

No. 14-1158

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**United States Court of Appeals for the Fourth Circuit**

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DAVID KING, et al.,

*Plaintiffs-Appellants,*

v.

KATHLEEN SEBELIUS,  
Secretary of Health and Human Services, et al.,

*Defendants-Appellees,*

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**BRIEF OF AMERICA'S HEALTH INSURANCE PLANS  
AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS-  
APPELLEES AND AFFIRMANCE**

\_\_\_\_\_  
On Appeal from the United States District Court for the  
Eastern District of Virginia, No. 3:13-CV-630  
\_\_\_\_\_

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## **RULE 26.1 CORPORATE DISCLOSURE STATEMENT**

America's Health Insurance Plans (AHIP) is the national trade association representing the health insurance industry. AHIP has no parent company and no publicly-held company has a 10% or greater ownership interest.

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**STATEMENT OF IDENTITY, INTEREST IN CASE, AND  
SOURCE OF AUTHORITY TO FILE<sup>1</sup>**

America's Health Insurance Plans ("AHIP") is the national trade association representing the health insurance industry. Along with its predecessors, AHIP has over fifty years of experience in the health insurance industry. AHIP's members provide health and supplemental benefits to more than 200 million Americans, offering a wide range of insurance options to consumers, employers of all sizes, and governmental purchasers. As a result, AHIP's members have broad experience working with hospitals, physicians, patients, employers, state governments, the federal government, pharmaceutical and device companies, and other healthcare stakeholders to ensure that patients have access to needed treatments and medical services. That experience gives AHIP extensive first-hand and historical knowledge about the Nation's healthcare and health insurance systems and a unique understanding of how those systems work.

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<sup>1</sup> All parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person other than the amicus curiae, its members, or its counsel contributed money that was intended to fund the preparation or submission of this brief. See Fed. R. App. P. 29(c)(5).

Health insurance plans are among the entities most directly and extensively regulated by the Patient Protection and Affordable Care Act, Pub. L. No. 111–148, 124 Stat. 119 (2010), amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111–152, 124 Stat. 1029 (“ACA”). AHIP has participated as *amicus curiae* in other cases to explain the practical operation of the ACA.<sup>2</sup> Likewise here, because other briefs address the legal standards applicable to this appeal, AHIP seeks to provide the Court with its expertise regarding the operation of the health insurance market, the changes made by the ACA, and the consequences that would follow from precluding access to the ACA’s premium assistance tax credits in the 34 States in which consumers purchase individual insurance through a federally facilitated exchange (“FFE”). This perspective will provide the Court with a more detailed understanding of the practical consequences of the construction of the statute urged by Appellants and their *amici*.

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<sup>2</sup> Brief of AHIP and Blue Cross Blue Shield Ass’n as *Amici Curiae* on Severability 27–33, *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012) (No. 11–393), 2012 WL 72449; Brief for AHIP as *Amicus Curiae* in Support of Neither Party, *Virginia ex rel. Cuccinelli v. Sebelius*, 656 F.3d 253 (4th Cir. 2011) (No. 11–1057), 2011 WL 795219.

## INTRODUCTION AND SUMMARY OF ARGUMENT

The Affordable Care Act fundamentally changed our Nation's system of health insurance. The individual health insurance market prior to the ACA—other than in the few States that had implemented their own variants of healthcare reform—was based on individualized assessments of risk. Consumers seeking individual health insurance—like consumers purchasing life insurance and auto insurance—shopped for and purchased insurance policies with availability, scope of coverage, and price determined on the basis of the consumer's own personal circumstances.

The ACA employed three types of reforms to accomplish its goal of making quality, affordable health insurance available to more Americans: (1) insurance market reforms, including “guaranteed issue” (which means that no one can be denied insurance based on individual characteristics, including pre-existing health conditions), “adjusted community rating” (which means that premiums may vary based only on age, geography, family size, and tobacco use), and minimum coverage requirements (which mandate that policies at least provide specified types of coverage); (2) personal responsibility for obtaining health

insurance, reinforced by a tax penalty when individuals fail to obtain minimum essential insurance coverage (the “shared responsibility requirement”); and (3) premium tax credits to make the mandated coverage affordable for low- and middle-income individuals and families.

These three elements work together to create a viable insurance market based on broad consumer participation. Because the market reforms effectively eliminate risk-based underwriting based on the individual consumer’s characteristics, risk must be spread across a demographically-balanced pool of insureds, particularly individuals of different ages who are likely to incur different levels of medical expenses.

Without the shared responsibility requirement (which increases the cost of remaining uninsured) and the premium tax credits (which make it easier for many individuals to obtain insurance), only those who expect to incur substantial healthcare costs would participate in the individual market, which would in turn push up the average medical cost incurred by that pool of insureds, leading to a so-called “death spiral” of premium increases and market contraction. If the shared

responsibility requirement and premium tax credits did not work hand-in-hand with the market reforms, the ACA's reforms would lead to unstable markets in the 34 States with federally-facilitated exchanges.

