The Heritage Foundation

ISSUE BRIEF

No. 4685 | APRIL 18, 2017

Addressing Pre-Existing Conditions and Encouraging Continuous Coverage

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Americans are understandably concerned that they have access to health insurance and not be turned away because of a pre-existing medical condition. However, to sustain a health insurance market that can meet the needs of all Americans, including those with pre-existing conditions, health insurance rules must be crafted in a way that encourages individuals not only to get, but also to maintain coverage.

Unfortunately, the drafters of Obamacare took the wrong approach by writing their ban on exclusions for pre-existing conditions in a way that removed an important incentive for people to keep health insurance coverage during periods when they do not need medical care. Yet insurance cannot function if people can buy it only when they expect to file claims. Under such circumstances, premium revenues will be insufficient to offset claims costs—exactly what has happened under Obamacare.

Thus, a key element in stabilizing the individual health insurance market and repairing the damage caused by Obamacare is for Congress to set better rules around the prohibition on plans imposing pre-existing condition exclusions. The rules that Congress set for employer group coverage under a 1996 law, the bipartisan Health Insurance Portability and Accountability Act (HIPAA), provide the model for how Congress can correct Obamacare's mistake.

The Importance of Continuous Coverage

Health insurance is commonly understood as pooling risks *across a group* of people—that is, the premiums paid by the healthy offset the claims incurred by the sick. Another, though often unrecognized essential component of health insurance is that it also spreads risks *over time*. In other words, if an individual regularly pays premiums year after year, in the long run, most (or possibly all) of his claims costs will be covered by the premiums that he himself has paid.

All forms of insurance spread risks both over groups and over time to varying degrees, depending on the risk being insured. Life insurance offers the clearest example of how time can be an important factor in insurance calculations. Because all life insurance policyholders will eventually die, life insurance relies more on spreading risk over time than do other forms of insurance.

In the case of health insurance, it is important to have incentives for individuals to maintain continuous coverage, because the more claims costs that insurers can spread over time, the smaller the share that they will need to spread across enrollees. The result is a more stable market with more stable premiums.

The implication for policymakers is that they need to focus less on getting people to obtain coverage and more on getting them to keep paying for coverage when they do not immediately need medical care. If people have incentives to keep paying premiums when they are healthy, those same incentives will also encourage them to buy coverage in the first place.

This paper, in its entirety, can be found at **http://report.heritage.org/ib4685**

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How Obamacare Detracted from Continuous Coverage

Understanding the importance of the concept of continuous coverage is key to recognizing one of Obamacare's biggest mistakes and how Congress can now correct it.

Obamacare failed to link the prohibition on health plans applying pre-existing condition exclusions *directly* to a requirement that individuals maintain continuous coverage. Thus, it destabilized the market by enabling (and even encouraging) individuals to pay for coverage only when they expected to incur claims. The resulting imbalance between premiums and claims costs is one of the two biggest causes of escalating premiums under Obamacare.[1]

The architects of Obamacare thought that they could avoid those adverse effects by instead offering subsidies to lower-income individuals and imposing a mandate on all Americans to buy coverage. However, as is now clear from the experience with Obamacare, that approach failed in practice.

How Congress Can Address Pre-existing Conditions and Encourage Continuous Coverage

Not only can Congress correct those Obamacare mistakes, but it already has the template for how to do so: the earlier HIPAA rules that limited the application of pre-existing condition exclusions in employer group coverage.[2] Established 15 years before Obamacare, those rules applied to the 90 percent of Americans with private health insurance covered by employer group plans.

The HIPAA rules specified that pre-existing condition exclusions could not be applied to an individual enrolling in an employer plan if the individual had at least 12 months of prior coverage with no gap in coverage longer than 63 days.[3]

Furthermore, the HIPAA group market rules set reasonable and fair parameters for individuals who lacked sufficient prior coverage. They specified that a pre-existing condition exclusion could not be applied for more than 12 months and that if the individual had periods of coverage during the prior 12 months, the length of the pre-existing condition exclusion period had to be further reduced to give the individual credit for that partial coverage.

Thus, under the HIPAA group market rules, pre-existing-condition exclusions could be applied—and only on a limited basis—only to those who were without prior coverage or who waited until they needed medical care to enroll in their employer's plan.

