2. The Role of Independent Agents in the Success of Health Insurance Market Reforms

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THE CRITICAL ROLE THAT INSURANCE AGENTS PLAY IN the sale of health insurance is often overlooked in formulating market reforms (Garnick, Swartz, and Skwara 1998). Most sales of individual and small-group health insurance occur through agents, yet market reforms focus almost entirely on insurers, and many evaluations of these reforms and the functioning of the market ignore the role of the agents who sell the products. Insurance agents are also neglected in the empirical and analytical literature on health care public policy. One notable exception is a study by Garnick, Swartz, and Skwara (1998), which analyzes and documents the impact of New Jersey's individual-market reforms on the role of agents in that state. This important first effort is limited, however, by its focus on only one portion of the market in a single state. A report by the General Accounting Office (1998) on the initial experience under the Health Insurance Portability and Accountability Act (HIPAA) noted that some insurers are using agent commissions and other tactics to discourage sales to higher risks, but the report cites only a few instances and does not indicate the magnitude of the potential abuse. In this article, I will add to, and expand on, these initial efforts. Drawing from an extensive qualitative study in seven states, I

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will report on the role agents play in the functioning of small-group and individual-market health insurance reforms.

Terminology and Classification of Agents

At the outset, a word or two is required about terminology. Health insurance, like any other industry, has a specialized vocabulary, composed of terms that sometimes differ from common understandings and often are used inconsistently even within the industry, in part because of regulatory differences among the states. For present purposes, simplicity is preferred over precision, so I will use a lay vocabulary that glosses over many of the distinctions that are important within the industry. Thus, “insurer” describes, generically, both indemnity carriers and health maintenance organizations (HMOs), and “managed care” refers primarily to HMO plans, including point-of-service (POS), in contrast to “indemnity,” which means both traditional, unconstrained fee-for-service and more managed forms of indemnity, such as preferred provider organizations (PPOs). Further, “health insurance” means comprehensive major medical, in contrast to more limited or specialized coverages.

When speaking of agents, whom the industry also calls “producers,” it is common to distinguish captive agents, who work primarily or exclusively for one insurer, from independent agents, who are often called “brokers.” Agents also distinguish themselves according to the types of insurance they sell. Some specialize in health insurance; others sell mostly health, life, and disability policies (all of which arise from the same sector of the industry); and still others also offer property, casualty, and liability insurance, either to individuals or to businesses. Sometimes, agents who cover a broad range of products are called “general agents,” but more often this term is used in a technical fashion to describe yet another division in the industry, “managing agents,” who are used by insurers to recruit, train, and service their independent agents. These “managing general agents” can also be either independent or captive.

Compensation and Selection of Agents

Independent agents are paid exclusively by commissions and bonuses, and this is often the primary compensation for captive agents as well.

Commissions are usually higher in the first year of a new sale, but they continue to accrue each year a customer remains with the insurer. Typical commissions for small-group sales to group sizes under 25 are 8 to 10 percent of total premiums. Commissions are approximately twice as high for individual insurance and half of this for groups of 40 to 50. In addition, insurers pay the general agents or account representatives who are responsible for recruiting and managing agents about one-quarter of the commission that agents receive. Insurers often give agents additional bonuses and incentives based on their meeting productivity goals.

Agents are licensed by state insurance regulators and must pass an exam and meet ongoing training and other professional requirements. In order for agents to offer an insurer's products, they must also meet the insurer's requirements for training and volume of sales for its own products. Insurers are usually free to pick and oversee agents by whatever method they choose. A few employ agents or retain them on an exclusive basis, but most use independent agents. Among the latter insurers, some have a large number of agents, many of whom generate few sales, whereas others use only agents who generate a high volume of sales. Insurers can also sell insurance directly through salaried staff, rather than retaining agents. Traditionally, many HMOs have relied exclusively on direct sales through salaried staff, but most are now also using commissioned agents. Blue Cross plans also frequently use a combination of marketing vehicles.

These varied compensation and selection arrangements create different sets of incentives and interests that critically affect how insurance market reforms function. The independence of most agents, and the fact they are paid on commission, means they are eager to sell health insurance, regardless of the client's health status, and they are in a good position to enforce market reforms. However, because most agents represent several, or even many, insurers, whose commission rates vary, they are in a position to steer clients toward or away from different insurers. Also, the complexity introduced by market regulation could make it difficult for nonspecialists to continue selling health insurance. Which of these or other possibilities came about in response to health insurance market reforms was a principal focus of the three-year study that is the basis for this article. A full description of this study and its findings on numerous topics can be found at <http://www.phs.wfubmc.edu/insure>.

Study Methodology

Seven study states were selected to reflect a range of intensity in individual and small-group market reforms, as indicated in table 1. Strong reforms are those with pure (or nearly pure) community rating and guaranteed issue (or open enrollment) for all products; medium reforms are those with age-adjusted community rating or tight rating bands; and light reforms are those with loose rating bands and guaranteed issue (or open enrollment) for only some products. (For more extensive explanation of the content of the reforms and the meaning of these terms and concepts, see Hall [1994].) These states also reflect different demographic, economic, and insurance industry characteristics.

