



Institute for  
Policy Integrity  
*new york university school of law*

**Hearing on  
Affordable Care Act's (ACA) Summary of Benefits and Coverage (SBC),  
Coverage Examples, and Uniform Glossary**

**Written Testimony of Michael A. Livermore**

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**Mr. Chairman**, thank you for the opportunity to testify before the Senate Committee on Commerce, Science, and Transportation today. My name is **Michael Livermore** and I am the executive director of the Institute for Policy Integrity at New York University School of Law. Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

The focus of my testimony is section 2715 of the Public Health Service Act, as added by the Patient Protection and Affordable Care Act, which requires uniform disclosure standards in providing benefits and coverage explanation to insurance applicants and enrollees. On February 14, 2012, a Final Rule was published by the Department of Health and Human Services, Department of the Treasury, and Department of Labor on Summary of Benefits and Coverage and Uniform Glossary (the SBC Rule) pursuant to this section.

My testimony will make three basic points:

- Analysis conducted by the agencies prior to promulgation of the final rule shows that the benefits of section 2715, which included both improved consumer decisionmaking and improved health outcomes, will outweigh the costs, likely by a substantial margin.
- The substantive requirements of section 2715 and the SBC Rule accord with available evidence on consumer decisionmaking. In particular, the use of examples and the standardization of disclosure of benefits and coverage information will empower consumers to process information about plan alternatives to make more informed choices that better match their risk preference and long-term needs.
- The agencies have committed to continually testing, updating, and improving the SBC Rule, which will lead to increased performance and greater net benefits over time. Because many regulatory contexts involve conditions of uncertainty, the agencies have adopted an appropriate policy of moving forward with well-justified measures while continually revising and improving their regulatory requirements in the face of new information.

### **The Benefits of Section 2715 and the SCB Rule Outweigh the Costs**

In their final rule implementing the requirements of section 2715, the agencies find that benefits are likely to outweigh costs. Annual compliance costs are estimated at \$73 million. Given the massive size of the private health insurance market in the United States, even a small improvement in consumer decisionmaking would overwhelm this relatively modest cost.<sup>1</sup>

The agencies cite several ways in which the rule will benefit consumers. First, improved access to information will allow consumers to “make better coverage decisions, which more closely

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<sup>1</sup> For general background on the role of cost-benefit analysis in administrative decisionmaking, see RICHARD L. REVESZ & MICHAEL A. LIVERMORE, *RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH* (2008). This testimony is based on comments submitted by the Institute for Policy Integrity to the Department of Health and Human Services on July 6, 2011, [http://policyintegrity.org/documents/IPI\\_Letter\\_to\\_HHS\\_7.6.11\\_.pdf](http://policyintegrity.org/documents/IPI_Letter_to_HHS_7.6.11_.pdf).

match their preferences with respect to benefit design, level of financial protection, and cost.”<sup>2</sup> Improved consumption decisions will result in increased consumer satisfaction.

The factual premise underlying this conclusion is that, without the rulemaking, consumers would not have access to, and process, an optimal amount of information when making health insurance decisions. There are good reasons to believe that this is correct. Choosing a health insurance plan is a complex decision, involving a wide range of probabilistic judgments on the part of consumers. This decision is made infrequently, and any feedback that consumers receive is attenuated by time and intervening circumstances. Firms will not have the incentive to present consumers with the socially optimal amount of information, in the form most easily processed, if consumers cannot readily predict their satisfaction levels based on product choices. Health insurance is, therefore, a context that is very well suited to a government disclosure requirement meant to improve consumer decisionmaking.<sup>3</sup>

Second, the rule is expected to “benefit consumers by reducing the time they spend searching for and compiling health plan and coverage information.”<sup>4</sup> Search time reduction can be a substantial savings and can be as valuable as pecuniary savings or improved health. Collecting information about health insurance plans is not a leisure activity; it is a form of work that carries disutility: hourly wages serve as a reasonable proxy for the rate at which individuals are willing to trade leisure for monetary compensation. The agencies cite research by the National Bureau of Economic Research that shows that making health insurance decisions, in particular, involves substantial search costs.<sup>5</sup> This type of information gathering activity is also redundant with similar efforts undertaken across the economy by other individuals: if a trustworthy agent can act on behalf of the American public to compile relevant information in an easily accessible format, it represents a real economic savings.