This phenomenon, known as “adverse selection,” is well recognized in the literature and features prominently in the analysis of the ACA by the American Academy of Actuaries. It occurred in conjunction with a series of failed pre-ACA health insurance reform efforts in the States (described *infra* at 12–14), which demonstrate that when market reforms are enacted without a shared responsibility requirement or tax incentives, the result is an ever-shrinking market in which only the very sick ultimately find it advantageous to purchase health insurance.

Premium tax credits (and the related shared responsibility payments) are thus essential components of an actuarially-viable marketplace because of their integral relationship to the ACA's market reforms. And there is no practical reason to distinguish between State- and federally-operated exchanges in this regard. The ACA's shared responsibility obligation and eligibility for premium assistance tax credits are governed by nationally-established standards with payment from the federal treasury, regardless of which sovereign administers the

particular exchange. It makes no difference to the market reforms whether the exchange is State- or federally-operated. Likewise from the perspective of consumers, State- and federally-operated exchanges perform the same basic functions—facilitating the comparison of plan choices, the determination of eligibility, and the enrollment process.

Delinking the three integrated components of the ACA's reform package in States with federally-facilitated insurance exchanges would create severely dysfunctional insurance markets in those 34 States, significantly disadvantaging millions of consumers in those States. Far beyond the question of whether certain individuals could obtain subsidies on their premiums, the lack of tax credits in the FFEs would alter the fundamental dynamics of those markets in a manner that would make insurance significantly less affordable even to those who would not rely on subsidies. It would leave consumers in those States with an unstable market and far higher costs.

## ARGUMENT

### **PREMIUM ASSISTANCE TAX CREDITS IN FEDERALLY FACILITATED EXCHANGES ARE AN ESSENTIAL SAFEGUARD AGAINST THE DESTABILIZATION AND FAILURE OF THESE INSURANCE MARKETS.**

The Affordable Care Act employs three integrated reforms to create a new framework for the individual health insurance marketplace—standards governing availability, coverage, and pricing of insurance (the “market reforms”); shared responsibility payments; and premium tax credits to help low- and middle-income individuals purchase insurance policies. *See infra* Section A. Severing the shared responsibility payments and the tax credits from the market reforms in the States with FFEs would prevent the creation of the balanced risk pools that are essential for the proper functioning of these markets.

Young and healthy individuals would opt out of the exchanges and millions of low- and middle-income families would become exempt from the ACA’s shared responsibility payments. The resulting individual health insurance markets would be unstable in the 34 States with



FFEs,<sup>3</sup> producing a deleterious impact on the residents of those States.

*See infra* Section B.<sup>4</sup>

**A. The Shared Responsibility Payments And Premium Tax Credits Are Essential To Create The Broad Risk Pools Needed For Proper Functioning Of The Market Reforms.**

The Affordable Care Act took a comprehensive approach to reform. Recognizing the key elements of a well-functioning insurance market—and the critical importance of a balanced risk pool—the statute pairs reforms that increase availability of health insurance and decrease disparities in premiums with tax credits and a financial penalty for failing to purchase insurance, a combination essential to produce well-functioning markets.

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<sup>3</sup> Those States are Alabama, Alaska, Arizona, Arkansas, Delaware, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Michigan, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, Wisconsin, and Wyoming.

<sup>4</sup> There are three primary markets for health insurance: large group, small group, and individual (sometimes called nongroup). *See* 42 U.S.C. § 18024(a). The tax credits at issue in this case apply only to the individual market. *See* 26 U.S.C. § 36B(b)(2)(A).

1. **A balanced risk pool is essential for a stable health insurance marketplace.**

Like all forms of insurance, health insurance is based on the pooling and transfer of risks. Individuals' future healthcare expenses are unpredictable; the purpose of insurance is to transfer from the individual to the insurer the risk of an unanticipated and unaffordable spike in medical costs. An insurer aggregates risk into a larger pool and spreads that risk by setting premiums that reflect the average risk in the pool.

Prior to the enactment of the ACA, insurers had to employ a number of tools to prevent development of unbalanced risk pools in the individual insurance market. In particular, applicants were “underwritten to determine their insurability, and \* \* \* charged higher or lower premiums based on age and health status.”<sup>5</sup>

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<sup>5</sup> Nat'l Ass'n of Ins. Comm'rs, *Adverse Selection Issues and Health Insurance Exchanges Under the Affordable Care Act* 1 (2011), <http://www.naic.org/store/free/ASE-OP.pdf>; see also Kathryn Linehan, *Underwriting in the Non-Group Health Insurance Market: The Fundamentals* 4–6 (Nat'l Health Pol'y Forum Background Paper No. 69, 2009), [http://www.nhpf.org/library/background-papers/BP69\\_UnderwritingNonGroup\\_06-04-09.pdf](http://www.nhpf.org/library/background-papers/BP69_UnderwritingNonGroup_06-04-09.pdf).

When individuals' premiums for health insurance *do not* reflect such risk-based underwriting, the economic phenomenon of "adverse selection" is likely to occur.<sup>6</sup> As the ACA's statutory findings explain, if individuals are guaranteed that they will be able to purchase insurance at a set price, many will "wait to purchase health insurance until they need[] care." 42 U.S.C. § 18091(2)(I).

