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Potential Impacts of Uncertainty Regarding Affordable Care Act (ACA) Cost-Sharing Reduction Payments

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Funding for the cost-sharing reduction (CSR) payments established under the Affordable Care Act (ACA; P.L. 111-148, as amended) has been the subject of recent hearings about the individual insurance market, numerous press articles, and analyses from actuaries to the Congressional Budget Office (CBO). The continuation of CSR payments has come into question, and insurers warn that they may leave the market or raise premiums without a commitment to sustained funding. To understand the concern about funding CSR payments, it is important to understand the context in which CSRs are provided, beginning with insurance premiums.

How Does Cost-Sharing Affect Premiums?

Consumers with private health insurance generally pay for health care in two ways: a periodic premium to purchase the insurance and cost-sharing requirements (e.g., deductibles, copayments, etc.) that are related to health services received. Insurers collect premiums from consumers and use that revenue to pay primarily for medical claims. To this end, a premium is determined through a months-long process to develop a rate (a price for a given insurance policy) sufficient to cover expected medical claims and other expenses and earn a positive margin.

Once insurers file individual insurance rates with applicable state and federal authorities and such rates are finalized, premiums are generally set for policies that cover the upcoming benefit year. Federal regulations require that any insurer in the individual insurance market develop an "index rate" that incorporates prior claims experience for all of the insurer's individual market policyholders and projects the medical costs for covering the essential health benefits. This rate is then adjusted to account for factors applicable to the individual market, a given insurance policy (including that policy's specific set of cost-sharing requirements), and the characteristics by which premiums are allowed to vary among consumers purchasing the same policy. An insurer may only establish an index rate and make adjustments on an annual basis. (The ongoing uncertainty about the future of CSR payments has motivated some states to adjust the process by which rates are set.)

How Do CSRs Affect Consumer and Insurer Spending?

Given the rate-setting rules described above, the premium for an individual insurance policy typically reflects the cost-sharing requirements as determined by the insurer. However, in the case of an eligible consumer, the ACA requires changes to his or her actual cost-sharing requirements. A consumer must enroll in a "silver plan" and meet income and other eligibility criteria to receive CSRs. The ACA requires that a low-income consumer who is determined to be eligible for CSRs be enrolled in a plan variation that reduces cost-sharing requirements. Because overall consumer spending is reduced, insurer spending must increase in order to pay for the covered health services, with the premium staying the same. Under this scenario, the revenue from collected premiums no longer reflects an actuarial estimate of the amount needed to cover expected medical claims. To fully offset this imbalance, the ACA requires the HHS Secretary to provide regular and timely payments to insurers that provide CSRs.

What Is the Status of Funding for the CSR Payments?

The ACA did not provide appropriations for the CSR payments; in the time since the ACA was enacted, neither has Congress. While the previous and current Administrations have funded the payments through the same source that finances the ACA tax credit, such funding is the subject of a legal challenge. In 2016, the U.S. District Court for the District of Columbia concluded that the payments were unconstitutional, but stayed its decision, allowing the CSR payments to continue for the time being. However, continuation of the payments is not guaranteed. Although legislative ideas have been explored, no bill to fund the CSR payments appears to be currently moving through the legislative process.

What Are the Potential Impacts of Terminating the CSR Payments?

Termination of CSR payments has the potential to affect not only insurers, but also consumers and the federal budget. Without CSR payments, many insurers would face substantial losses. Consequently, insurer reactions may range from exiting the exchanges (per contract language allowing for possible mid-year exit), raising premiums (if allowed in a given state), or not taking any action, with a mix of these options depending on the timing of potential payment termination (current year or for the upcoming benefit year). There are pros and cons for a given insurer with each of these options. Moreover, just the possibility of payment termination has created enough market uncertainty to affect certain insurer decisions.

According to CBO, the impact on consumers may be mixed. While CBO projects silver plan premiums to increase substantially, premiums for other plans were projected to grow with the baseline in later years. Moreover, the number of uninsured individuals was projected to be higher in 2018 compared to baseline estimates, but lower after a few years compared to the same baseline. CBO also projected that the federal deficit would increase. Because the formula for calculating the ACA tax credit is based on silver plan premiums, an increase in such premiums would result in larger federal outlays. Also, CBO projected that more individuals would receive premium tax credits, which would contribute to an increase in federal spending.