In each study state, in-depth interviews were conducted with two to four of the regulators who were best informed about the reform laws, five to six independent agents who specialized in health insurance (except in North Carolina, where only three agents were interviewed), and actuaries, underwriters, marketers, product designers, or lawyers at three to four of the top insurers, including Blue Cross plans, leading HMOs, and commercial indemnity insurers. Interviews were also conducted at 11 national insurers with business in some or all of these study states. In all, more than 100 subjects were interviewed in 1997, and over half of these were interviewed again in 1998. Interviews lasted approximately one to two hours each and were based on an interview guide, but the

TABLE 1
Intensity of Reforms in Each Study State

State ^a	Small-group reforms	Individual-market reforms
New York	Strong	Strong
Vermont	Strong	Strong
Colorado	Medium	—
Florida	Medium	—
Iowa	Light	Light
Ohio	Light	Light
North Carolina ^b	Light	—

^aMinnesota and New Mexico were added to the market-testing study, but no interviews were conducted there.

^bNorth Carolina was not included in the market-testing study, and elsewhere in this project it was studied less extensively because it was used primarily to field test interview techniques.

discussions were free ranging and the coverage of topics varied somewhat among them. Most interviews were in person and one on one, but a number were over the phone and in groups of two to five subjects. It is important to stress that the agent interviews, which form the basis for this article, were with agents who specialize in health insurance and who, in many instances, are leaders in their profession. Therefore, they do not necessarily represent the views of agents who sell health insurance only occasionally or who do not have the same professional stature.

Also, a market-testing study was conducted to determine the ability of an actual small employer and unhealthy individual to obtain insurance. (For more information, see Richardson and Hall 2000.) The owner of a three-person business contacted an average of 18 agents each in eight states (for a total of 142) to inquire about the availability of health insurance, using a designed scenario in which some members of the group had health problems (one with juvenile diabetes and another with a genetic predisposition to breast cancer). Selection of agents was stratified so that one-third were "captive" agents referred directly by the insurer, and two-thirds were independent. Among the latter, roughly 60 percent specialized in health insurance, and the remainder sold a broad range of insurance products. The captive agents were selected from the largest insurers in the state to represent a balance between indemnity and HMO products. The independent agents were selected randomly within their categories.

Finally, extensive documentary data were collected from insurers, regulators, and agents, and supplementary information was compiled from newspapers and other academic and public policy studies. These multiple sources of information and data were analyzed based on both qualitative and quantitative techniques.

Agents' Subjective Views about Insurance Reforms

Health insurance agents are highly enthusiastic about insurance market reforms. Most agents interviewed see these reforms as beneficial to their clients and to themselves. Decreased medical underwriting makes it easier to sell health insurance, and reforms have brought greater attention to the small-group and individual-market segments, and so have stimulated sales. Across all our study states, we heard from leading agents that these laws are "wonderful things," "phenomenal," "absolutely spectacular,"

have done “great things,” are “the best thing that has happened to us in a long time,” are “very positive,” have been “a real boon to business,” created “a marketing opportunity,” and “opened a floodgate of business.” One Colorado agent reported enthusiastically:

I feel like I’m a kid in a candy store representing my clients today. Because in the past in dealing in group health insurance, insurance companies could pick and choose as far as who they wanted to bring on based on what type of health conditions that were out there. . . . [Now], it’s just so easy for us to be able to go out and spreadsheet the various companies and then make a determination with the client as far as what to go with It’s wonderful because I can literally offer whatever the clients want and not have to worry about, “Well, I wonder if I’m going to have to go out and offer them a different program if they [are rejected by their first choice].” So it’s been a very pleasant experience My business has tripled in size in less than a year . . . following the reform, . . . and it tripled again this year.

A Florida agent also had words of praise:

For the agent, [market reform has] been terrific because most of us didn’t want to be in the health insurance business previously. You were in it because it was an accommodation [to the client] or you used it to get some [other kind of business] that you wanted. But now a lot of us are in it because it’s a good place to be. It was a great opportunity when it came in I don’t have to worry that I can’t write the group It’s nice to know when I walk in to [sell] a group I don’t have to worry about, okay, who do you have that is sick, you know, what’s lurking out there. Because previously, [I would] go in and start enrolling and the employer didn’t know somebody had a problem until we started filling out the medical applications and then, oh no, [the insurer would tell us] we can’t do this. And that makes you look bad, and makes the employer look bad. That’s the very best positive side of small-group reform, that you don’t have to do that anymore.

Several agents noted that the small-group reforms have been especially successful in stimulating sales to micro-sized groups of five or fewer, which previously were not viewed as profitable business.

