

The Evidence Is Clear: Too Many Health Insurance Choices Can Impair, Not Help, Consumer Decision Making

SUMMARY

A key question confronting policymakers is whether consumers are better or worse off when provided with as many health insurance choices as possible. Consumers Union reviewed the substantial literature in this area and the evidence is clear. While a few choices are good, too much choice undermines consumer decision making, particularly high stakes decisions involving health insurance. Cognitive limits with respect to decoding and analyzing data lead individuals to take decision making short-cuts or avoid choosing altogether.

Policymakers should explicitly consider limiting consumers' health plan choices in the new health insurance exchanges to a manageable number. Furthermore, they should provide robust decision making aids to improve consumers' ability to navigate the resulting choice set. Such interventions include standardizing benefit design, direct assistance, summary data about plans, and more to help consumers organize and evaluate their options.

As health reform implementation proceeds, federal and state governments must decide on rules that will regulate how many choices consumers see when they shop in the new health insurance exchanges in late 2013. While most Americans with employer-sponsored coverage are offered a limited number of health insurance options, the situation is very different in other markets. Consumers purchasing in the commercial individual market or among Medicare's private plan options can face between 20 and 40 health plan options. A key question that policymakers must consider: is more choice better?

At first glance, it may seem that having more choices helps consumers. A common assumption is that more choices will increase the likelihood that consumers can find a plan that meets their needs. However, Consumers Union reviewed the substantial literature in this area and found that while some choice is good, too much choice actually undermines consumer decision making.

A Little Bit of Choice is Good

The research on choice shows consumers prefer and benefit from having some choice. A number of studies have found that individuals place a higher value on products when they are offered alongside other options, as opposed to when they are offered only one choice (Bundorf, 2010; Szrek, 2007; Iyengar, 2000). Several studies found that consumers' satisfaction with their health plan selection generally increased as their hypothetical choice set increased; people were more likely to feel they made an informed choice when choosing among a larger choice set – particularly compared to having no choice (Bundorf, 2000; Gwande 1998; Schone 2001). For example, when consumers were presented with the same hypothetical insurance policy, they were willing to pay more for the policy when it was one of two options rather than when it was offered as a single option (Szrek, 2007).

Too Many Choices Undermine Consumer Decision Making

A significant body of research has found that tension exists between consumers' perception of the benefits of choice and their ability to make a choice when the number of options increases.

The classic experiment involved a display of exotic, high-quality jams. One consumer group was presented with 6 varieties of jam. The other group was presented with 24 options. The large array of jams attracted more people to the table than the small array, though in both cases, on average, people taste-tested about the same number of jams. When it came to purchasing the jam, however, there was a significant difference between the two sets of choice options. Thirty percent of the people exposed to the small array of jams actually purchased a jar, whereas only 3 percent of those exposed to the large array of jams purchased any.

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What's more, of those that did end up purchasing jam, those from the group with the smaller number of choices reported being happier with their selection (Iyengar, 2000).

Similar research with 401(k) retirement plans showed that as the number of 401(k) plan options rose, the employee participation rate fell (Iyengar, 2004). These studies controlled for other factors such as the amount of employer match, employee wages and other factors. 401(k) plans offering fewer than 10 fund options had significantly higher employee participation rates, yet many funds offer 30 or even 60 options.

Cognitive Costs of Too Much Choice

Leading researchers have concluded that after a certain point, more options increase stress for consumers and make it harder to decide (Wood, 2011; McWilliams, 2011; Iyengar 2004; Schwartz, 2004; Chernov, 2003; Iyengar 2000).

People have cognitive limits on what they can absorb and analyze. When the amount of information exceeds a person's ability to assess it, the cognitive costs impair their decision making abilities (Lowenstein, 1999).

Cognitive costs can be broken down into three types: time, error and psychic costs. The time cost of choice is, literally, the increased amount of time required to make a decision. The larger or more complex the choice set, the larger the likelihood of errors in the decision making process. The psychic costs of choice involve the emotional effort that has to be expended to make the choice.

HIGH STAKES INCREASE COGNITIVE COSTS

When the choices involve high stakes decisions about things such as money, occupation opportunities, or health care, the stress of decision making is amplified and even further impaired (Bundorf, 2010; Botti, 2006; Abaluck, 2009). Because decisions regarding health insurance coverage are complicated and carry important implications for financial security and health, the cognitive and psychic/emotional costs of health insurance choices may be particularly high (Bundorf, 2010).