The consequences of adverse selection are extremely significant. "When healthier individuals perceive no economic benefit to purchasing coverage, the insurance pool becomes increasingly skewed to those with higher expected claims."<sup>7</sup> Because premiums are a function of the average expected payout of benefits to pool participants, an upward shift in the risk profile of the pool will lead to increased premiums for all participants in that pool.<sup>8</sup>

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<sup>6</sup> See Linehan, *supra* note 5, at 4.

<sup>7</sup> See Am. Academy of Actuaries, *Critical Issues in Health Reform: Risk Pooling* 1 (July 2009), [http://www.actuary.org/pdf/health/pool\\_july09.pdf](http://www.actuary.org/pdf/health/pool_july09.pdf).

<sup>8</sup> See Linda J. Blumberg & John Holahan, *Do Individual Mandates Matter?* 2 (Urban Inst. 2008), [http://www.urban.org/UploadedPDF/411603\\_individual\\_mandates.pdf](http://www.urban.org/UploadedPDF/411603_individual_mandates.pdf).

Left unaddressed, adverse selection will destabilize insurance markets in an adverse-selection “death spiral.” When healthy individuals opt out of the individual insurance market, those who are left are, on average, less healthy (and therefore prone to higher-than-average medical expenses). A sicker pool of consumers results in higher premiums, which causes an additional relatively healthy subset of participants to drop out, which in turn results in a further increase in premiums.<sup>9</sup>

This effect is particularly pronounced for health insurance, because the individuals who know that they will require substantial amounts of medical care—*i.e.*, those who are most likely to benefit from risk-sharing and most likely to seek insurance—have much greater medical costs. Just 5% of the population accounts for 49% of medical spending while 50% of the population accounts for only 3%.<sup>10</sup>

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<sup>9</sup> Katherine Swartz, *Sharing Risks, How Government Can Make Health Insurance Markets More Efficient and More Affordable*, in *THE ECONOMICS OF RISK* 117 (Donald J. Meyer, ed., 2003); see also Am. Academy of Actuaries, *Critical Issues in Health Reform: Market Reform Principles* (2009), [http://www.actuary.org/pdf/health/market\\_reform\\_may09.pdf](http://www.actuary.org/pdf/health/market_reform_may09.pdf).

<sup>10</sup> Mark W. Stanton, *The High Concentration of U.S. Health Care Expenditures* 2–3 (Agency for Healthcare Research & Quality Pub. No. (footnote continued)

The perils of adverse selection are not merely theoretical. History shows that market reforms implemented without requiring that individuals purchase insurance or pay a penalty and without premium subsidies produce adverse selection. Thus, prior reforms in Kentucky, Maine, Massachusetts, New Hampshire, New Jersey, New York, Vermont, and Washington that prohibited risk-based underwriting but did not require the purchase of insurance or provide other significant incentives for obtaining insurance resulted in markets with “death spiral” characteristics.<sup>11</sup>

In Washington, for example, the Legislature reformed the individual health insurance market in 1993 to guarantee that residents could purchase insurance based on community—and not individual—rates.<sup>12</sup> During the first three years, premiums in Washington’s

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06-0060, 2006), <http://www.ahrq.gov/research/findings/factsheets/costs/expriach/expandria.pdf>.

<sup>11</sup> See Brief of AHIP and Blue Cross Blue Shield Ass’n as *Amici Curiae*, *supra* note 2, at 27–33. Although Massachusetts is recognized as a model for the Affordable Care Act, there was a prior, failed reform attempt dating to 1996. *Id.* at 31–32.

<sup>12</sup> Adele M. Kirk, *Riding the Bull: Experience With Individual Market Reform in Washington, Kentucky, and Massachusetts*, 25 J. HEALTH POLITICS, POLICY & LAW 133, 136–37 (2000).

individual health-insurance market increased by 78 percent.<sup>13</sup> Enrollment fell by 25 percent.<sup>14</sup> By September 1999—six years after the reforms had been introduced—all but 2 of the State’s 19 private health insurers had withdrawn from the market, and the last 2 had announced their intention to withdraw. “[T]he individual market had essentially collapsed.”<sup>15</sup> Washington repealed the market reforms in 2001.<sup>16</sup>

New York experienced a similar dynamic. In 1992, the Legislature reformed the health-insurance market by guaranteeing the issuance of insurance at community-based rates. These reforms prompted a “sharp decline” of the individual insurance market.<sup>17</sup> In

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<sup>13</sup> See Peter Suderman, *The Lesson of State Health-Care Reforms*, WALL ST. J., Oct. 15, 2009, at A21.

<sup>14</sup> Roger Stark, *Overview of the Individual Health Insurance Market in Washington State* 1 (Wash. Pol’y Ctr. Jan. 2011).

<sup>15</sup> *Id.*; see also Conrad F. Meier, *Universal Health Insurance in Washington State: A Grim Prognosis for All of Us*, Medical Sentinel (Mar./Apr. 2000).

<sup>16</sup> See Jill Bernstein, *Issue Brief: Recognizing Destabilization in the Individual Health Insurance Market* 4 (Robert Wood Johnson Foundation July 2010).

