Public Policy Options for Small Employer Health Insurance

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Despite the fact that fewer people are covered under an employer health plan than have been in the past, employer-based insurance is and likely will remain the cornerstone of our health insurance system for the foreseeable future. Employees of small firms are less likely than employees of large firms to be offered insurance through their job and, as a result, more likely to be uninsured. For example, data from the 2002-2003 Medical Expenditure Panel Survey showed that only 57.2% of employees working in firms with fewer than 50 employees were offered health insurance. Small firms employ a significant portion of North Carolina’s workforce, so the lack of insurance among these firms is a serious public policy concern. Policy options aimed at improving our rate of insured among employees of small firms can and should be considered.

Before considering these options, it is useful to understand certain aspects of North Carolina’s regulation of small group health insurance premiums. Premiums for small employer groups (those ranging in size from self-employed individuals up to firms with as many as 50 employees) are set using a methodology known as “adjusted community rating with rate bands.” The “community rate” is the statewide expected per-person annual claims cost for an insurer’s entire book of small group business. The “adjusted community rate” is the differentiation in premium costs from the community rate for a particular small group, based on the small group’s “case characteristics,” which are defined as age, sex, family composition, and geographic location.

Using the community rate creates a substantial subsidy effect on the premiums charged to groups whose members have higher than average medical risk, because the premium rate for all small group insureds, regardless of risk status, is generated from the same starting point. In other words, higher-risk groups benefit from subsidies because the costs are spread across the groups that are less costly to insure. Working from the community rate, each small employer’s premium is adjusted to reflect their differences in expected medical costs due to case characteristics and the specific benefit plan chosen. In addition, premiums are permitted to differ—up to 20%—based on the estimated medical risk of the specific group. Thus, North Carolina laws governing small group health insurance premiums reflect a balance of three rating philosophies: a substantial subsidy effect for groups with higher medical risks, full differentiation based on demographics, and limited differentiation based on medical risk.

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Potential Changes to Current Small Group Regulation

Small group regulation cannot be adjusted to produce dramatic changes because this regulation is based on cost shifting rather than the underlying healthcare costs that influence insurance premiums. However, some pricing improvements can be achieved through modest adjustments to current law.

Some employers and interest groups advocate for increasing the subsidy effect for the higher-risk employees, while others advocate for reducing the subsidy effect so coverage wouldn’t be too expensive for lower-risk employees. A change to our current system will create undesirable tradeoffs at either extreme since it is based on a cost-shifting approach. Because increasing the subsidy effect produced by the rating process shifts more expense to employers and employees who have fewer health risks, fewer employers will be able to afford the higher-cost insurance, and the youngest and healthiest employees offered coverage on the job may decide it is not a good value and opt out. As those with fewer health risks (i.e., the number of those who cost the least insure) leave the market, the community rate

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rises. Therefore, in reality, increasing the subsidy effect too much would actually produce the opposite of the effect intended—it would inadvertently lead to a lower subsidy effect because there are fewer healthy people in the group to diffuse the costs incurred by those with higher health risks. On the other hand, a rating system that extracts a smaller subsidy from the low-risk groups would increase the likelihood that coverage would become prohibitively expensive for the high-risk groups. Therefore, too great a decrease to the subsidy effect would benefit only the healthiest people and would cause higher numbers of uninsured among less healthy employees. A balance between these opposing forces providing a sufficient subsidy effect to help those who cost the most to cover, but not so much subsidy that it drives the low-risk employees out of the market—produces the most beneficial overall results from a public policy standpoint.

The North Carolina Department of Insurance (NCDOI) recently recommended to the North Carolina General Assembly House's Select Committee on Health Care adjustments to the state small group rating laws that would reduce premiums for groups with lower medical risks or certain demographic factors that make them less costly to cover. These changes would result in a modest decrease in the subsidy effect for groups with higher medical risks or certain demographic factors that make them more costly to cover. An additional effect of these changes would be lowering premiums or to reducing premium increases for all small groups. This would occur because more lower-risk employees would be able to buy and retain coverage, which would depress the average claims cost and boost the subsidy effect that the community rate has for higher-risk employees. This latter effect is the reason that NCDOI recommends these rating changes.

Some state and federal legislation—most notably bills proposing special treatment for association groups—purport to reduce the high cost of health insurance for small groups. However, these approaches have been flawed due to the fact that they would reduce (or eliminate completely, by fragmenting the small group market) the subsidy effect for higher-cost small employers without providing any offsetting benefit to these groups. Some of these proposals go even further, suggesting the deregulation of association health plans, which would create an un-level playing field within the market and deprive some citizens of consumer protections under state law. As a result, lack of insurance would become an even greater problem for employers whose employees are higher-risk. Association health plans are not a part of the solution for small employers.

**New Product Options**

New health insurance products may keep coverage affordable for employers who currently offer health insurance coverage to their employees. These products may also appeal to some employers and individuals currently unable to afford to offer or buy coverage. Examples of these products include: high-deductible health plans offered alone or in conjunction with health savings accounts, “limited benefit plans” that cover a certain amount of costs up-front or after meeting a high deductible, and so-called “tiered benefit plans” where an employer contributes toward a base plan with the option for employees to “buy up” to a richer plan. In a few cases, a change to state law would be required to allow these products to be offered or to enable these products to function as intended; in other cases, insurers can and do offer them now.