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POPULATION CHARACTERISTICS AFFECT COGNITIVE COSTS

While several studies found that older adults perform more poorly than younger adults confronted with a large choice set (Wood, 2011; Hanoch, 2009; Hibbard, 2001), it appears that cognitive ability, rather than age per se, is the over-riding factor affecting a person's ability to select from among a large choice set (Wood, 2011; Tanius, 2009). A specific ability, numeracy, appears to play a key role. Numeracy is the ability to reason with numbers and it is an important indicator of one's ability to make sound choices when confronted with multiple options (Wood, 2011; Tanius, 2009).

A recent study on Medicare Part D (Hanoch, 2010) found that even among people with higher numeracy skills, less than half end up choosing the product that would provide the best value when offered in a large choice set. In one study evaluating choice of Medicare Part D plans, medical students and internal medicine residents were randomly assigned to 1 of 3 surveys, differing only in the number of health plan options to be evaluated (3, 10, and 20). As choice sets increased, physicians-in-training had difficulty identifying the best plan, suggesting that even among this highly educated group, plan selection was impaired as the choice set grew larger. Researchers found that those comparing 10 or 20 plans were "significantly less likely" to identify the most beneficial plan. Thus, large choice sets can undermine decision-making even when numeracy skills are high.

LARGE CHOICE SETS LEAD TO UNDERSIRABLE OUTCOMES

When choice sets are too large, we see undesirable outcomes. Because a large number of choices reduces the consumer's ability to identify the best option for themselves, we may see consumers:

- Defer or avoid making a decision (Iyengar, 2004; Dhar, 1997; Tversky, 1992);
- Delegate their choices to others (Hibbard, 2001);
- Experience a greater sense of regret or dissatisfaction with their selection (Chernov, 2003; Schwartz, 2002; Iyengar, 2000); and
- Be less confident in the choices they make (Botti, 2004, Schwartz, 2002).

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Study Samples from Health Care

A significant amount of evidence comes from recent experience with two Medicare programs: Medicare Advantage and Medicare Part D.

In one study that examined consumer decision making in Medicare Advantage plans, a choice set of 15 or fewer plans was associated with higher rates of enrollment. Providing between 15-30 plan choices did not lead to increased enrollment, and offering more than 30 choices actually decreased enrollment (McWilliams, 2011).

Another study found that Medicare beneficiaries—who faced approximately 40 stand-alone Part D drug plans in 2006—did not enroll in the plan that would minimize their out-of-pocket costs (Abaluck, 2009). Put another way, researchers found that a large portion of enrollees had other alternatives that would have lowered their costs as compared to the plans that they actually chose. The researchers conducted modeling that predicted that restricting the choice set to the three lowest cost options would have raised welfare for seniors under the program.

Finally, survey data shows that people find the Medicare Part D plan selection process—featuring a large number of choices—confusing and difficult. Nearly three-fourths (73 percent) of people ages 65 and older felt that the Medicare prescription drug benefit was too complicated, along with 91 percent of

MEDICARE ADVANTAGE

Medicare Advantage is a private plan alternative to traditional fee-for-service Medicare, covering the same benefits as Parts A and B and often including additional or supplemental benefits. Approximately 25 percent of Medicare beneficiaries enroll in Medicare Advantage plans. For the 2012 plan year open enrollment period, beneficiaries were able to choose among 20 Medicare Advantage plans, on average, with even more options in urban counties.

MEDICARE PART D

Prescription drug plans provide drug coverage that complements the coverage offered under traditional Medicare Parts A and B. For the 2012 open enrollment period, Medicare Part D beneficiaries had a choice, on average, of 31 stand-alone prescription drug plans.

pharmacists and 92 percent of doctors (Kaiser Family Foundation II, 2006). When asked if they agree with the statement: “Medicare should select a handful of plans that meet certain standards so seniors have an easier time choosing,” 60 percent of seniors answered in the affirmative (Kaiser Family Foundation, 2006).

Facilitating Consumer Decision Making

Policymakers and exchange staff must recognize the well documented limits on consumer decision making and not subscribe to the fallacy that more choice is always better. As one researcher concluded (in the context of health care decision making), “[g]iven the financial and medical ramifications involved, policymakers must recognize these difficulties and their potential harms” (Hanoach, 2010).

When faced with the high cognitive costs of a large choice set, individuals will turn to a variety of “cognitive shortcuts” to make the task easier, such as shopping based on brand or asking a neighbor what she would do (Quincy, 2012).

However, taking an inappropriate short-cut can leave a valuable option on the table (Botti, 2006).