Other agents were not as enthusiastic, and a few were outright negative. One New York agent said the reform law spurred many sales initially, but the interest quickly died down as rates rose “astronomically”: “Basically it was, ‘I couldn’t afford it before. What makes you think I can afford it now? I’m not paying this kind of money for my employees.’” Another New York agent commented that community rating caused his

agency initially to lose about 15 percent of its clients, and “those who we kept, we had to work very hard to keep.” But they were able to replace the lost groups with about as many new ones by taking advantage of guaranteed issue: “I just told my brokers look for anybody you know is sick. This is a great opportunity. Go for it.” A few agents, like the one from Colorado quoted below, objected to the complex rules and excessive regulation they associated with these reforms and with health insurance generally:

The unfortunate part about this whole business is that as all these rules, regulations, everything has become more and more complicated, it's harder and harder to write business. What we found is that more and more [agents are] leaving that marketplace . . . We want to run a knowledgeable, professional business here . . . but there is a certain cost structure that goes with that, so you've got to decide how much time can you spend screwing around with this stuff . . . The work that we do to place a new piece of business, a two-, three-, four-, five-life group, will be this thick . . . It's just that there is so much more crap you've got to go through. And the consumer isn't as knowledgeable. And they ask you questions about how does this work and that work, and you just spend so much time that you say to yourself after awhile, is it really worthwhile?

Negative views were more commonly voiced in states like New York and Florida, where insurers used market reforms as an occasion to reduce commissions, sometimes slashing them in half. However, one Vermont agent explained that the greater ease of selling individual insurance justified lower commissions (see also Garnick et al. [1998]):

When I was first in the business, individual health insurance would pay a 25–30% commission. In those days . . . you needed a 25 or 30% commission because you had a hell of a lot of work to do because of the medical underwriting. Now, I would tell you, they typically pay 10% or less. The reason is that it is pretty easy when you can't get turned down. Do you have paperwork to fill out, money to collect and plans of insurance to explain? Yes you do, but you don't have all that back room struggle, going back and forth with medical care providers to furnish information and try and negotiate with company underwriters to get them to accept groups.

A New York agent said that he and other agents adjusted to the much lower small-group commissions by working harder and adding other lines of insurance.

We observed greater negativity about reforms to the individual market than to the small-group market. For the individual market, agents in states with strong reforms were usually, but not entirely, negative. One Vermont agent who deals mainly with medium and large groups said that he does not sell individual insurance “if I can help it It’s a pain in the neck.” Another Vermont agent said that he simply gives out the 1–800 number for Blue Cross, explaining: “I could write a hundred [individual policies] a year, that might inflate to a couple of thousand of commissions. It’s not worth that one phone call that we have to spend time on.” Negative views like these were encountered, however, mainly in states with community rating in the individual market, and even there they were not uniformly held. Elsewhere, agent support for market reforms was strong and widespread.

Market Testing

Agents’ embrace of insurance market reforms is also revealed in the market-testing portion of this study. A small employer contacted a variety of agents about the purchase of insurance for a group of three that included a sick individual. The employer scored agents according to their responsiveness to her inquiry and indicated whether the agents appeared to be avoiding a sale or steering her toward or away from certain purchasing options (Richardson and Hall 2000).

Ninety-seven percent (138/142) of agents indicated that coverage would be available for the group of three that included one worker with a serious health problem (juvenile diabetes), and only 5 percent of agents indicated this individual could not obtain coverage on her own (7/142). Although another 12 percent indicated this individual might encounter some difficulty in finding coverage, the great majority (83 percent) indicated there would be no trouble obtaining individual coverage. These responses did not vary significantly by the strength of regulation in each state. Overall, the market tester rated only 4 percent (5/142) of these agents as being unreasonably slow or unresponsive to her inquiries, although 19 percent (27/142) were rated as having a sluggish response. The great majority (78 percent) were responsive, despite the very small size of the group and its apparent health problems.

The market-testing study also explored differences among types of agents. Grouping agents according to captive versus independent, and

generalists versus health-care specialists, produced no notable differences in agent behavior. Different types of agents were remarkably consistent in various measures of their responsiveness and compliance with the reform laws. In only one area was there a significant difference ($p = .051$, Fisher's exact test). General agents who do not specialize in health insurance were four times more likely (12.1 percent vs. 2.7 percent) to indicate that the worker with diabetes could not obtain individual coverage. This suggests either that specialists have greater skills in arranging coverage for difficult cases, or that they are more willing to take on these cases despite the difficulties.

Insurers' Manipulation of Agents

On the surface, agents' attitudes and behavior reflect a very a positive reaction to market reforms. Below the surface, however, there are structural reasons for some concern. Using commissioned agents to sell insurance creates a market structure that insurers could manipulate to circumvent or undermine market reforms. Insurers could influence agents either through the size and structure of commissions or through the selection and management of agents. I will look first at commissions.