Proliferation of plans that provide less coverage raises concerns over the financial barriers to obtaining necessary care and whether some employers now offering more comprehensive plans will “trade down.” But the reality is, without alternatives, some employers who currently offer coverage may drop it in the future due to cost, and people who cannot afford coverage now will continue not to have any options. A more pressing concern is that these products actually offer value to someone who presently does not have insurance; without value, these products will not even provide incremental improvement in the numbers of uninsured among employees of small firms.

Realistically, alternative products are needed as a part of any multi-pronged approach to sustaining and expanding the small group market. Although tempting from a public policy standpoint, placing limitations on the sale of certain products in an attempt to prevent them from being substituted for more generous coverage is not practical, since there is no way to identify employers or employees who would have to drop coverage due to cost in a future period, but for having the ability to switch to an alternative product. However, requirements can and should be used to preclude the offering of alternative products in a way that subverts small group regulation.

**Additional Ways to Subsidize the Cost of Coverage**

Because health insurance premiums are simply unaffordable for some employers and employees, additional forms of subsidy may be required to enable some to buy or continue to buy insurance at its present true cost. Attention in our state has focused on tax credits for employers offering coverage and on a program (dubbed “Healthy North Carolina”) offering coverage reinsured by the state. Ideas for other, more simple subsidy mechanisms should also be considered.

Tax credits for employers’ contributions toward health insurance may help some employers continue to afford offering coverage when they might not otherwise be able to do so. Critics of tax credits rightly point out that credits will reward employers who would offer coverage even without a credit, and therefore are not an efficient use of state funds. Targeted credits, such as credits for employers with lower-paid employees or those not currently offering coverage could be a more effective

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a Association Health Plans are groups of small employers pooling together to self-insure.
tool to contain or decrease the ranks of the uninsured.

The Healthy North Carolina proposal, modeled after an existing program in New York state, would rely upon state-provided reinsurance to reduce the level of premiums that insurers would charge eligible employers and workers for coverage. For this program to work in North Carolina, key differences between this state’s and New York’s insurance market must be addressed. Funding for the reinsurance needs to be both adequate and reliable in order to have the desired effect on premiums. Premiums and benefits need to appeal to the target population. Eligibility and other program rules need to be set in such a way as to avoid attracting only high-risk groups to the program and also avoid causing erosion of the existing small group insurance market. Even with all of these conditions satisfied, the opportunity to buy health insurance at subsidized rates does not guarantee increased uptake among small employers and employees. However, if there is the will to use state funds for a program such as this, the task of properly structuring it is doable, and the opportunity to thoroughly explore this option should not be passed up.

Addressing the Cost of Medical Care

Although the other policy options discussed here may present some opportunity to reduce the net (or effective) premium costs paid by small employers and their employees, they do not address the primary driver of the cost of health insurance—the cost of the medical care that the insureds receive. Containing the cost of care will entail employing a wide variety of tactics to exploit numerous opportunities for improvement. Chief among these are reducing the amount and level of care needed through promotion of healthy lifestyles, better disease management, and improved treatment protocols. The full impact of initiatives to address these and the other factors fueling the growth of healthcare costs will not be realized all at once or in the short-term. However, tackling medical costs is the only way to achieve meaningful, sustained improvements to the insurance market as a whole.

Conclusion

The small group health insurance market in North Carolina can be improved through a number of policy approaches that can work individually or in combination.

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First and foremost, maintain the basic framework of our current small group regulation. Do not allow or support changes to small group regulation that would fragment the market and benefit only the healthiest workers. This is necessary regardless of any other policies adopted.

Make adjustments to the details of small group rating law as recommended by the Department of Insurance, in order to realize modest beneficial effects on premiums.

Allow insurers to offer alternative benefit plans that can help employers continue to afford offering insurance and appeal to some of those employers and employees in the small group market who do not currently offer or buy coverage. Do not allow or encourage products that would undermine the small group market by circumventing small group regulation.

Use state fiscal policy to subsidize the cost of coverage in order to help employers who currently offer coverage to continue offering it, and enable or encourage employers who are not offering coverage to do so. Target these funds to help those most at risk of having to drop coverage due to cost and those who are the least able to afford insurance today. Make sure that no mechanism used to provide subsidies has a harmful effect on the small group market.

Implement policy and support specific initiatives to reduce the total cost of medical care provided over the long term.

Take actions aimed at reducing the numbers of uninsured outside of the small group market that also have a positive impact on small groups. Examples include approving a limited expansion of Medicaid for low-wage workers so that the burden of uncompensated care on all (including the small group market) will be reduced, and establishing a high-risk pool for individual coverage so that removing self-employed individuals (the most risky of all small groups to cover) from the small group market can be considered as an option in the future, and the cost of subsidizing these costly groups can be spread beyond the small group market.

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b Reinsurance is essentially insurance coverage for insurance carriers. If the annual claims for an individual in the plan reach some predetermined amount, then the reinsurer covers at least some part of the claims above that level.