

# Premiums and Stability in the Individual Health Insurance Market

## The Effects of Young Adult Enrollment and Subsidies

### Key findings:

- Eliminating the Affordable Care Act’s premium tax credits would substantially increase premiums and reduce overall enrollment in the individual market.
- Reduced enrollment of young adults in the individual health insurance market would lead to modest premium increases.
- Alternative types of subsidies—such as vouchers—could cause premiums to become more sensitive to the age mix of enrollees.
- Eliminating the individual mandate would cause small increases in premiums but large declines in enrollment.

The Affordable Care Act (ACA) established new online markets for obtaining health insurance known as “Marketplaces.” The law requires insurers in the Marketplaces to offer coverage to all eligible buyers. To keep insurance affordable, insurers need to spread risk across a broad pool of individuals, including healthier young adults, to offset the costs of older and sicker enrollees. In theory, low levels of young adult enrollment could cause insurers to raise premiums, which could in turn price an ever-increasing number of buyers out of the market. In the worst-case scenario, this would lead to a “death spiral” in which the market collapses from high premiums and dwindling enrollment.

However, the ACA has built-in mechanisms to buffer the effects of lower-than-expected enrollment by young adults (see sidebar). The ACA also encourages participation by younger adults and healthier populations of all ages by including a

“carrot”—subsidies in the form of tax credits for lower-income individuals—and a “stick”—the individual mandate, which requires all adults to have coverage or pay a fine.

Given these provisions, how sensitive are premiums to the share of young adults enrolled in the Marketplaces? What role do other mechanisms, such as premium tax credits, play in ensuring market stability? How would changes—such as a shift to voucher-type subsidies or eliminating subsidies altogether—affect the enrollment of young adults? To address these questions, RAND researchers used the Comprehensive Assessment of Reform Efforts (COMPARE) microsimulation model to estimate the effect of changes in young adult enrollment on premium prices in the individual market, taking into account the ACA’s buffering mechanisms.

### Reduced Enrollment of Young Adults in the Individual Market Translates into Slight Premium Increases

In a baseline scenario for 2015, the RAND COMPARE simulation suggests that 27 percent of enrollees in the individual market would be young adults between ages 18 and 34. If this share were to fall, premiums would rise modestly. The team estimated that a 1 percentage point reduction in the share of young adults is associated with an increase of less than half of 1 percent (Figure 1). The modest effect size is driven partly by the ACA’s tax credits, which create an incentive for some young adults who are eligible for subsidies to remain in the individual market even if other young adults—including a mix of those eligible for subsidies and those not—drop out. In addition, the spending data used as input to COMPARE suggest that, for most enrollees of all ages, premium payments are enough to cover the costs of health care claims, an effect that is boosted by the age rating provisions of the ACA.

This research highlight summarizes RAND Health research reported in the following publication:

Eibner C and Saltzman E, *Assessing Alternative Modifications to the Affordable Care Act: Impact on Individual Market Premiums*, Santa Monica, Calif.: RAND Corporation, RR-708-DHHS, 2014 (available at [www.rand.org/t/RR708](http://www.rand.org/t/RR708)).

### The ACA's Buffering Mechanisms

The ACA contains provisions intended to stabilize premiums and buffer against premium shocks and insurer losses from uncertainties about the mix of enrollees:

*Premium tax credits:* Refundable tax credits designed to help eligible individuals and families with low or moderate income (between 100 percent and 400 percent of the federal poverty level) afford health insurance purchased through the health insurance Marketplaces beginning in 2014. The credit can be paid in advance to the beneficiary's insurance company to lower monthly premiums or can be claimed all at once through one's income tax return.

*Individual mandate:* The requirement that most individuals have health insurance coverage or pay a fine. In 2014, the fine is \$95 per adult and \$47.50 per child (up to \$285 per family), or 1 percent of income, whichever is greater. In 2015, the fine increases to \$325 per person and \$162.50 per child (up to \$975 per family), or 2 percent of income, whichever is greater. In 2016 and beyond, the fine will increase to \$695 per adult and \$347.50 per child (up to \$2,085 per family), or 2.5 percent of income, whichever is greater.