<sup>17</sup> Paul Howard, *Building a Market-Based Health-Insurance Exchange in New York* 7 (Ctr. for Med. Progress 2011),

(footnote continued)

1992, 1.2 million New Yorkers purchased individual insurance policies.<sup>18</sup> But premiums had increased 35–40% by 1996.<sup>19</sup> By 2010, only 31,000 New Yorkers remained in the individual insurance market—a decrease of 97%.<sup>20</sup> At that point, the only people who participated in the market were those who were “very sick (and affluent).”<sup>21</sup>

**2. The Affordable Care Act’s reforms include features critical to promoting market stability.**

The Affordable Care Act imposed nationwide minimum standards governing availability, coverage scope, and pricing of individual policies, which bar insurers from using the tools that they previously had employed to manage and price their risks and to ensure market stability. To prevent market destabilization, the ACA coupled those

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<http://nyshealthfoundation.org/uploads/resources/market-based-health-insurance-exchange-april-2011.pdf>.

<sup>18</sup> See Sarah Lyall, *Bill to Overhaul Health Insurance Passes in Albany*, N.Y. TIMES, July 2, 1992, at A1.

<sup>19</sup> Stephen T. Parente & Tarren Bragdon, *Why Health Care Is So Expensive in New York*, WALL ST. J., Oct. 16, 2009.

<sup>20</sup> *Id.*

<sup>21</sup> Howard, *supra* note 17, at 7.

changes with new measures designed to promote balanced risk pools and to deter adverse selection.

Those changes—the prohibition of prior tools used to manage risk pools and the adoption of shared responsibility payments and tax credits—constitute a single integrated package. None of the reforms, standing alone, would result in a healthy and sustainable marketplace for insurance. Rather, as a prominent scholar in healthcare economics explained at the time, the exchanges were built on “a three-legged stool that is useless without all three legs.”<sup>22</sup>

**a. Insurance market reforms**

The ACA contains one set of reforms that significantly alters relationships between insurers and consumers. These reforms ensure that all individuals have access to health insurance for which premiums are assessed at the *community*-level rather than based on *individual* risk factors.

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<sup>22</sup> Uwe E. Reinhardt, *Lost in the Shuffle: The Overarching Goals of Health Reform*, N.Y. TIMES ECONOMIX BLOG (Aug. 7, 2009), <http://economix.blogs.nytimes.com/2009/08/07/lost-in-the-shuffle-the-overarching-goals-of-health-reform>).



Guaranteed issue. The ACA provides that “each health insurance issuer \* \* \* must accept every \* \* \* individual in the State that applies for such coverage.” 42 U.S.C. § 300gg–1. Prior to the ACA, insurers were able to construct risk pools that included only individuals with characteristics specified by the insurer. Thus, individuals who were previously deemed uninsurable based on their individual characteristics (e.g., pre-existing conditions) are guaranteed to be issued healthcare coverage. *See also* 42 U.S.C. § 300gg–4 (prohibiting eligibility rules based on enumerated “health status-related factors”).

Adjusted community rating. The ACA changed the methodology for calculating premiums. Prior to the ACA, premiums could be calculated on the basis of a variety of factors, including gender (with younger females paying more than younger males<sup>23</sup>), age (with older tiers of Americans paying more than younger tiers<sup>24</sup>), and personal health histories. Under the ACA, only four factors may be considered:

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<sup>23</sup> Robert Pear, *Gender Gap Persists in Cost of Health Insurance*, N.Y. TIMES, Mar. 19, 2012.

<sup>24</sup> Robert Wood Johnson Foundation, *Implications of Limited Age Rating Bands Under the Affordable Care Act* 1 (2013), [http://www.rwjf.org/content/dam/farm/reports/issue\\_briefs/2013/rwjf404637/subassets/rwjf404637\\_1](http://www.rwjf.org/content/dam/farm/reports/issue_briefs/2013/rwjf404637/subassets/rwjf404637_1).

(1) whether a plan covers an individual or a family; (2) the geographical area; (3) the consumer's age; and (4) tobacco use. 42 U.S.C. § 300gg(a)(1)(A). The ACA caps age-based variations by a 3-to-1 ratio. See 42 U.S.C. § 300gg(a)(1)(A)(iii). As a result, health insurance is relatively more affordable for older Americans, but relatively more expensive for younger Americans. Likewise, premiums for younger males have become relatively more expensive and premiums for younger females have become relatively less expensive.

Prohibition on pre-existing medical condition exclusions. The ACA prohibits insurers from excluding pre-existing medical conditions or imposing a waiting period before their coverage. 42 U.S.C. § 300gg–3. Prior to the ACA, insurers mitigated risk in the individual market by issuing policies that excluded coverage for pre-existing medical conditions, either temporarily or permanently.<sup>25</sup> Therefore, persons with pre-existing medical conditions now have greater incentives to participate in the healthcare exchanges.

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<sup>25</sup> See Henry J. Kaiser Family Foundation, *Health Insurance Market Reforms: Pre-Existing Condition Exclusions* (Sept. 2012), <http://kaiserfamilyfoundation.files.wordpress.com/2013/01/8356.pdf>.