The HIPAA rules offered a fair approach and struck a reasonable balance between the individual's need to get or change coverage and the insurer's need to have enrollees consistently paying premiums over time. Under those rules, individuals who get and maintain coverage are rewarded, while individuals who wait until they are sick to get coverage risk having to pay for their own care for a limited time.

The problem with HIPAA was that it did not apply the same kind of rules to the individual (non-group) market. Thus, an individual could have purchased non-group health insurance for many years but still face pre-existing condition exclusions when he needed or wanted to enroll in another plan. Therefore, responsible people with individual market coverage were effectively not being given credit for having done the right thing in buying and maintaining coverage. This structure was not only unfair, but also contrary to the objectives of encouraging people to buy coverage before they need it and keep paying premiums when they are healthy.

The obvious, modest, and sensible reform is for Congress to restore the HIPAA rules that governed the employer group market before the enactment of Obamacare and in the process also apply a similar set of rules to the individual health insurance market.

1. The other big driver of higher premiums is the law's benefit mandates. See Edmund F. Haislmaier and Drew Gonshorowski, "Responding to *King v. Burwell*: Congress's First Step Should Be to Remove Costly Mandates Driving Up Premiums," Heritage Foundation *Issue Brief* No. 4400, May 4, 2015, http://www.heritage.org/health-care-reform/report/responding-king-v-burwell-congresss-first-step-should-be-remove-costly.
2. Health Insurance Portability and Accountability Act of 1996, P.L. 104-191.
3. The HIPAA rules also specified that pre-existing condition exclusions could not be applied to newborn or adopted dependents; that a pre-existing condition exclusion could be applied only with respect to a condition for which the individual was treated within the prior 12 months; and that only actual treatment—not a diagnosis or genetic test—could be the basis for a pre-existing condition exclusion. For a more comprehensive discussion of these and other insurance market provisions of HIPAA, see Edmund F. Haislmaier, "Saving the American Dream: The U.S. Needs Commonsense Health Insurance Reforms," Heritage Foundation *Backgrounder* No. 2703, June 22, 2012, http://www.heritage.org/research/reports/2012/06/saving-the-american-dream-the-us-needs-commonsense-health-insurance-reforms.

Continuous Coverage Provisions of the American Health Care Act

Rather than restoring the HIPAA group market rules and expanding them to the individual market, the American Health Care Act (AHCA) under consideration in the House of Representatives leaves in place the Obamacare rules but adds a provision for insurers to impose a one-year, 30 percent premium surcharge on applicants with fewer than 12 months of prior coverage.

That particular remedy is likely to be inadequate. The concern shared by the Congressional Budget Office and the Joint Committee on Taxation,[4] as well as by insurance industry experts, is that the premium surcharge approach in the AHCA might prove to be an insufficient inducement for healthier individuals to maintain coverage. The most effective solution would be for Congress instead to reinstate and extend the HIPAA rules that explicitly link the prohibition on applying pre-existing condition exclusions to a requirement that individuals maintain continuous coverage.

Conclusion

Americans are concerned about individuals with pre-existing conditions being denied health insurance—and understandably so. To ensure that individuals with pre-existing conditions are able to get coverage and at the same time maintain the stability in the market needed to make that coverage accessible, policymakers should link the ban on exclusions for pre-existing conditions to a requirement of continuous coverage. Having the right parameters in place is essential both to ensuring that insurance markets can function and to avoiding the premium escalation experienced under Obamacare. This approach is compassionate, is fair, and encourages people to do the right thing.

As Members of Congress debate repealing and replacing Obamacare, they should learn from the failures of that law in crafting a better set of health care policies. One important step in that crafting is the establishment of a fairer and more reasonable set of rules for limiting health plans' application of pre-existing condition exclusions. Setting the right rules around the prohibition on plans applying pre-existing condition exclusions will not only stabilize insurance markets, but also provide a firmer foundation for future reforms of other aspects of health care policy.

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4. Congressional Budget Office, "American Health Care Act: Budget Reconciliation Recommendations of the House Committees on Ways and Means and Energy and Commerce, March 9, 2017," Congressional Budget Office *Cost Estimate*, March 13, 2017, p. 12, https://www.cbo.gov/system/files/115th-congress-2017-2018/costestimate/americanhealthcareact.pdf (accessed April 12, 2017).