Third, the rule is anticipated to “result[] in cost-savings for some value-conscious consumers who today pay higher premiums because of imperfect information about benefits.”<sup>6</sup> This consumer benefit could be interpreted as a transfer from insurance companies to their consumers, rather than a pure efficiency gain. However, the existence of these types of rents creates incentives for firms to compete, in an economically unproductive way, to capture them, at the very least through advertising. Equally problematic, from an efficiency perspective, would be attempts by insurance companies to increase these rents through product design, which not only involves the inefficient (from a social perspective) allocation of firm resources, but results in a marketplace with distorted consumer choices.

Finally, by “making it easier for consumers to understand the key features of their coverage,” the rule is anticipated to “enhance consumers’ ability to use their coverage.”<sup>7</sup> If consumers are better

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<sup>2</sup> 77 Fed. Reg. 8682.

<sup>3</sup> For an overview of recent scholarship concerning how government provision of information and improved “choice architecture” can facilitate better consumer decisionmaking, see RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (2008).

<sup>4</sup> 77 Fed. Reg. 8682.

<sup>5</sup> 77 Fed. Reg. 8681.

<sup>6</sup> 77 Fed. Reg. 8682–83.

<sup>7</sup> 77 Fed. Reg. 8683.

able to access health care services when they need them, it can lead to substantial health benefits, which has obvious economic value. Increased utilization of preventative health care services, in particular, can lead to social value if long-term chronic or catastrophic health outcomes can be avoided through early medical intervention.<sup>8</sup>

An additional, longer-term benefit of the rule, which is alluded to in the final rulemaking document, is that “health insurance issuers and employers may face less pressure to compete on price, benefits, and quality” if consumers lack appropriate information.<sup>9</sup> The consequence is a marketplace with a distorted set of product choices. By helping improve consumer decisionmaking, the rule can facilitate a virtuous circle in which consumer satisfaction is increased not only through better choice between existing products, but also through the creation, and offer for sale, of insurance products that better conform to consumer preferences.

While the agencies provide a qualitative discussion of the benefits of the rulemaking, there is no quantitative estimate of regulatory benefits. Since President Reagan issued Executive Order 12291 in 1981, there has been a stated policy within the Executive of quantifying and monetizing regulatory costs and benefits, and the agencies recognize that the current Executive Order governing regulatory review “emphasizes the importance of quantifying both costs and benefits.”<sup>10</sup> The types of benefits anticipated by the rule, including increased consumer satisfaction, improved health outcomes, and time savings are all, in principle, amenable to quantification and monetization.

Although ongoing analysis of the effects of the rulemaking, including quantification and monetization of regulatory costs and benefits, is appropriate (as discussed below), the agencies followed a prudent path by moving forward with this regulatory action and avoiding unnecessary delay in the service of additional ex-ante analysis. Executive Order 12866 (still operative) encourages agencies to utilize “alternatives to direct regulation, including . . . providing information upon which choices can be made by the public,”<sup>11</sup> and Executive Order 13563 encourages agencies to “consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public . . . includ[ing] disclosure requirements as well as provision of information to the public in a form that is clear and intelligible.”<sup>12</sup> The difficulty of predicting the effects of disclosure requirements ex-ante, however, sometimes interferes with the ability to quantify and monetize benefits in advance. Nevertheless, the benefits of disclosure requirements will often exceed their costs, because they are among the least restrictive forms of regulation. Furthermore, the costs of alternative disclosure requirements are likely to be similar: the important question is often not whether some form of disclosure is economically justified, but how to design the disclosure to maximize its net benefits. In these cases, the inquiry associated with cost-benefit analysis collapses into a technical exercise of how best to design the disclosure to improve consumer decisionmaking.

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<sup>8</sup> Of course, some preventative care interventions are more justified on cost-effectiveness grounds than others. See generally, Joshua T. Cohen, *Does Preventive Care Save Money? Health Economics and the Presidential Candidates*, 358 N. ENGL. J. MED. 881 (2008).

<sup>9</sup> 77 Fed. Reg. 8681.

<sup>10</sup> 77 Fed. Reg. 8680.

<sup>11</sup> 58 Fed. Reg. 51736.

<sup>12</sup> 76 Fed. Reg. 3822.