Commissions

A blatant form of manipulation is to pay agents less for higher-risk business, which might occur if commissions or bonuses were explicitly based on loss ratios or if commission structures were negatively correlated with risk classifications. Examples of each were observed in some study states. In three of seven states, most notably Florida, some or most insurers adopted a policy of paying much lower commissions for disfavored business, such as guaranteed-issue policies in markets that also allow underwritten policies or "micro" groups of one to five members. For instance, in Florida, many insurers were paying only 1 to 3 percent for groups under four, in contrast to 5 to 8 percent for small groups of up to 25 or 50. These groups are disfavored because their smaller size leads to greater adverse selection and generates higher administrative costs. Nevertheless, this commission structure is in stark contrast with the traditional industry practice of paying higher commission rates for the smallest groups, considering that the smallest groups require the

most work of agents for the amount of premium earned. Because of these diseconomies of scale, commission rates for individual sales are usually twice as high as for small groups, and small-group rates are usually two to three times higher than for larger groups. Reversing field and paying the lowest rates for the business that requires the most work had a strong impact on Florida agents. One agent explained, "In my opinion, the insurers just fired the entire sales force." Another elaborated on the difficulties this strategy had caused:

I'm in the phone book for "Group Health Insurance" and "Individual" and I wish I wasn't. I get probably two, three calls a day [from one-life groups] and it's not a nice call to have to call back and know that I am going to waste 15 minutes of my time. And those people want to shop and see more mail than anybody. I am stereotyping but . . . I lose money when they call me because I have to pay a secretary, I have to pay postage, I have to pay for the phone call, and I have to take 15–20 minutes to explain it. And . . . if it's for her little kid, six-years-old, \$80 a month is the premium. I think I get 3% commission on this one, so that's \$2.40 a month times a year is 26 bucks. Take out the taxes and I haven't paid the secretary. You see what I mean? And [they want me to] drive over [to meet them in person]. It's ridiculous.

Still, as this subject and others noted, most Florida agents continued to service microgroups out of a sense of professional obligation and because it is not feasible to market by group size.

After years of complaints, in July, 1998, Florida regulators banned the practice of paying lower rates for smaller businesses. They delayed doing so because they were not confident they had the statutory authority to regulate commission rates. The primary legislative authority lies in a provision that requires fair marketing of all small-group plans, but there is a strong tradition in Florida and most other states of not regulating agent commissions. This tradition is reinforced by agents' professional trade and lobbying groups, which strongly resist the creation of any precedent that would allow regulation of commissions, for fear that this could result in commissions being reduced across the board. Therefore, regulators often believe they need explicit statutory authority before regulating commissions. It would appear, however, that the requirement of "fair marketing" is easily broad enough for regulators to enforce basic equity considerations in the structure of relative commission rates, even if they refrain from regulating the absolute level of commissions. In several of our study states, regulators intervened quickly either to require

uniform commissions or to limit commission variation to a reasonable range.

Even more extreme than reducing commissions is eliminating them altogether. We observed this occurring in some states for individual policies that are guaranteed issue and community rated, notably, in Ohio, New York, and Vermont. Although the case against zero commissions would appear to be even stronger than the one against reduced commissions, this is not necessarily so. First, the equity of commission rates is usually judged within a market segment for a similar line of products. Individual policies are a distinct market segment, and guaranteed-issue policies are distinct from medically underwritten ones. Second, there is a long tradition of paying no commissions for open-enrollment, community-rated policies sold by Blue Cross or through high-risk pools. Commissions are considered unnecessary for those policies because the people who buy them are motivated to search them out on their own, and the policies are sold directly rather than through agents. It is easy for agents who encounter uninsurable clients to refer them to toll-free numbers to inquire about these direct sales. Even where agents are involved in the sale of these policies, insurers can legitimately take the position that eliminating commissions helps to reduce the high cost of policies designed for high risks, and that agents should bear some of these social costs, just as insurers do by cross-subsidizing the rates. An Iowa agent reflected on the reasoning behind lower commissions:

Part of the concept of this health care reform and increasing availability and affordability and so forth had to do with the notion that everybody in the system is giving a little bit. The carriers are, hopefully, not making their normal . . . underwriting profit. In fact, they would argue vehemently that they've only got 10 [percentage] points in the [price of the] state-mandated plan in which to do everything: pay agents' commissions, underwrite, you know, do it all. So there's simply not enough money in the sock to pay more commission, and I think they're right about that. They can prove that in black and white. So I don't think they're attempting to discourage [sales] per se by artificially depressing the commissions. I think there's the recognition that there's a limited amount of money available here for underwriting and commissions and marketing and so the commissions are depressed accordingly.

Still, there is a difference between eliminating commissions only for policies designated for high risks and doing so for all policies sold in a

market segment. To treat an entire market segment as if it were a high-risk pool is a self-fulfilling prophecy. If there is no-financial incentive to recruit lower risks, then the market will naturally tend to collapse into a high-risk pool. One interview subject explained that the critical role agents play in any insurance market is to convince healthy people that they need to buy health insurance, in order to balance out those who purchase because they know they need it. This role is eliminated if no commissions are paid. Some evidence of this outcome can be seen in New York, where essentially no insurer pays any commission for the sale of individual insurance, and several subjects characterized that market as a virtual high-risk pool (Hall 2000d).