Minimum coverage requirements. The ACA requires individual insurance plans to offer government-specified “essential health benefits,” which include items and services in ten categories: ambulatory patient services; emergency services; hospitalization; maternity and newborn care; mental health and substance use disorder services, including behavioral health treatment; prescription drugs; rehabilitative and habilitative services and devices; laboratory services; preventive and wellness services and chronic disease management; and pediatric services, including oral and vision care. 42 U.S.C. §§ 300gg–6, 18022. These policies must cover at least 60 percent of anticipated medical expenses (known as actuarial value) with statutorily-determined ceilings on out-of-pocket payments by consumers. Before the statute’s enactment, consumers could purchase policies tailored to their limited needs. As a result of the minimum coverage requirements and the minimum actuarial value requirements, previously popular low-premium, less comprehensive policies are unavailable under the ACA.<sup>26</sup>

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<sup>26</sup> See also 42 U.S.C. § 18022(d)(2) (prescribing requirements for actuarial value). Individuals are eligible to enroll in an insurance plan with a higher deductible (that therefore has a lower actuarial value) if

(footnote continued)

**b. Reforms to create a balanced risk pool**

If enacted by themselves, the insurance market reforms would have produced unstable insurance exchanges. Indeed, the ACA expressly acknowledges that many individuals—knowing that they could not be refused coverage—“would wait to purchase health insurance until they needed care.” 42 U.S.C. § 18091(2)(I). Individuals could have purchased health insurance on the way to the hospital emergency room, the equivalent of purchasing auto insurance after an accident. A well-functioning insurance pool must include low-risk individuals to balance the medical costs of high-risk individuals, but the insurance market reforms, standing alone, would attract high-risk individuals and deter participation by low-risk individuals.

Healthy and young Americans, who traditionally have opted-out of the insurance market at disproportionate rates,<sup>27</sup> face increased

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they are younger than 30 years old or are exempt from shared responsibility payments. *Id.* § 18022(e).

<sup>27</sup> Christina Postolowski & Abigail Newcomer, *Helping Students Understand Health Care Reform and Enroll in Health Insurance* (2013), [http://health.younginvincibles.org/wp-content/uploads/2013/09/ACA-Toolkit\\_Helping-Students-Understand-Health-Care-Reform-and-Enroll-in-Health-Insurance.pdf](http://health.younginvincibles.org/wp-content/uploads/2013/09/ACA-Toolkit_Helping-Students-Understand-Health-Care-Reform-and-Enroll-in-Health-Insurance.pdf) (“Young adults ages 18 to 34 are uninsured at almost double the rate of older adults.”).

premiums compared to premiums in the pre-ACA insurance markets as a result of community rating. And persons with chronic pre-existing conditions who otherwise might have been uninsurable are now eligible for insurance at the same premiums as persons in good health. The ACA includes incentives for obtaining insurance (and disincentives for declining to carry insurance) that collectively “minimize this adverse selection and broaden the health insurance risk pool to include healthy individuals.” 42 U.S.C. § 18091(2)(I).

Shared responsibility payment obligation. To maximize the number of younger and healthier individuals who participate in the market for individual health insurance, the ACA requires individuals to obtain minimum essential healthcare coverage or to make a shared responsibility payment through the tax system. Those payments—which vary based on an individual’s household income—create additional costs for those who might otherwise choose not to enroll in healthcare insurance coverage.<sup>28</sup>

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<sup>28</sup> After a phase-in period that ends in 2016, persons who fail to carry minimum essential coverage will owe an annual tax equal to the greater of \$695 or 2.5% of household income in excess of the IRS’s threshold for filing a tax return (\$10,150 for an individual for tax year

(footnote continued)

Premium tax credits. The ACA pairs the shared responsibility payment obligation with a system of premium tax credits for low- and middle-income Americans. Just as the penalty for nonparticipation imposes a cost on those who opt out of health insurance, tax credits make it easier for these individuals to purchase insurance in the individual health insurance marketplace—and thereby provide an incentive for participation.

The tax credits were intended to affect the cost-benefit calculus for a large number of Americans. Prior to passage of the ACA, the Congressional Budget Office estimated that the vast majority of all exchange enrollees—78%—would be entitled to premium assistance tax credits.<sup>29</sup> The early experience in the Exchanges has corroborated those estimates, with 82% of enrollees claiming subsidies.<sup>30</sup>

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2014). See 26 U.S.C. §§ 5000A, 6012(a)(1)(A)(i); Rev. Proc. 2013–35, 2013–47 I.R.B. 537.

<sup>29</sup> See Congressional Budget Office, *An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act* 24 (Nov. 30, 2009) (JA90).

<sup>30</sup> See ASPE Issue Brief, *Health Insurance Marketplace: February Enrollment Report* 4 (Feb. 12, 2014), [http://aspe.hhs.gov/health/reports/2014/MarketPlaceEnrollment/Feb2014/ib\\_2014feb\\_enrollment.pdf](http://aspe.hhs.gov/health/reports/2014/MarketPlaceEnrollment/Feb2014/ib_2014feb_enrollment.pdf).