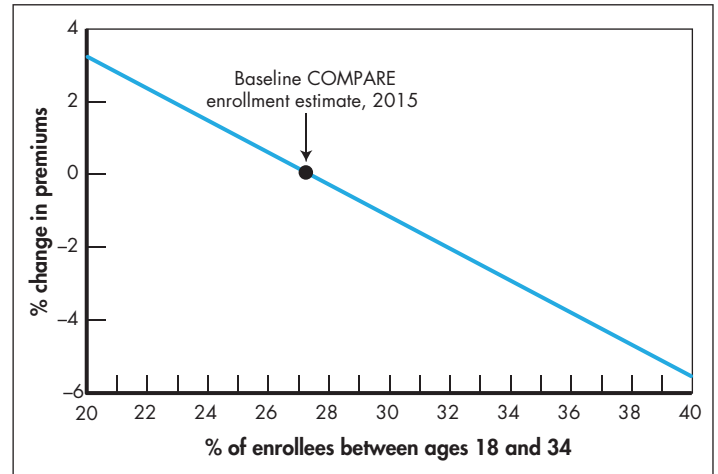
*Age rating:* Allows insurers to set premiums up to three times higher for older adults than for younger adults. This helps limit the extent to which younger, healthier adults are subsidizing participation by older, less healthy adults. Premiums for young adults would be higher if all enrollees were charged the same price regardless of age.

*Risk adjustment:* Transfers funds from plans with low-risk enrollees to plans with high-risk enrollees, which helps to ensure that plans are viable if they attract a relatively sick population and reduces incentives to "cherry-pick" healthier, lower-cost enrollees.

*Risk corridors:* Temporary, revenue-neutral transfers from insurers to the federal government if comparison of claims to premiums suggests that the insurer priced too high, or from the federal government to the insurer if comparison suggests that the insurer priced too low.

*Reinsurance:* Temporarily provides payments to insurance plans if they have an enrollee with unusually high costs.

**Figure 1. A 1 Percentage Point Change in the Share of Young Adult Enrollment in the Individual Market in 2015 Means a 0.4 Percent Change in Premiums**



### Eliminating Tax Credits Would Substantially Reduce Enrollment and Increase Premiums

Eliminating premium tax credits for lower-income enrollees would disrupt the individual market. All enrollees would be required to pay the full cost of premiums. The research team estimated that, if this happened, premiums would rise nearly 45 percent and enrollment would fall by nearly 70 percent (see table). This effect is driven by the fact that higher-risk individuals are likely to sign up for coverage regardless of whether they are eligible for tax credits, whereas lower-risk individuals—including those from the “young invincible” population—often need incentives to sign up. When they do, they improve the risk pool and help contain the price of premiums.

### Alternative Types of Subsidies—Such as Vouchers—Could Cause Markets to Become More Sensitive to Age Mix

The analysis also examined the effect of the ACA's premium tax credits, which cap individual spending on health insurance premiums as a percentage of income, up to the price of the second-least-expensive silver plan in an individual's rating area. This design protects enrollees against rising premiums because, once an individual's required contribution is met, any additional premium cost is paid by the federal government. If this design were changed to an alternative structure—such as a voucher for a fixed dollar amount or a fixed percentage contribution—then the individual market would likely become more sensitive to the share of young adult enrollees. For example, if enrollees were given a fixed-dollar voucher to buy insurance, then a 1 percentage point reduction in the share of young adults in the market would be associated with an

**Eliminating Subsidies Would Increase Premiums and Reduce Enrollment in the Individual Marketplaces**

	Premium (age-standardized)*	Total ACA-Compliant Individual Market Enrollment (in millions)	ACA-Compliant Individual Market Enrollment Among 18-to-34-Year-Olds	Total Insured (in millions)
ACA	\$3,400	19.8	5.4	244.9
No premium tax credits	\$4,900	6.3	1.6	233.6
Difference	+43%	-68%	-70%	-5%

NOTES: This table shows enrollment and premiums for 2015 as estimated in the COMPARE model under the ACA and under an alternative scenario in which we assume that there are no subsidies (premium tax credits). Estimates reflect enrollment and premiums for all ACA-compliant individual market enrollees, whether enrolled on or off the marketplaces. We apply a ratio adjustment to the enrollment figures to bring COMPARE's estimates into line with the Congressional Budget Office's estimates, and to the premium spending estimates to bring COMPARE's estimates into line with 2014 premium filings. The same ratio adjustments are applied both to the ACA scenario and to the "No premium tax credits" scenario.

\* The age-standardized premium reflects the silver premium for a 40-year-old nonsmoker. While premium amounts will vary by age, the change in premiums resulting from the elimination of tax credits is 43.3 percent for all age groups because of the ACA's rating requirements.

increase in premiums of roughly three-quarters of 1 percent (Figure 2). This is true even if we set the initial voucher amounts so that they are equivalent to the premium tax credit amounts predicted by the model at baseline.