Where some insurers pay commissions but others do not, then, absent any other disincentive, agents will naturally favor those who do. It might be thought that agents will send both good and bad risks to the insurers that pay the best, but if insurers encourage “field underwriting” through the techniques discussed below, then insurers paying the best commissions could receive the best risks, and those paying no, or lower, commissions could receive the worst risks. Whether by accident or by design, just this eventuality emerged in Vermont, for instance (Hall 2000e). In the individual market, Blue Cross pays no commission, and so its market share (from Department of Insurance data) fell from 50 percent in 1994 to 34 percent in 1997. Time/Fortis paid a 10 percent commission (before it withdrew in 1999), and its individual market share rose from 20 percent to 50 percent over the same three years. Yet Time/Fortis maintained a much healthier risk pool than Blue Cross. Its average premium for individual policies was 40 to 50 percent lower than Blue Cross’s, and its average claims were 60 to 70 percent lower, for products with similar, although not identical, benefits. (Time/Fortis benefits are somewhat leaner.) According to interview sources, Time/Fortis was able to maintain a “low profile” with respect to high risks by using only agents who generated a high volume of business and by marketing only through agents, not directly to the public.

A final way in which commissions can be used to separate good from bad risks is to adjust commissions or bonuses to reflect the risk profile of subscribers from each agent. For instance, it is common for other lines of insurance, such as property and casualty, to pay a bonus based on low loss ratios. This explicit incentive to seek lower risks is banned for health insurance in all the study states, except Ohio. There, we heard from a number of subjects that it is common practice, although others said it is

not. One Ohio regulator said that it is illegal to penalize agents for high loss ratios but acceptable to pay a bonus for low loss ratios. Another Ohio regulator said both would be illegal, but he had received no reports of these practices. However, Ohio regulators did ban the practice of paying zero commissions for guaranteed-issue plans issued at substandard rates. The department ruled that insurers may permissibly cap commissions at the standard or median premium in order to remove the incentive for agents to bring in higher risks, but insurers may not use commissions to discourage higher risks.

Field Underwriting

Insurers can also attempt to manipulate the role of agents by using their selection and management of agents to deter agents from sending them high-risk applicants. Insurers have at their disposal a range of techniques to encourage what has been called “field underwriting.” This term refers to having agents screen out applicants they know or suspect will not meet the insurers’ underwriting criteria. In unregulated insurance markets, this practice efficiently avoids unnecessary work for insurers and agents and helps to steer subscribers to the plans and insurers that are most likely to offer affordable coverage (Garnick et al. 1998). This helps to explain why, where medical underwriting is allowed, health insurers report a much lower rate of rejecting applications—typically less than 10 percent (Office of Technology Assessment 1988)—than is usually assumed to occur. Field underwriting also helps to detect when applicants are not being truthful about their risk factors. Insurers need to detect subscriber fraud and misrepresentation at the outset because courts and regulators have restricted insurers’ rights to rescind policies when misinformation in the application is discovered at the time claims are submitted (Farnham 1985; Six and Thompson 1985). In part, this practice explains why agents refer to themselves as “underwriters” in their professional certifications and trade association names, even though they do not perform the full underwriting function of insurers in the home office. Insurers give their lead agents field manuals or software programs that contain the general underwriting guidelines so agents will know whether it is worth their effort to submit applications. Insurers or general agents also give field agents informal, “prescreening” opinions by phone for the same purpose. As a result, many applications from uninsurable clients never come in to the home office for a formal decision.

Although these practices may be legitimate and efficient for most lines of insurance, they undermine the functioning of an open-enrollment or guaranteed-issue environment by discouraging agents from taking higher-risk clients. This also creates an uneven playing field by encouraging agents to send higher-risk clients to one insurer rather than another and by putting insurers that choose not to use these tactics at a distinct disadvantage. Fair-marketing rules in insurance market reforms prohibit explicit use of field underwriting, but implicit encouragement can occur in a number of ways. We explored the speculative possibilities in some depth and found evidence of a wide variety of tactics. However, we found only limited evidence that these tactics are having any significant impact, and no evidence that they are undermining the core functioning of the reform laws. Because of the importance of field underwriting to the functioning of insurance markets, I will explain the competing views in some detail.

One indication of the presence of field underwriting is that a number of insurers sell insurance only through their agents, and will not do so directly. One insurer observed that “our clients are our agents,” not the general public. Some insurers advertise exclusively in professional magazines directed to agents, rather than directly to the public. One reason for this, according to agents and competing insurers, is to rely on agents to perform the screening function previously done by medical underwriters. Other reasons include greater economy in marketing costs and competition among insurers for the attention of the best or the most agents.