Fortunately, there is some literature that points to possible remedies. Research indicates that policymakers can reduce the negative effects of too much choice in a number of ways.

DON'T ALLOW AN UNLIMITED NUMBER OF CHOICES

Many researchers suggest that reducing an otherwise large choice set can help consumers (McWilliams, 2011; Iyengar, 2010; Abaluck, 2009; Hanoach, 2009). While there is significant data demonstrating that many choices impair decision making, there is less data suggesting what the “right” number is. It is likely that the right number will depend on how complex the underlying choices are and how much effort is required to compare the options (Loewenstein, 1999). As a guideline, however, it appears that more than fifteen choices reduces a consumer’s ability to make a health plan selection in their best interest. It is also possible that the ideal number is less than fifteen.

Consumer testing in Massachusetts showed that many consumers felt overwhelmed by the original number of choices offered in the state’s health

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insurance exchange. Guided by this consumer research, the state opted to standardize the benefit packages offered in the exchange and reduced the number of plans offered from thirty-six down to nine. Subsequent feedback from consumers showed that consumers were highly satisfied with the standardization of benefits, enabling easier comparison among products (Day, 2012).

Another study found that up to 16 (hypothetical) Part D plan choices were associated with satisfaction with the plan selected. While satisfaction with plan choices increased as their option set grew from 2 to 16, the study evidence suggests (but is not conclusive) that satisfaction peaked at 10 choices (Bundorf, 2010).

A third study examined enrollment, not satisfaction, and found that offering 15 or fewer plans was associated with increased enrollment in Medicare Advantage. Making 15-30 plan choices available did not lead to increased enrollment, and more than 30 choices actually decreased enrollment (McWilliams, 2011).

Still another study looking at Medicare Part D plan offerings saw that participants performed worse when presented with 24 plans and found six offerings more manageable (Tanius, 2009).

When it is not possible or practical to reduce a large set of choices, interventions that reduce the cognitive work required to process the information about each choice may be helpful to consumers.

INTERVENTIONS MAY HELP MANAGE A LARGE CHOICE SET

When it is not possible or practical to reduce a large set of choices, interventions that reduce the cognitive work required to process the information about each choice may be helpful to consumers (Kling, 2012; McWilliams, 2011; Bundorf, 2010; Iyengar, 2010; Abaluck, 2009).

Interventions that can help manage a large choice set include:

- Standardizing options (Day, 2012; Hanoch, 2009);
- Offering screening tools and other decision aids (Hanoch, 2010; Iyengar, 2010; Botti, 2006; Hibbard, 2003),
- Providing educational interventions (McWilliams, 2011, Hibbard, 2000),
- Presenting specific personalized information (Kling, 2012), and

- Recommending a trusted resource such as a health benefit exchange (McWilliams, 2011) or health care provider (Abaluck, 2009) who can play a role to vet and/or filter the choices based on the consumer’s needs.

For example, one study that randomly assigned one group of Medicare Part D beneficiaries to receive a letter with personalized cost information found that providing personalized cost information to Medicare Part D applicants had a significant impact on their plan switching behavior. The beneficiaries who received the information switched plans 28% of the time, compared to 17% for beneficiaries who had to take an action to get the same information off the web. Predicted savings from switching was estimated to lower costs to consumers by about \$100 per year (Kling, 2012).

Policymakers have the option of providing vetted, consumer-friendly short-cuts to help consumers navigate their choices. For example, several health plan chooser tools in use today provide a measure of each health plans “Total Estimated Costs” – essentially “doing the math” for the consumer and making it easier to identify the best plan for them (Krughoff et al.; Kleimann Communication & Consumers Union, 2012).

Conclusion

It is critically important that policymakers appreciate that too many choices can harm consumers’ decision making abilities and actually result in lower enrollments in health insurance. Blanket claims that increasing consumer choice is beneficial must be reviewed critically in light of the robust literature on this topic.

Put simply, a large choice set may indeed contain a “best” option for an individual, but it is unlikely that the shopper will be able to find the best option if there are too many choices to sift through. The high cognitive costs associated with a large set of complex choices mean stress and uncertainty for the consumer. A large choice set is *more* likely to lead to hasty or wrong choices.

Given the complexity of health plan benefit designs, policymakers should give careful consideration to the number of choices provided to consumers. They

should pair this caution with tested interventions that make it easier for consumers to navigate the remaining choice complexity. A rigorous examination of the literature, along with robust consumer testing, should be used to guide decisions about the consumers' health plan choices in the new health insurance exchanges.

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