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## **RSC Policy Brief:** **The Pitfalls of Guaranteed Issue** *April 30, 2008*

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**The RSC has prepared the following policy brief analyzing the consequences of “guaranteed issue” regulations that force insurance carriers to accept all applicants, regardless of health status.**

**Background:** Beginning in the early 1990s, some states began to consider various policy solutions to reduce the number of uninsured Americans. One such solution required insurance carriers in a state to accept all applicants, regardless of their age or health status. Advocates believed that these guaranteed issue regulations would improve access to health insurance coverage for those individuals with chronic health conditions for whom policies had heretofore been unobtainable.

In many instances, imposition of guaranteed issue restrictions on insurance carriers was coupled with additional regulation in the form of community-rated premiums. Community rating provisions generally require insurance carriers to charge all individuals the same premium, with minor variations occasionally permitted due to geographic variations or general age bands. As with guaranteed issue regulations, community rating attempts to expand access to insurance for those with chronic conditions by ensuring they will pay no higher premiums than healthy individuals.

In the 2008 presidential campaign, both remaining Democratic candidates support guaranteed issue and community rating restrictions on insurance carriers. Sen. Barack Obama (D-IL) notes that his proposed health insurance exchange will “charge fair and stable premiums that will not depend upon health status.”<sup>1</sup> Sen. Hillary Clinton (D-NY), claiming that “insurance companies in America spend tens of billions of dollars per year figuring out how to avoid costly beneficiaries,” would impose guaranteed issue restrictions on carriers, along with prohibitions on

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<sup>1</sup> “Barack Obama’s Plan for a Healthy America,” available online at <http://www.barackobama.com/issues/pdf/HealthCareFullPlan.pdf> (accessed April 12, 2008), p. 4.

“charging large premium differences based on age, gender, and occupation.”<sup>2</sup> However, because she accepts the criticism that placing such restrictions on carriers in the absence of a mandate to purchase insurance would only encourage individuals to “game” the system by waiting until they become sick to submit an insurance application, Sen. Clinton has also incorporated an individual mandate to purchase health insurance into her platform.

**Problems in Implementation:** Most of the available data from states that have imposed guaranteed issue and community rating restrictions are consistent with the concern articulated by the Clinton campaign—that because individuals can obtain health insurance at any time and at standard rates, they have little incentive to purchase coverage until such time as they become ill. This rational choice on the part of individuals creates a moral hazard whose burden is borne by insurance carriers—because their insured population is sicker than the population as a whole, they have no choice but to raise premiums across-the-board, as they are prohibited from imposing even slightly higher premiums on sicker populations. These across-the-board increases further discourage young, healthy individuals from purchasing insurance.

Data from a prominent online broker of health insurance policies nationwide illustrate the disparity in premiums between states with guaranteed issue policies and states lacking them. A report released last September found that in 2006, the average monthly cost of an individual health insurance policy in two states with guaranteed issue and community rating restrictions—New York and New Jersey—was \$338 and \$277 respectively.<sup>3</sup> These numbers are approximately twice the average amount paid for health insurance by individuals in neighboring Pennsylvania—a state without guaranteed issue and community rating restrictions, and whose average premium of \$148 per month equals the national average.<sup>4</sup> Due to the wide difference in premiums created by excessive regulation in some states, some conservatives may support legislation permitting individuals to buy health insurance across state lines, to take advantage of lower premiums in states with more realistic levels of insurance regulation.

The perverse incentives created by guaranteed issue and community rating policies that have driven up premiums have also helped to drive insurance carriers out of states where they have been imposed. For instance, Kentucky enacted both guaranteed issue and community rating procedures in 1995, but ultimately ended up repealing both, due in large part to the fact that by 1997 most every insurance carrier ceased operations in the state. The regulations were repealed in 2000, and by May 2007 seven insurance carriers had returned to offer individual insurance products in Kentucky.<sup>5</sup>

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<sup>2</sup> “American Health Choices Plan,” available online at <http://www.hillaryclinton.com/issues/healthcare/americanhealthchoicesplan.pdf> (accessed April 12, 2008), pp. 6-7.

<sup>3</sup> “The Cost and Benefits of Individual Health Insurance Plans: 2007,” available online at <http://www.ehealthinsurance.com/content/expertcenterNew/CostBenefitsReportSeptember2007.pdf> (accessed April 12, 2008), p. 23.

<sup>4</sup> Ibid. Perhaps paradoxically in light of the above evidence, Gov. Ed Rendell (D-PA) has proposed extending guaranteed issue and community rating restrictions to the Pennsylvania insurance market. See <http://www.gohcr.state.pa.us/prescription-for-pennsylvania/PlainEnglishLegislation.pdf> (accessed April 12, 2008), p. 5.