Insurers encourage field underwriting through a variety of overt and subtle methods. As noted above, commission structures can influence agents to avoid bad risks. Also, insurers can indicate to agents that they will not allow them to continue selling their products if they detect any disturbing pattern of “dumping” high risks on them, as explained by this Iowa agent:

Insurance companies . . . can cut their field force down . . . or they can suddenly say, “Don’t bring us that business . . .” That happens every day. When I talk to any of the carriers, the first things they are telling me about is we want to do business with you. But, we don’t want your bad business. If you have these kind of cases, just don’t bring them here. Send those to Blue Cross or American Medical or whoever the other carriers may be. If you bring in enough bad business, . . . all of the sudden you just don’t have a contract anymore. They can terminate a contract for cause or no cause. They don’t have to have a

cause to terminate your contract. They can do it for almost any reason they want to.

One knowledgeable source, who has worked both as a regulator and in the industry, admitted candidly, "That's how it's done." Insurers "clean out" from their agent rolls those who are "dumping" bad risks on them.

Although these tactics could lead an agent to complain to insurance regulators, which a few agents said they would be quick to do, other subjects said that agents usually just accept an insurer's termination because this usually is done by insurers with whom they conduct only a little business, and insurers can invoke a variety of legitimate grounds for dropping agents. Also, insurers can convey their point in less overt ways. One insurer reports demanding more documentation from agents it believes are systematically sending it their worst cases. This Vermont agent explained how insurers communicate their wishes without openly asking agents to violate the law:

I've been to some seminars from [ABC Insurance Company] where they say, "Look, the only way that we can try and help ourselves is you're our field underwriters. We expect you to give us good business," and stuff like that . . . They say, "We just want you to keep your eyes open." They're not coming out and saying, "Don't sell this stuff to bad people," but that's essentially what they're saying.

Rather than act selectively against agents who are sending them bad risks, some insurers have taken more systematic steps to avoid this potential by choosing their agents more carefully at the outset. Insurers can foster loyalty by using only agents who generate a high volume of business. Moreover, by allowing agents to sell for other insurers, the companies hope that agents will send them only the more attractive business and steer the unfavorable clients to others. For instance, according to one source, some insurers find that 80 percent of their highest-risk cases comes from agents who only sell one policy a year to that insurer. Because "dumping" usually comes only from agents who do very little business with the insurer, we heard repeatedly from both agents and insurers that, in response to guaranteed-issue laws, insurers are "really trying to get rid of the marginal producers." A knowledgeable Iowa agent comments:

That is why I say you see carriers cutting their contracts down from 40,000 agents down to 2,000. It is because they don't want

that agent writing 10 groups a year to be doing the business with them anymore. Out of that 10 groups, if that agent brings two to the table that are really sick, there just isn't enough premium in the other eight groups to make that a profitable block of business . . . [Insurers] want to get a better quality agent, a better relationship with the agent. Have the agent do a more thorough job of field underwriting and just not take that business to them . . . [Insurers] want relationships with agents that they can trust that will walk by some of that business and just not write it.

To concentrate their sales in fewer agents, an insurer can set higher production quotas that an agent is required to meet in order to remain certified, or the insurer can increase the mandatory training requirements, or erect other "barriers" that make it very inconvenient for the agent to remain certified unless he or she is committed to doing a substantial volume of business with that insurer.

Furthermore, insurers inculcate in agents a sense of loyalty in a number of overt and subtle ways, which one subject likened to "sending out invisible rays." Insurers pay "production bonuses" or give free vacations to agents with a higher volume of business. Also, their field representatives who recruit and train agents use their personal skills to create an "atmosphere" of friendship and cooperation that bolsters the likelihood of agents sending their bad cases elsewhere. Insurers foster in agents the natural desire to want to "work with a winner." Agents tend to do most of their business with a handful of insurers, sometimes as few as one or two, and they realize that the insurer's success translates into their own success through lower prices, more sales, and a better profit margin from which to pay increased commissions.

Reports of these various aspects and indications of field underwriting were heard repeatedly from agents in different states, but one Florida agent gave an especially thorough and candid explanation:

Q: I have heard it argued in other states that there is a kind of subtle pressure put on by carriers to do, in effect, field underwriting. To not sell to certain groups. To find ways to avoid selling to them.

A: To pre-underwrite, . . . be selective of what you bring to them.

Q: Does it happen?

A: Yes . . . It depends how loyal [agents] are to their number-one carrier—the carrier they place most business with. If a group comes along that's a really sick group that has lots of problems, I'm sure they [agents] think twice about it. I don't know any human

being who wouldn't think twice about it. If your livelihood is coming from one carrier who has taken good care of you, you don't want to lose that relationship you have with that carrier. It's ultimately that's how we make a living. . . .

Q: How do [insurers encourage this?] I mean you'd like to make this sale I assume?

A: It's their sales reps. They become your friends. They become who you depend on and they pull strings for you. They get things accomplished for you and in return they unsbtly or subtly ask you to be careful what you send them. . . . It's not anything official. It's nothing written. It's nothing official. It's more or less, I scratch your back, you scratch my back. . . . It really boils down to, the more business you place with a particular carrier, the more they're going to go that extra mile for you. But in return, they want you to be careful what you send them.

Q: How can agents be careful?

