 5.5 percent premium reduction to induce the switch.

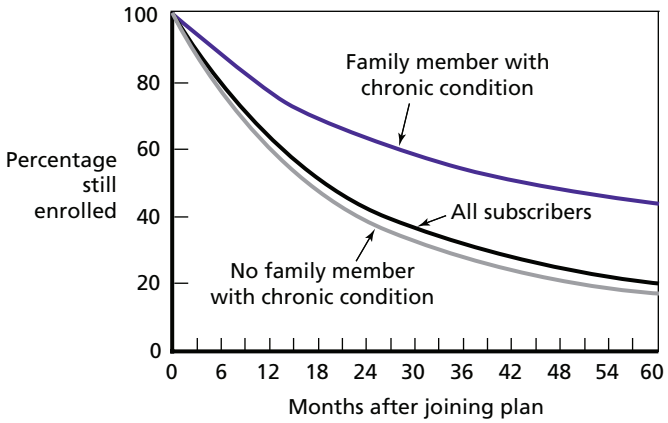
**Can Only Healthy People Purchase Individual Insurance?** Consumers who purchase individual insurance are in better health than those who remain uninsured. This is not surprising: Experts have long assumed that insurers deny coverage or charge higher premiums to individuals whom they think may use large amounts of health care. However, RAND found that many people with health problems do in fact obtain individual insurance: Almost one-third of purchasers report having an adult family member with at least one chronic condition. People in poor health at enrollment do pay higher prices than healthy people, but the differences are not large—on the order of 10 percent. This suggests that insurers pool risks to some extent—that is, spread risks across purchasers rather than charge much higher premiums for those in poor health.

However, the nature of the risk pool changes over time. Purchasers of individual insurance are guaranteed the opportunity to renew their coverage, even if they become sick. Thus, over time, the pool of enrollees in a plan has more sick people in it than it did when they initially enrolled. For example, 75 percent of new enrollees have no health condition, but among those who have been enrolled three to four years, that number drops to 50 percent. And enrollees in poorer health are more likely to remain in a plan (see Figure 4).

As the number of sick people in the plan increases, insurers will increase premiums to cover their payouts. As a

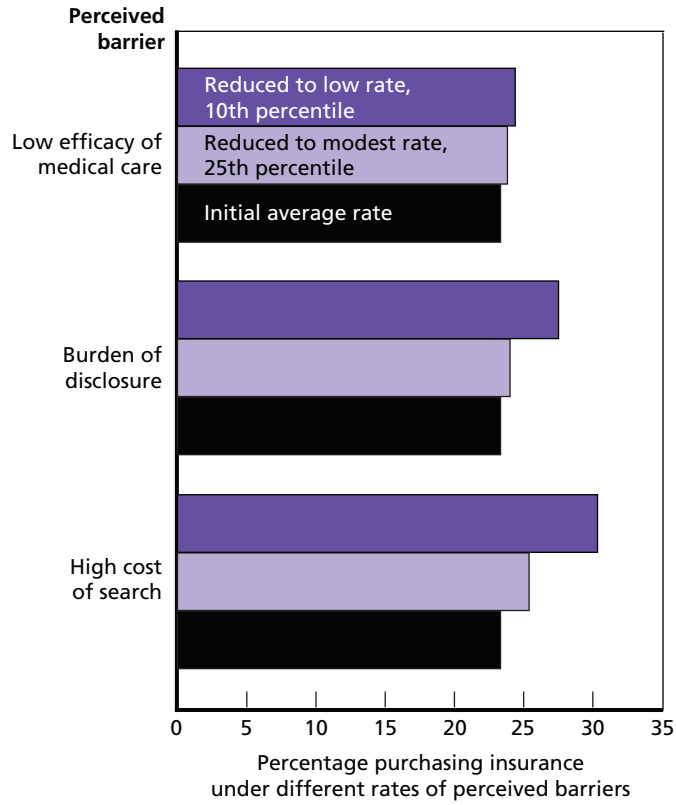
[1] This and the following results are not shown in the tables. They can be found in Marquis, Buntin, Escarce, Kapur, Louis, and Yegian, 2006.

**Figure 4**
**Enrollees in Poor Health Are More Likely to Remain in a Plan**




SOURCE: Marquis, Buntin, Escarce, and Kapur, 2005/2006.

