

Budgetary Treatment of Proposals to Regulate Medical Loss Ratios

CBO has been asked to review a proposal that would require health insurers to provide rebates to enrollees to the extent that their medical loss ratios are less than 90 percent. (A medical loss ratio, or MLR, is the proportion of premium dollars that an insurer spends on health care; it is commonly calculated as the amount of claims incurred plus changes in reserves as a fraction of premiums earned.) In particular, CBO has been asked to assess whether adding such a requirement to the provisions of the Patient Protection and Affordable Care Act (PPACA) put forward by Senator Reid (as an amendment to H.R. 3590) would change its judgment as to how various types of health insurance transactions that would occur under that legislation should be reflected in the federal budget.

In May, CBO released an issue brief entitled [*The Budgetary Treatment of Proposals to Change the Nation's Health Insurance System*](#). That publication identified the primary elements of proposals that CBO thought were relevant to whether purchases of private health insurance should be treated as part of the federal budget. CBO concluded (on page 4) that “at its root, the key consideration is whether the proposal would be making health insurance an essentially governmental program, tightly controlled by the federal government with little choice available to those who offer and buy health insurance—or whether the system would provide significant flexibility in terms of the types, prices, and number of private-sector sellers of insurance available to people.” (Note: CBO estimates the budgetary impact of legislation as it is being considered by the Congress; if legislation is enacted into law, the Administration’s Office of Management and Budget ultimately determines how its effects will be reflected in the federal budget.)

The PPACA would make numerous changes to the market for health insurance, including requiring all individuals to purchase health insurance, subsidizing coverage for some individuals, and establishing standards for benefit packages. Taken together, those changes would significantly increase the federal government’s role in that market. Nevertheless, CBO concluded that there would remain sufficient flexibility for providers of insurance and sufficient choice for purchasers of insurance that the insurance market as a whole should be considered part of the private sector. Therefore, except for certain transactions that explicitly involve the government, CBO would treat the cash flows associated with the health insurance system (for example, premium and benefit payments) as nongovernmental.

Certain policies governing MLRs, particularly those requiring health plans whose MLR falls below a minimum level to rebate the difference to enrollees, can be a powerful regulatory tool. Insurers operating at MLRs below such a minimum would have a limited number of possible responses. They could change the way they provide health insurance, perhaps by reducing their profits or cutting back on efforts to restrain benefit costs through care management. They could choose to pay the rebates, but if they raised premiums to cover the added costs they would simply have to rebate that increment to premiums later. Alternatively, they could exit the market entirely. Such responses would reduce the types, range of prices, and number of private-sector sellers of health insurance—the very flexibilities described in CBO’s issue brief.

In CBO's judgment, an important consideration in whether a specific MLR policy would cause such market effects is the fraction of health insurance issuers for whom the policy would be binding. A policy that affected a majority of issuers would be likely to substantially reduce flexibility in terms of the types, prices, and number of private sellers of health insurance. Taken together with the significant increase in the federal government's role in the insurance market under the PPACA, such a substantial loss in flexibility would lead CBO to conclude that the affected segments of the health insurance market should be considered part of the federal budget. (CBO made similar judgments in its issue brief in assessing the level of required coverage that would, in combination with a mandate to purchase coverage, make the purchase of insurance essentially governmental.)

Setting a precise minimum MLR that would trigger such a determination under the PPACA is difficult, because MLRs fall along a continuum. However, CBO has identified MLRs in the principal segments of the insurance market above which a significant minority of insurers would be affected; if a minimum MLR were set at or below those levels, CBO would not consider purchases of private health insurance to be part of the federal budget. Compared with MLRs anticipated under current law, MLRs under the PPACA would tend to be similar in the large-group market, slightly higher in the small-group market, and noticeably higher in the individual (nongroup) market—for reasons that are discussed in CBO's November 30 analysis of the effect of Senator Reid's proposal on insurance premiums. Taking those differences into account, CBO has determined that setting minimum MLRs under the PPACA at 80 percent or lower for the individual and small-group markets or at 85 percent or lower for the large-group market would not cause CBO to consider transactions in those markets as part of the federal budget.

A proposal to require health insurers to provide rebates to their enrollees to the extent that their medical loss ratios are less than 90 percent would effectively force insurers to achieve a high medical loss ratio. Combining this requirement with the other provisions of the PPACA would greatly restrict flexibility related to the sale and purchase of health insurance. In CBO's view, this further expansion of the federal government's role in the health insurance market would make such insurance an essentially governmental program, so that all payments related to health insurance policies should be recorded as cash flows in the federal budget.

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