A: Well, when you are talking to an employer, . . . you find out, have you got any health problems that you are aware of, any large claims, any ongoing maternities? You field-underwrite it. You ask the questions that previously the employees each had to answer, at least generic questions. Which also not only helps you determine [whether] that's a really bad account [that] I don't want to take to my best carrier because my name will be mud there, it also helps you to determine who's going to give you the best price for it.

Q: Do agents then ultimately place these groups with somebody else?

A: Some of them do Some agents will probably walk away from [the group]. Won't even do anything for it. Ignore it.

Q: I see. So they just don't call back.

A: Yeah. They figure some other agent will come along and they'll take care of it. I [personally] can't do that. I have a problem with [doing] that. The [other] guys in [my] office say it's the mothering in me.

Q: What do the employers do under these circumstances?

A: They're not aware of it.

As noted above, these accounts were largely confirmed by sources with insurers, although usually in reference to their competitors' behavior. According to one, field underwriting "goes on all the time but no one will admit it." Most insurer subjects describe their company's position on field underwriting in defensive terms, explaining that they do not have a corporate policy or practice of discouraging agents from sending them their reasonable share of bad risks, but they are acutely concerned that some agents will "dump" only their bad cases on them.

Despite the pervasiveness of field underwriting, none of the subjects believed it was undermining or seriously compromising the core of the reform laws. Minimizing the seriousness of field underwriting could be attributed to self-interested statements by the guilty parties, or to the sampling bias that comes from interviewing primarily industry and professional leaders rather than a more representative cross-section of agents. However, these are the most knowledgeable subjects, and they showed little hesitation in candidly admitting the existence of field underwriting. Therefore, their assessment of the magnitude of its impact merits some credence. Moreover, there are independent, objective reasons for downplaying the significance of field underwriting.

First, as I documented earlier, actual market testing shows that unhealthy individuals and small groups have little or no difficulty finding willing and cooperative agents. This shows that very few agents are trying to avoid high risks altogether. However, our methods were not sufficiently sensitive to determine whether agents are steering business away from favored insurers. Although the great majority of agents (70 to 80 percent) offered more than one type of plan and most offered plans from more than one insurer, we had no basis for determining which plans may have been avoided or how agents made these choices. The closest our measures came to providing a direct test for steering was whether the agent suggested arranging separate coverage for the diabetic employee, apart from the group. Eighty-five percent of the agents made no hint or suggestion of this kind. Among those who did, this is not an unambiguous indication of field underwriting or steering. Instead, some agents were engaging in the practice known as “list-billing” or “lasering out,” in which an employer helps to pay for a worker’s individual coverage in order to keep down the cost of group coverage. This practice is viewed by many as abusive, but others see it as sometimes being in the collective best interests of the employer and worker, and in some states it is or may be legal, depending on how regulators interpret and enforce their statutes (Hall 2000c).

Second, a number of experienced agents, some in heavily regulated states, said that field underwriting is nonexistent or occurs only at a minimal level. Notably, the divergence in agents’ views was not associated with the stringency of reforms across these states. One New York agent said there is no pressure whatsoever from small-group insurers to avoid older groups or attract younger ones, and another said that the only pressure is to generate a lot of business, both good and bad. A Florida agent commented that field underwriting “in the small-group market is

not even an issue Most of the carriers down here now aren't even . . . bothering to ask health questions." An Iowa agent commented, "I think the carriers have been very honorable, and I think they're doing a good job."

Third, it is important to compare the potential for field underwriting through independent agents with the even greater potential for circumvention if all insurance was sold directly by insurers. The independence of agents enables them to resist insurers' pressures to avoid high risks, and they are well motivated to do so because they are paid on commission. One confirmation emerges from a comparison of the results of our market-testing study, in which most contacts were made with independent agents, with the results of a similar test conducted in New York in 1998 by the Attorney General's Office, in which 16 consumer inquiries about individual coverage were made directly to the home offices of each of 31 HMOs. In 25 percent of the New York calls (74/296), the insurer did not respond at all, and 19 percent of the New York insurers (6/31) failed to respond to 25 percent or more of the calls to them (Vacco, Gold, and Oechsner 1998). The fact that New York HMOs sell individual insurance directly, and not through agents, is one possible explanation for this much lower response rate.

Finally, many of the professional leaders we interviewed said they do not do field underwriting and they will complain to insurers if they detect apparent noncompliance. When they complain, insurers are usually responsive because they want to stay in the good favor of their agents. For some agents, like the one from Colorado quoted here, the resistance to insurers' pressures arises from fear of being caught doing something wrong:

The Division of Insurance almost made the agents the enforcers. Because we're on the street, . . . we're dealing with the carrier and . . . the Division of Insurance was very specific about [saying] you're as liable as the general agent or the carrier. That made big believers out of us We can't afford to mess with the Division because our license is everything to us. They have more time, more money, more resources. I mean, yeah, we want to be in compliance.