**Figure 5**
**Reducing Nonprice Barriers to Purchasing Coverage Can Substantially Increase Purchase Rates**




SOURCE: Marquis, Buntin, Escarce, Kapur, Louis, and Yegian, 2006.

result, premiums could become too high for some purchasers. Insurers need to attract new, healthier subscribers to keep premiums low.

**Are There Nonprice Barriers to Purchasing Coverage?** Price is not the only barrier to purchasing individual insurance. There are nonprice barriers as well. The team identified some of the perceived barriers by asking consumers to agree or disagree with statements about the difficulty of searching for information, the burden of disclosure requirements, and the low efficacy of medical care.

RAND found that reducing these perceived barriers could increase the purchase rate (see Figure 5). For example, if one could reduce the perceived cost of searching from the average to a modest level, purchase rates would increase by 9 percent—equivalent to a 20 percent subsidy. Reducing perceived search costs to a low level would increase participation by 30 percent. Similarly, reducing the perceived burden of disclosure requirements and reducing the perception that medical care is not efficacious would both increase purchase rates.

Making information about products readily available to consumers would do more than just increase purchase rates. It could help consumers make smarter choices. The RAND team found that people pay quite different amounts for the same coverage, even after adjusting for geography, age, and benefits. For example, in 2002, 25 percent of purchasers in California paid an age- and benefit-adjusted premium of $175 a month or less, but 25 percent purchased products with benefit-adjusted premiums that were almost 50 percent higher. Thirty percent of purchasers reported that they did not have comparative information about products in making their choice. That information could help consumers save money by shopping for products.

## California's Individual Insurance Market: Policy Lessons

RAND's analysis of California's individual insurance market offers some lessons for encouraging more of the uninsured to participate in this market. The lessons are summarized in the table.

- **Tax credits and subsidies** are intended to give low-income individuals a financial incentive to purchase insurance. However, they are likely to have only modest effects on the number of uninsured: The decision to purchase insurance is not very responsive to changes in price, and the poor and the nonpoor are about equally unresponsive.
- Proposals that permit products to **eliminate state-specific benefit mandates and other regulations** are intended to lower costs. But they are unlikely to have a substantial

effect because price has only a small effect on the decision to purchase insurance.

- **Making contributions to health savings accounts (HSAs) tax deductible** when coupled with high-deductible plans is intended to encourage insurance purchase. But high-deductible plans alone are not likely to motivate coverage, and we lack sufficient experience with HSAs to predict their effects.
- **Reinsurance** is intended to lower overall premium costs by spreading the costs of high-risk cases more broadly. Reinsurance could modestly increase purchase rates if prices fall or access increases, but risks are already pooled in the individual insurance market.
- Making it **easier to get information about products** and simplifying the application process could increase purchase rates as much as modest subsidies would. ■

**Study's Implications for Current Policy Proposals**

| Policy and Examples | Intended Effect | Likely Effect |
|---|---|---|
| ***Tax credits or subsidies***<br>Bush administration proposal for refundable health care tax credits for low-income people who purchase individual insurance<br>Trade Adjustment Assistance Reform Act of 2002 implemented health tax credits for certain workers displaced by international trade | Provide financial incentive to purchase insurance | Modest reduction in number of uninsured and the number of disenrollees, and a modest increase in purchase of whole-family coverage |
| ***Permit products that eliminate state benefit mandates and other regulations***<br>Association health plans that would be exempt from state regulations, including benefit mandates<br>Shadegg (House of Representatives) bill would allow insurers to sell in all states under rules of state in which licensed | Stimulate demand by eliminating the costs and restrictions resulting from state regulations | Will not substantially increase coverage because price has only a small effect on purchase rates |
| ***Promote consumer-directed health plans***<br>Medicare Modernization Act permits tax deductible contributions to health savings accounts (HSAs) if coupled with high-deductible plans<br>Bush administration proposal to make premiums for high-deductible plans with HSAs tax deductible for those who buy individual products | Encourage purchase of insurance and encourage purchase of more cost-conscious choices | High-deductible plans alone will not spur demand for coverage; evidence to predict effect of HSAs is not yet available. Could segment the market because the sick are more resistant to high-deductible plans |
| ***Reinsurance***<br>"Healthy New York" program has state-financed reinsurance strategy to limit insurer liability for eligible members | Increase risk pooling and stimulate demand | Could lead to small increase in purchase rates by slightly lowering prices or increasing access to the market. Substantial risk pooling already exists in the individual insurance market |
| ***Reduce difficulty of obtaining information about products and burden of applications*** | Lower barrier to participation | Could spur coverage as much as modest subsidies do |

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