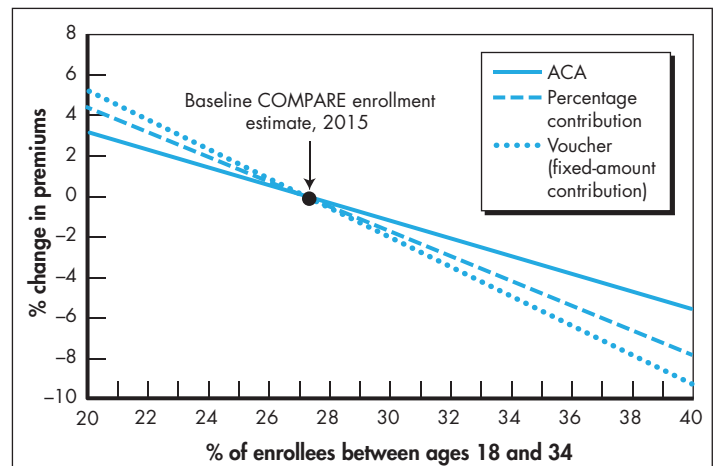
**Eliminating the Individual Mandate Would Cause Modest Increases in Premiums but Large Declines in the Number of Insured**

Without the mandate, the overall number of people enrolled in the individual market would fall by nearly 20 percent, from 19.8 to 15.8 million. The number of young adults would decline from 5.4 million (27 percent of those enrolled) to 3.9 million (24.8 percent of those enrolled), and premiums would rise by about 7 percent. The sharp decline in enrollment in this scenario suggests that the individual mandate is important to achieving the ACA's goal of universal coverage.

**Conclusions**

Many of the mechanisms included in the ACA help provide stability across shifts in the enrollee age mix. In particular, premium tax credits, which encourage participation and guard against financial shocks from rising premiums, play an important role in stabilizing the individual market. Without the ACA's premium tax credits, the RAND COMPARE model estimates large premium increases and dramatic declines in Marketplace enrollment.

**Figure 2. Alternative Types of Subsidies Would Make Premiums More Sensitive to Changes in Young Adult Enrollment**



NOTES: This figure shows the change in individual market premiums that could be expected as the share of young adult enrollees increases or decreases under three alternative assumptions about the structure of premium subsidies. The solid line shows the ACA premium subsidy, which is a tax credit that caps spending as a percentage of income, up to the cost of the second-lowest-price silver plan in an individual's rating area. The dashed line shows an alternative subsidy in which both individuals and the federal government contribute a fixed percentage to the premium; each individual's percentage contribution varies with income and age. The dotted line shows a voucher approach, in which each individual receives a fixed dollar amount that can be used to purchase health insurance coverage. Voucher amounts also vary by age and income. All estimates are derived from the COMPARE model and represent calendar year 2015.

---

Abstracts of all RAND Health publications and full text of many research documents can be found on the RAND Health website at [www.rand.org/health](http://www.rand.org/health). The RAND Corporation is a nonprofit institution that helps improve policy and decisionmaking through research and analysis. RAND's publications do not necessarily reflect the opinions of its research clients and sponsors. RAND® is a registered trademark. © RAND 2014

[www.rand.org](http://www.rand.org)



CHILDREN AND FAMILIES  
EDUCATION AND THE ARTS  
ENERGY AND ENVIRONMENT  
HEALTH AND HEALTH CARE  
INFRASTRUCTURE AND  
TRANSPORTATION  
INTERNATIONAL AFFAIRS  
LAW AND BUSINESS  
NATIONAL SECURITY  
POPULATION AND AGING  
PUBLIC SAFETY  
SCIENCE AND TECHNOLOGY  
TERRORISM AND  
HOMELAND SECURITY

The RAND Corporation is a nonprofit institution that helps improve policy and decisionmaking through research and analysis.

This electronic document was made available from [www.rand.org](http://www.rand.org) as a public service of the RAND Corporation.

## Support RAND

[Browse Reports & Bookstore](#)

[Make a charitable contribution](#)

## For More Information

Visit RAND at [www.rand.org](http://www.rand.org)

Explore the [RAND Corporation](#)

View [document details](#)

## Research Brief

This product is part of the RAND Corporation research brief series. RAND research briefs present policy-oriented summaries of individual published, peer-reviewed documents or of a body of published work.

## Limited Electronic Distribution Rights

This document and trademark(s) contained herein are protected by law as indicated in a notice appearing later in this work. This electronic representation of RAND intellectual property is provided for non-commercial use only. Unauthorized posting of RAND electronic documents to a non-RAND website is prohibited. RAND electronic documents are protected under copyright law. Permission is required from RAND to reproduce, or reuse in another form, any of our research documents for commercial use. For information on reprint and linking permissions, please see [RAND Permissions](#).