These credits play an especially important role because the ACA's minimum coverage requirements, minimum actuarial value requirements, new premium taxes,<sup>31</sup> and new adjusted community rating rules make unavailable less-costly insurance that was purchased by many consumers prior to enactment of the reform law. To encourage the purchase of insurance, the tax credits were calibrated to offset the additional costs resulting from these new requirements. The credits also address the tax disadvantage suffered by individuals and families who purchase insurance on their own, and therefore do not receive the tax preference accorded to employer-based coverage.<sup>32</sup>

The statute provides that individuals with household incomes less than 400% of the federal poverty limit (in 2014, \$46,680 for an individual or \$95,400 for a family of four<sup>33</sup>) are entitled to tax credits (26 U.S.C. § 36B) that immediately reduce their premiums for health insurance purchased through an exchange (42 U.S.C. § 18082(c)(2)).

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<sup>31</sup> *See, e.g.*, 42 U.S.C. § 18061; 26 U.S.C. note preceding § 4001;

<sup>32</sup> *See* 26 U.S.C. § 106(a) (excluding employer-provided health plans from gross income).

<sup>33</sup> *See* Annual Update of HHS Poverty Guidelines, 79 Fed. Reg. 3593 (Jan. 22, 2014).

By making insurance with the new, statutorily-mandated scope of coverage less expensive, the credits tilt a rational consumer's cost-benefit calculation in favor of purchasing insurance. That is particularly true for young and healthy individuals who otherwise might not perceive a sufficient economic benefit. The tax credits can be substantial—they are expected to average \$4,700 in 2014.<sup>34</sup> For many consumers, that tax credit is sufficient to pay 100 percent of premiums.<sup>35</sup>

Moreover, the tax credits work in tandem with the shared responsibility payment obligation. That is because no payment obligation attaches when insurance cost would exceed 8% of household income after government contributions (26 U.S.C. § 5000A(e)(1)). In the absence of the tax credits, a large portion of the population would fall within that exempt category, because there would be no tax credits

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<sup>34</sup> See Congressional Budget Office, *The Budget and Economic Outlook: 2014 to 2024*, at 108 tbl. B–2 (2014), <http://www.cbo.gov/sites/default/files/cbofiles/attachments/45010-Outlook2014.pdf>.

<sup>35</sup> See Henry J. Kaiser Family Foundation, *State-by-State Estimates of the Number of People Eligible for Premium Tax Credits Under the Affordable Care Act* (2013), <http://kff.org/health-reform/issue-brief/state-by-state-estimates-of-the-number-of-people-eligible-for-premium-tax-credits-under-the-affordable-care-act>.



to reduce the insurance cost to the 8%-or-below level.<sup>36</sup> That would significantly undermine the incentive structure provided by the shared responsibility payments and the tax credits, which is necessary to achieve broad participation and balanced risk pools in the individual insurance markets.

\* \* \*

In sum, the ACA took away certain tools for managing risk but introduced new mechanisms for assuring a stable risk pool by keeping adverse selection in check. The tax credits and the shared responsibility payments are essential components of a sustainable private market for insurance.

**B. If Tax Credits Were Unavailable In Federally Facilitated Exchanges, The Risk Pool Would Skew Significantly Toward High-Risk Individuals.**

Eliminating premium assistance tax credits for participants in the federally-facilitated exchanges (“FFE’s”) would undermine the ACA’s

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<sup>36</sup> The tax credits are also tied to the so-called “employer mandate” as well. See 26 U.S.C. § 4980H(b) (imposing shared responsibility payment of \$3,000 per year for large employers for each employee who receives a tax credit). Although beyond the scope of this brief, the link between tax credits and the health-insurance incentives for large employers underscores the interconnected nature of the ACA’s reforms.

central goal of achieving stable insurance markets based on a broad risk pool containing an appropriate mix of low-risk and high-risk individuals.

The 34 States in which the exchange is facilitated by the federal government contain 56% of those projected nationwide to enroll in health insurance through an exchange.<sup>37</sup> If tax credits were unavailable in those States, the integrated and essential companions to the market reforms would not work as designed—the incentives to purchase insurance (the tax credits) would disappear and the disincentives to remaining uninsured (the shared responsibility payments) would be eroded significantly; those changes inevitably would trigger adverse selection and instability in the exchanges.

1. **The elimination of tax credits would disproportionately deter participation of those consumers needed to create a balanced risk pool.**

The most critical element to maintaining the exchanges' stability involves the attributes of those enrolled, not in terms of raw numbers,

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<sup>37</sup> See Memorandum from Marilyn Tavenner, CMS Admin., to Kathleen Sebelius, Sec'y of Health & Human Services, Re: Projected Monthly Enrollment Targets for Health Insurance Marketplaces in 2014 (Sept. 5, 2013), [http://waysandmeans.house.gov/uploadedfiles/enrolltargets\\_09052013\\_.pdf](http://waysandmeans.house.gov/uploadedfiles/enrolltargets_09052013_.pdf).

but in terms of their relative risk characteristics. As explained above, an insurance plan that attracts only unhealthy subscribers will face upward pressure on premiums in a manner that triggers adverse selection and a pattern of premium increases and participant departures leading to substantial instability.

Eliminating premium tax credits for insurance purchased on FFEs will inevitably produce this effect.