## The Rule Is Based on the Available Evidence Concerning Consumer Decisionmaking

Extensive research in the fields of behavioral economics, psychology, and cognition show that it is not enough to simply “provide information.”<sup>13</sup> Consumers are known to have cognitive biases that affect their decisionmaking. Academic research on how individuals absorb and process information can inform the design of government policy to deliver the best possible results for the American Public.<sup>14</sup>

Professor Cass Sunstein, until recently the administrator of the Office of Information and Regulatory Affairs, has argued that even seemingly small alterations in presentation format can “highlight different aspects of options and suggest alternative heuristics” that have demonstrable effects on people’s behavior.<sup>15</sup> Interventions taking advantage of these effects can be strikingly cost-benefit justified, since these psychological cues typically cost very little.<sup>16</sup>

OIRA has issued guidance on the use of disclosure to achieve regulatory ends.<sup>17</sup> According to this guidance document, summary disclosure should be concise and straightforward to “highlight the most relevant information” and to “increase the likelihood that people will see it, understand it, and act in accordance with what they have learned.”<sup>18</sup> Disclosure should avoid technical language or extraneous information that may be inaccessible to the average reader. OIRA has cautioned that “[u]nduly complex and detailed disclosure requirements may fail to inform consumers” because the disclosure “may not be read at all, and if it is read, it may not have an effect on behavior” because it is poorly understood.<sup>19</sup>

Presenting information in this manner coincides with the statutory mandate to account for linguistic and educational barriers to health and literacy.<sup>20</sup> There are large variations in the “degree to which individuals have the capacity to obtain, process and understand basic health information.”<sup>21</sup> The Center for Health Care Strategies (CHCS) notes that “[w]hile low health literacy is found across all demographic groups, it disproportionately affects non-white racial and ethnic groups; the elderly; individuals with lower socioeconomic status and education; people with physical and mental disabilities; those with low English proficiency (LEP); and non-native

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<sup>13</sup> Christine Jolls et al., *A Behavioral Approach to Law and Economics*, in CASS R. SUNSTEIN, BEHAVIORAL LAW AND ECONOMICS 13, 42 (Cass R. Sunstein ed., 2000).

<sup>14</sup> See e.g., Judith H. Hibbard, et al., *Informing Consumer Decisions in Health Care: Implications from Decision-Making Research*, 75 MILBANK Q. 395 (1997).

<sup>15</sup> Cass R. Sunstein, *Introduction*, BEHAVIORAL LAW AND ECONOMICS 1, 1.

<sup>16</sup> Hunt Allcott, *Beliefs and Consumer Choice* (MIT Working Paper, Nov. 2010), available at <http://web.mit.edu/allcott/www/papers.html>.

<sup>17</sup> Memorandum from Cass R. Sunstein, Administrator, Office of Information and Regulatory Affairs to Heads of Exec. Dep’ts and Agencies 4 (June 18, 2010).

<sup>18</sup> *Id.* at 3.

<sup>19</sup> Office of Information and Regulatory Affairs, 2010 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities, Appendix D: Disclosure and Simplification as Regulatory Tools 55 (2010).

<sup>20</sup> § 2715(b)(2).

<sup>21</sup> Stephen A. Somers & Roopa Mahadevan, *Health Literacy Implications of the Affordable Care Act* 4, Center for Health Care Strategies, Inc., November 2010 (report commissioned by the National Institute of Medicine).

speakers of English.”<sup>22</sup> Indeed, low health literacy has been estimated to cost the U.S. economy between \$106 billion and \$236 billion annually.<sup>23</sup> Presenting information in a format that is easy to understand and to act on will allow a wide range of consumers to make more informed insurance choices. If the SBC Rule prevents even a small portion of the costs of low health literacy, it will be extremely well justified in economic terms.

The SBC Rule was developed after a consultation process facilitated by a working group convened by the National Association of Insurance Commissioners that was composed of “a diverse group of stakeholders” and that “considered the results of various consumer testing sponsored by both insurance industry and consumer associations.”<sup>24</sup> The rule references two focus group exercises, one conducted by America’s Health Insurance Plans (a trade association) and the other conducted by Consumers Union.<sup>25</sup> This testing supports the agencies’ conclusion that the format of the disclosure information helped consumers make informed choices about their options.