For others, like this New York agent, resistance to insurers' entreaties arises from a sense of professional ethics:

If the agent is ethical, then he's going to serve the client regardless of who they are, where they come from, and what their needs are. He's going to lay out the plans to the consumer and say, "Here's

the best deal . . . ,” regardless of who the carrier is Because in reality, we could be influential in affecting the bottom line of that insurance company if we know the facts People call and say, “Listen, I was just diagnosed with cancer. What should I do?” That’s where an ethical agent is important. He or she should direct the consumer to where the best care is done and the best policy and the best service.

An Ohio agent observed that insurers’ strategies to encourage field underwriting can backfire if agents, like himself, decide to turn against the insurers they think are not playing fairly:

We had a little meeting about this [in our office] and the initial response [of some of the other agents] was, “Well, I’ll never do business with that company again.” And I said, “Well, wait a minute here. Why don’t we just take the reverse approach to this? You know they don’t want us to put any of our high risk business with them and we’ve got clients who need coverage. Why don’t we just put all of it with them? We’ll just go ahead and give it all to them We’ll just do a little reverse psychology.” I was talking with one of the company representatives about that . . . and I said, “Well, we’re going to give you all of our bad business.” There was just dead silence It’s such a crazy business right now.

These accounts are only one side of the story, however. It is revealing that several agents admitted in interviews that they in fact succumb to insurers’ pressures. A Vermont agent conceded:

Agents will always, fortunately or unfortunately, keep their own well-being in mind. That means a couple of different things. First of all it means, if I know that garbage haulers have horrendous health insurance experience and my carriers have told me, “We are not interested in writing garbage haulers. They have horrendous experience,” am I gonna run around and try to sell insurance to garbage haulers? Probably I am not.

Undoubtedly, then, field underwriting is a significant feature of how insurance markets operate under guaranteed issue. For the most part, however, this appears to affect only *where* higher risks obtain insurance, not whether insurance is available *at all*. This may reduce the range of choices or increase the price for higher-risk purchasers. Also, some insurers may be worse off as a result, and avoiding this result consumes

insurers' attention and competitive energies, which introduces unfortunate inefficiencies and dislocations. However, it appears that systemic incentives and relationships in the industry work reasonably well to enforce the basic consumer protections in the law. Despite documenting a number of possible and actual instances of manipulation and circumvention, we observed no widespread indications of overt noncompliance with the core requirements of the reform laws.

Conclusions and Recommendations

Insurance is a much maligned industry, and insurance agents in particular often feel the brunt of the public's cynicism and frustration with insurers. This study reveals, however, that agents play a critical role in the success of insurance-market reforms. Their independence from insurers places them in a good position to enforce the interests of purchasers, and the fact they are paid on commission encourages them to solicit both good and bad risks. Both factors also give insurers leverage to manipulate agents in ways that undermine market reforms, but we found only limited evidence that this is occurring. Despite numerous examples or confirmations of insurers using various techniques for field underwriting, these ultimately have little or no impact on the ability of high-risk applicants to obtain insurance. Such techniques may be causing some insurers to suffer greater adverse selection than others, but it is difficult to know how much of the differences among insurers' risk pools is due to these tactics, rather than to natural or preexisting selection patterns.

In any event, it is not feasible to eliminate all potential for such manipulation. Some techniques are simply too subtle to detect or prevent and so must be tolerated to some degree if independent agents are to remain central to the market's structure. The most prophylactic approach would be to eliminate agents entirely, but they serve a valuable function for which there is no readily available substitute. Insurance agents assist purchasers with the complex and daunting task of choosing insurance. Most markets have a dozen or more insurers to choose from, and most insurers offer a dizzying array of ways to mix and match various components of coverage, such as deductibles, copayment levels, maximum payouts, and various riders for prescription drug benefits or mental health coverage (Hall 2000a). Agents are also expert in exploiting nuances of insurers' rating methods, such as whether or to what extent they rate for

gender, age, or family composition factors (Hall 2000b). Thus, agents serve an important information function for individuals and small employers, similar to that performed by benefit managers for large firms. Agents also fill an important service role in resolving claim disputes and billing problems for small purchasers that otherwise have little clout. Agents' repeat experience in these matters with different insurers informs their recommendations about which policies to purchase, thereby improving purchasers' information about the quality of products in the market. There may be other conceivable ways to perform some or all of these functions, but at present independent agents are the preferred method for small employers and individual purchasers.

If the agent–insurer relationship is to be regulated, the most obvious point of focus is the structure of agent commissions. Many states already oversee commission structures as an aspect of fair marketing. In states where this has not traditionally been done, state regulators are properly beginning to ban commission structures that are clearly designed to discourage sales to higher risks. More difficult to resolve are traditional arrangements in which open-enrollment plans for high-risk subscribers are sold directly, without any agent commissions. This helps to hold down costs in a segment of the market where normal market forces are not functioning, but extending this precedent to all guaranteed-issue and community-rated plans might convert the entire market to a high-risk pool. Absent mandated purchase, insurance-market reforms are not likely to succeed unless agents remain motivated to convince younger, healthier subscribers, who may not realize it, that their need for health insurance justifies the cost.

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