A rational consumer deciding whether to purchase health insurance will compare the annual cost of the insurance to his or her expected medical costs. Particularly when the consumer's budget is stretched—as it often is for low- and middle-income families—the consumer will likely be reluctant to purchase insurance unless projected medical expenses exceed premium costs, and the insurance cost is relatively low. Although insurance provides other important benefits—such as the assurance that unexpected medical costs will not lead to bankruptcy—such benefits may be less significant to low- and middle-income families than more immediate necessities.

The cost differential produced by eliminating the tax credits is substantial. For example, in States with FFEs, the tax credits reduce

insurance premiums to less than \$50 per month for 46 percent of uninsured young adults.<sup>38</sup> Without tax credits, the average lowest-cost bronze plan for young adults would cost \$163 per month<sup>39</sup>—a difference of more than \$1,200 per year.

In the absence of the tax credits, therefore, only consumers with significant anticipated medical expenses will conclude that the unsubsidized premium is a justifiable expenditure compared with more immediate and tangible needs. But without a distribution of enrollees with different expected medical expenses, the risk pool will be unbalanced and “death spiral” characteristics will result.

Indeed, an American Academy of Actuaries analysis found that a key factor in preventing premium increases in the exchanges is the availability of premium assistance tax credits to mitigate the effects of adverse selection:

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<sup>38</sup> Laura Skopec & Emily R. Gee, ASPE Research Brief, *Nearly 5 in 10 Uninsured Single Young Adults Eligible for the Health Insurance Marketplace Could Pay \$50 or Less per Month for Coverage in 2014*, at 3 (Oct. 28, 2013), [http://aspe.hhs.gov/health/reports/2013/UninsuredYoungAdults/rb\\_uninsureduyoungadults.pdf](http://aspe.hhs.gov/health/reports/2013/UninsuredYoungAdults/rb_uninsureduyoungadults.pdf).

<sup>39</sup> ASPE Issue Brief, *Health Insurance Marketplace Premiums for 2014*, at 3 (Sept. 2013), [http://aspe.hhs.gov/health/reports/2013/marketplacepremiums/ib\\_marketplace\\_premiums.cfm](http://aspe.hhs.gov/health/reports/2013/marketplacepremiums/ib_marketplace_premiums.cfm).

Changes in overall premium averages will depend on changes in the composition of the risk pool. \* \* \* This in turn will reflect the effectiveness of the individual mandate and premium subsidies designed to increase coverage among young and healthy individuals, combined with the increased ability of high-cost individuals to purchase coverage due to the guaranteed-issue requirement.<sup>40</sup>

2. **The elimination of tax credits in FFEs would restrict applicability of the shared responsibility requirement, substantially eroding its effectiveness in promoting balanced risk pools.**

The elimination of tax credits for insurance purchased on the FFEs would have an additional, extremely important effect: exempting numerous uninsured individuals from the shared responsibility payment obligation, and thereby eliminating that significant incentive for ensuring balanced risk pools.

The shared responsibility payment obligation does not apply to low- and middle-income individuals and families who could not afford coverage. Thus, the obligation to obtain minimum coverage excludes any individual whose “required contribution \* \* \* exceeds 8 percent of

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<sup>40</sup> Am. Academy of Actuaries, Issue Brief, *How Will Premiums Change Under the ACA?* 3 (May 2013), [http://www.actuary.org/files/Premium\\_Change\\_ACA\\_IB\\_FINAL\\_050813.pdf](http://www.actuary.org/files/Premium_Change_ACA_IB_FINAL_050813.pdf).

such individual's household income." 26 U.S.C. § 5000A(e)(1)(A). For persons eligible to purchase insurance only through an exchange, the "required contribution" is the "annual premium for the lowest cost bronze plan available in the individual market[,] \* \* \* reduced by the amount of the credit allowable under section 36B"—a reference to the premium assistance tax credits. *Id.* § 5000A(e)(1)(B)(ii). Because the tax credits are taken into account in calculating the annual premium—reducing the premium amount used in applying the statute's 8% test—they have the effect of increasing significantly the number of consumers subject to the shared responsibility payment obligation.

That statutory linkage between the tax credits and the shared responsibility payment obligation demonstrates that the provisions are designed to work in tandem to ensure broad participation in the health insurance system. Removing the tax credits would vitiate the payment obligation for a substantial number of Americans. When States, prior to the ACA, implemented market reforms without a financial penalty for failing to obtain insurance, the resulting adverse selection spiral produced unstable insurance markets.

The ACA includes two primary countermeasures to market-destabilizing adverse selection: tax credits and the shared responsibility payments. The unavailability of tax credits would significantly undermine both of those tools.

**3. Delinking the tax credits from the integrated reforms would create an unequal system in which residents of FFE states would be relegated to non-functioning marketplaces.**

Delinking the tax credits (and, consequentially, the shared responsibility payments) from the market reforms—which indisputably apply nationwide—would leave residents of the 34 States with FFEs significantly worse off than consumers in States with State-run Exchanges.