In addition to the standardized, simplified language used to disclose plan features, two benefits scenarios are included to illustrate plan differences. The common scenarios partially utilize the availability heuristic—people’s tendency to assess risk depending on how readily examples come to mind. The availability heuristic can, in this context, help counter detrimental overconfidence. Consumers tend to be overoptimistic regarding risks to life and health, which can lead them to select under-inclusive insurance coverage.<sup>26</sup> If people can easily think of relevant examples, they are far more likely to be concerned about those risks than if they cannot. Presenting common scenarios can encourage a realistic weighing of these scenarios in insurance purchasing.

### **The Agencies Plan to Continue Testing and Improving its Disclosure Format**

To maximize the benefits of the regulatory system, it is important to continually monitor and update regulatory programs in light of new information.<sup>27</sup> OIRA has found that this may be particularly important “[w]ith respect to summary disclosure [because] agencies will often be able to learn more over time.”<sup>28</sup>

Section 2715 requires a continual process “review[ing] and [update[ing]]”<sup>29</sup> the effects of the SBC Rule. The agencies have committed to measuring the effect of disclosure on behavior through

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<sup>22</sup> Center for Health Care Strategies, Inc., *Health Literacy Implications of the Affordable Care Act 1*, Missouri Foundation for Health’s Health Summit, Dec. 9, 2010, available at [www.mffh.org/mm/files/Summit\\_Mahadevan\\_handout.pdf](http://www.mffh.org/mm/files/Summit_Mahadevan_handout.pdf).

<sup>23</sup> *Id.*

<sup>24</sup> 77 Fed. Reg. 8670.

<sup>25</sup> 77 Fed. Reg. 8674.

<sup>26</sup> See generally David A. Armor and Shelley E. Taylor, *When Predictions Fail: The Dilemma of Unrealistic Optimism*, in *HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT* (Dale Griffin and Daniel Kahneman eds., 2002).

<sup>27</sup> Michael Greenstone, *Toward a Culture of Persistent Regulatory Experimentation and Evaluation*, in *NEW PERSPECTIVES ON REGULATION* 111, 113 (David Moss and John Cisternino eds., 2009).

<sup>28</sup> OIRA 2010 REPORT, *supra* note 19 at 101.

<sup>29</sup> § 2715(c).

ongoing empirical analysis and to modifying the standards accordingly. In particular, the agencies are “taking a phased approach to implementing the coverage examples and intend to consider additional feedback from consumer testing in the future.”<sup>30</sup> Revisions should be made “to the extent . . . the evidence warrants,”<sup>31</sup> and it should be recognized that empirical findings may support retention of the agencies’ initial design choice.

Best practices require testing of potential disclosure formats,<sup>32</sup> and as OIRA guidance documents make clear, testing should be a major component of any label evaluation process.<sup>33</sup> The agencies now have the opportunity to test the SBC design in market conditions. Questions that should be asked include “whether users are aware of the disclosure, whether they understand the disclosure, whether they remember the relevant information when they need it, whether they have changed their behavior because of the disclosure, and, if so, how.”<sup>34</sup>

## **Conclusion**

The SBC Rule is an important move towards increased transparency in the health insurance market, with the ultimate aim of improving consumer welfare via informed consumer decisionmaking. Given the relatively low costs of implementing the rule (compared to the size of the market and potential benefits), a primary focus should continue to be testing and improving the design of summary disclosure and labeling to maximize the benefits of disclosing information. Consumers must be able to select insurance policies that better match their preferences and unique health needs if consumer satisfaction and improved health outcomes are to be realized. The current rule is likely to yield substantial net benefits, and the costs of delay associated with further pre-implementation analysis is not justified: the agencies have appropriately chosen to move forward with a rulemaking now, while committing themselves to further ex-post study. The SBC template is grounded in sound behavioral, economic, and psychological understandings of how consumers make choices, and further research, and refinement, will continue to increase the utility of this important consumer protection measure.

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<sup>30</sup> 77 Fed. Reg. 8674.

<sup>31</sup> *Id.*

<sup>32</sup> See Sunstein, *supra* note 17 at 6.

<sup>33</sup> OIRA 2010 REPORT, *supra* note 19 at 56.

<sup>34</sup> Sunstein, *supra* note 17 at 5.