"Screening in Contract Design: Evidence from the ACA Exchanges"

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By steering patients to cost-effective substitutes within a therapeutic class of prescription drugs, formulary design can improve the efficiency of healthcare consumption. However, formularies can also be used to systematically discriminate against certain chronically-ill consumers/patients. In this paper we show why and how this has happened in the context of the ACA Marketplace plans:

- We show that despite risk adjustment and reinsurance that neutralize selection incentives for most consumer/patient types, some consumers are unprofitable in a way that is easily predictable by their prescription drug needs.
- For example, a consumer taking a drug in the Biological Response Modifiers class is among the most predictably unprofitable in our data. Such a consumer on average will generate $61,000 in claims costs but only $47,000 in net revenue after accounting for the large risk adjustment and reinsurance transfer payments to the plan enrolling her.
- Using data on every formulary used by ACA Marketplace plans in 2015, we show that Exchange insurers design formularies to be differentially unattractive to such unprofitable individuals. We show that plans are likely to place drugs that treat unprofitable patients on the specialty tier and/or put in place barriers to access in the form of prior authorization and step therapy.
- Our data allows us to compare formularies between Exchange and Employer plans. Employer plans act as a control group, as employers do not face the selection incentive we document.
- We find that drug classes in the upper 5% of the selection incentive distribution are 30 percentage points (50 percent) more likely to be placed on a specialty tier, to face utilization management, or simply to not be covered—relative to the same drugs in employer plans.
- We show that the contract design patterns we document are not simply a matter of insurers passing on underlying drug costs to the consumer, or of nudging consumers toward lower-cost substitutes within a therapeutic class of alternatives. Insurers are sophisticated enough to design formularies as screening devices that are differentially unattractive to unprofitable consumer types.
- The bottom-line impact on out-of-pocket consumer costs for certain patient groups is substantial—potentially thousands of dollars per year.
- While the current regulatory framework goes a long way toward weakening insurer incentives to avoid unhealthy enrollees, some selection incentives remain and lead to an equilibrium in which the offered contracts expose consumers to significant drug cost sharing risk.