<sup>5</sup> Cited in Anthony Lo Sasso, “An Examination of State Non-Group and Small Group Health Insurance Regulations,” (Washington, DC, American Enterprise Institute Working Paper #140, January 2008), available online at [http://www.aei.org/docLib/20080111\\_LoSassoState.pdf](http://www.aei.org/docLib/20080111_LoSassoState.pdf) (accessed April 12, 2008), p. 15.

**Alternatives to Guaranteed Issue:** Instead of imposing additional restrictions on carriers that in many cases have damaged insurance markets, many states have developed alternative solutions for medically high-risk individuals. In total, 34 states have established reinsurance mechanisms, or high-risk pools, providing approximately 200,000 individuals with chronic conditions access to care.<sup>6</sup> As a result, overall individual health insurance premiums in states with high-risk mechanisms are significantly lower than the \$300 monthly averages seen in guaranteed issue states like New York and New Jersey.

Although premiums are paid by participants in these state-based pools, and the premiums are higher than standard rates (generally 150-200% of rates for standard risks), other sources of revenue can be used to offset the pools' operating losses. These mechanisms are financed through means that vary from state to state, but can include *per capita* surtaxes on insurance plans, state general revenues, or other sources of dedicated funding. In addition, legislation reauthorized by Congress in 2006 (P.L. 109-172) provides for federal grants to state high-risk pools to offset their operating losses. The Fiscal Year 2008 omnibus appropriations measure (P.L. 110-161) included nearly \$50 million in grants to states appropriated pursuant to the 2006 authorization.

One further nuance on the high-risk pool mechanism involves a risk transfer model based solely on interactions among private insurance companies. Under this scenario, insurance carriers would resolve claims amongst themselves at year's end, based upon which carriers had disproportionate numbers of beneficiary claims associated with chronic diseases such as diabetes, chronic heart failure, or breast cancer. Some conservatives may find this model slightly preferable to the state-run risk pool mechanism, because the lack of state and/or federal funding removes a disincentive for carriers to "game" the system by ceding high-risk patients into a pool with a government backstop attached.

**Conclusion:** Based on the examples examined above, some conservatives may be concerned that the twin proposals of guaranteed issue and community rating have served to undermine insurance markets where they have been implemented. Because these policies serve as a *de facto* tax on young and healthy individuals—who pay higher rates than they would otherwise be charged in order to finance the coverage of older and sicker individuals—they encourage moral hazard, by making insurance plans prohibitively expensive for those healthy populations who are generally less inclined to purchase coverage in the first place.

Some policy-makers, conceding this point, therefore believe that an individual mandate to purchase coverage would succeed in forcing all healthy risks into purchasing insurance, thereby reducing the perverse effects of guaranteed issue regulations. However, that argument presupposes the efficacy of an individual mandate—and Massachusetts' experiment with a mandate has already resulted in 15-20% of the population being exempted from it due to cost concerns. In addition, some conservatives might question whether and how the concept of "personal responsibility" advanced by advocates of an individual mandate comports with community rating policies which would charge smokers with lung cancer, or other individuals with behaviorally-acquired diseases, the same insurance premiums as their healthier counterparts.

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<sup>6</sup> Additional information on state-based high risk pools can be found through the National Association of State Comprehensive Health Insurance Plans at [www.naschip.org](http://www.naschip.org).

While the concept of ending “insurance company discrimination” against less healthy people sounds politically appealing, many individuals who have already developed a chronic condition do not need access to *insurance*, but rather access to *health care*—and the existing state-based risk pool mechanisms have helped provide that care for a significant population. For other individuals, a landmark 1999 book by Wharton economists Mark Pauly and Bradley Herring demonstrated how the individual health insurance market does pool risk—because policies are guaranteed renewable, and one individual’s premium cannot be increased or decreased at the time of renewal based on changes in health status, healthy risks do subsidize sicker risks more effectively and efficiently than critics assert.<sup>7</sup> For these reasons, some conservatives may therefore view guaranteed issue and community rating as unnecessary policies that would unduly restrict the health insurance marketplace, and actually undermine their stated intention of reducing costs while increasing access to care.

For further information on this issue see:

- [\*Council for Affordable Health Insurance Paper: "What Were These States Thinking?"\*](#)

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<sup>7</sup> Bradley Herring and Mark Pauly, *Pooling Health Insurance Risks* (Washington, DC, American Enterprise Institute Press, 1999). See also Herring and Pauly, “The Effect of State Community Rating Regulations on Premiums and Coverage in the Individual Insurance Market,” (Cambridge, MA, National Bureau of Economic Research Working Paper #12504, August 2006), available online at <http://www.nber.org/papers/w12504.pdf> (accessed April 12, 2008).