*First*, eliminating the tax credits would result in grossly inequitable treatment of consumers in States with FFEs. Those families and individuals would not have the benefit of the tax subsidies available to individual market purchasers in other States with State-based Exchanges (or of the favorable tax treatment available to individuals and families with employer-based coverage). That would make health insurance less affordable—the precise result the tax credits were intended to prevent.

*Second*, eliminating the tax credits would inevitably produce significantly unbalanced risk pools in FFE States, leaving those States with dysfunctional insurance markets. The consumers who purchase insurance in the absence of tax credits and those who purchase insurance when tax credits are available will have markedly different risk profiles. That is what produces the adverse-selection dynamic.

By way of example, consider the economic decision for a hypothetical 27-year-old from Miami-Dade County, Florida who earns \$24,000 per year and seeks coverage on Florida's FFE. That individual would be eligible to purchase a bronze-level plan for \$75 per month (after a tax credit of \$88 per month).<sup>41</sup>

On an annualized basis, the individual's out-of-pocket cost would be \$900.00 (12 monthly premium payments of \$75)—but he or she also would have avoided a shared responsibility payment of \$138.50,<sup>42</sup> which results in an effective economic cost of \$761.50 per year compared to not

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<sup>41</sup> See <https://www.healthcare.gov/find-premium-estimates/#results/&aud=indv&type=med&state=FL&county=Miami-Dade&age0=27&employerCoverage=no&householdSize=1&income=24000>.

<sup>42</sup> The shared responsibility payment in 2014 for an individual earning \$24,000 is the greater of \$95 or 1% of income exceeding \$10,150, which is \$138.50. See *supra* note 28.



obtaining health insurance. In years after 2014, the shared responsibility payment would increase—to \$695 in 2016 for a person earning \$24,000—thereby further reducing the effective economic cost of obtaining insurance. *See* 26 U.S.C. § 5000A.

If tax credits were unavailable, the same individual would have to pay \$163 per month for the same policy and would be exempt from any shared responsibility payment (because the insurance cost would exceed the 8% threshold). Thus, he or she would face a choice between purchasing health insurance and paying a \$1,956 annual premium (12 monthly premium payments of \$163) or not purchasing health insurance and paying no penalty.

With the tax credits, an economically rational individual would acquire health insurance if that individual expected to derive at least \$761.50 per year in economic value from the policy. But if tax credits were unavailable, the individual would acquire health insurance only if he or she expected to derive at least \$1,956 per year in economic value from the policy.

There are marked differences in the risk profiles of those who expect to benefit at least \$761.50 per year and the smaller subgroup of

those who expect to benefit at least \$1,956 per year. This is what produces the adverse-selection dynamic. Only those persons who expected higher medical expenses would opt into the system, which would place upward pressure on premiums and further skew the pool of exchange participants, leading to further increases in premiums and a pool ever-more tilted toward those with higher expected medical expenses.

That same dynamic would play out across different age groups, in different States, and in different low- and middle-income brackets. The ACA's tools for balancing the risk pool would be ineffective, and the consequences would resemble the "death spiral" phenomenon accompanying the failed State reform efforts of the 1990s.

*Third*, eliminating the tax credits in States with FFEs would not just undermine the stability of the FFEs; it also would undermine the market for individual health insurance policies outside the FFE marketplaces.

Insurers may sell individual policies outside the exchanges, but the exchanges and other individual insurance markets are linked through common risk pooling mechanisms, which means that

dysfunctional FFEs will adversely affect the stability of non-exchange individual markets.<sup>43</sup> And insurers that operate both inside and outside the exchanges must “consider all enrollees \* \* \* to be members of a single risk pool.” 42 U.S.C. § 18032(c)(1).

These three significant adverse consequences are fundamentally inconsistent with the goals of the ACA, which was intended to achieve nationwide reform and make stable, functioning insurance markets available to all Americans.

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<sup>43</sup> For example, through the permanent risk adjustment program (42 U.S.C. § 18063), funds from lower risk plans in the individual and small group markets are transferred to higher risk plans, inside and outside the exchange, which means that an imbalance in the exchange also affects the outside market. In addition, a transitional reinsurance program (*id.* § 18061) links the inside and outside markets by providing funding to individual-market plans that enroll the highest cost individuals. And the temporary risk corridor program (*id.* § 18062), limits an insurer’s gains and losses inside and outside the exchanges. *See generally* Centers for Medicare & Medicaid Services, *Reinsurance, Risk Corridors, and Risk Adjustment Final Rule* (2012), <http://www.cms.gov/ccio/resources/files/downloads/3rs-final-rule.pdf>.

The ACA guards against instability in the non-exchange individual markets through the shared responsibility payment obligation, which can be avoided by purchasing insurance on these “outside” markets, and by providing for the sharing of risk among those outside markets and the exchanges, as just discussed.

## CONCLUSION

The judgment of the district court should be affirmed.

Dated: March 20, 2014

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Pursuant to Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 32(a)(7)(B) because it contains 6,109 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii). I further certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because the brief was prepared in 14-point Century Schoolbook font using Microsoft Word.

Dated: March 20, 2014

/s/ Andrew J. Pincus  
Andrew J. Pincus

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Dated: March 20, 2014

/s/ Andrew J. Pincus  
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