May 9, 2013

TO: Members, Senate Appropriations Committee

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SUBJECT: SB 161 (HERNANDEZ)--SMALL EMPLOYER: HEALTH COVERAGE: ELIMINATION OF COST CONTROL TOOL - OPPOSE
SCHEDULED FOR HEARING: MAY 13, 2013

The California Association of Health Underwriters (CAHU), the Independent Insurance Agents and Brokers of California (IIABCal) and the National Association of Insurance and Financial Advisors of California (NAIFA California) **OPPOSE SB 161 (Hernandez)**, as amended April 25, 2013. Our organizations are concerned that **SB 161** severely restricts ability of small employers in California to self-insure for health care coverage by unreasonably changing the limits and requirements of stop loss insurance policies.

Our organizations represent California's licensed health insurance agents. Our licensed members provide reliable insurance advice, act as the consumer's advocate when dealing with carriers and provide a number of essential services relating to the individual and group insurance coverage and obligations post-enrollment. Our members also act as a trusted and effective marketing and distribution channel for health insurance information for all consumers and potential consumers of health care insurance coverage.

As amended, **SB 161** would require a minimum specific stop-loss deductible of $65,000 per person, and an aggregate attachment point of $13,000 per individual and each dependent for small employers with 50 or fewer employees. This means that a small employer would have to incur $65,000 in per claim per employee costs before being able to seek reimbursement from the stop-loss carrier.

Our organizations are concerned that **SB 161** proposes to make it nearly impossible to provide reasonably priced catastrophic stop-loss insurance for small employers--most notably by requiring the small employer to bear an unreasonable level of claims costs before stop-loss coverage applies. Self-insurance combined with stop loss coverage for excessive, unexpected claims, frequently offers the best option for small employers seeking to find any way to provide affordable health coverage for their employees.

Today, in every state, stop-loss insurance can be purchased to cover claims over a certain amount for each individual plan member (specific stop-loss) or for the aggregated expected health claims of all covered members (aggregate stop-loss). An employer can choose one or both attachment points when purchasing coverage. The attachment point is the point at which the stop-loss insurer will reimburse the employer for paid claims. The self-insured employer remains liable to the employee and medical service provider to pay the claim; the stop-loss insurer is liable to the self-insured plan only.

Self insurance is also the only option for California-based businesses that have less than 50 percent of their employee base located in this state. Fully insured off-the-shelf products are simply not available. Small employers in this situation still must self-insure but SB 161 will make it even more expensive to do so.

Additionally, federal law, the Employee Retirement Income Security Act of 1974 (ERISA) permits all employers to choose to self-fund. These self-insured plans must comply with fiduciary standards, along with significant reporting and disclosure requirements. Federal law also prescribes procedures to handle denied claims, recourse options and an ability to sue to recover entitled benefits. Employers that choose to self-fund pay for the enrollees' (and if applicable, their dependants) health expenditures out of general assets or through a trust. It is not a process that any employer, particularly a small employer enters into lightly, due to all of the new duties, paperwork and other obligations all self-funded plans require.

A key point to note in the self-funded process is that the employer bears the risk for unexpectedly high claims. That is why employers purchase actuarial-based catastrophic or "stop-loss" insurance because it is a prudent financial management that protects against unexpected, high dollar catastrophic losses.

However, **SB 161** would serve to remove this important protection for small employers through a very high specific ($65,000) attachment point per individual, as well as an aggregate attachment point per policy year that is less than the greater of one of the following:

- Nineteen thousand dollars ($13,000) times the total number covered employees and dependents.
- One hundred twenty percent of expected claims.
- Sixty-five thousand dollars ($65,000).

SB 161 also includes an unreasonable provision that mandates direct coverage of an employee's health claims that will force a small employer to front the cost of their claims, and then wait for up to a year before being reimbursed by the insurer.

SB 161 takes away a critically important financial tool used by small employers to make prudent choices to control costs of providing health coverage. If a small employer wishes to finance their employee health coverage through self-insurance that includes purchasing actuarially appropriate stop loss policies, our three organizations believes they should continue to be allowed to do so.

For these reasons and more, CAHU, IIABCal and NAIFA California must respectfully **OPPOSE SB 161** (Hernandez).

Please do not hesitate to contact us if you require further information: Juli Broyles (CAHU) at 916-441-5050; John Norwood or Shane LaVigne (IIABCal) at (916) 447-5053, or Shari McHugh (NAIFA California) at (916) 930-1993.

Enclosure: Stop Loss Background

cc: Office of Governor Brown
The Honorable Ed Hernandez
Brendan McCarthy, Senate Appropriations Committee
Joe Parra, Senate Republican Caucus

SB 161 (Hernandez) Stop Loss Insurance

SB 161 (Hernandez) in its current form would severely restrict the ability of small employers to self-insure for health care coverage by unreasonably changing limits and requirements of stop loss policies. For some employers, the most appropriate, affordable health care coverage for employees is available through a variety self-funding arrangements. Stop loss insurance coverage is a prudent purchase for self-funded employers because it protects them from suffering unexpected, catastrophic losses. According to a report prepared by *Robert Bachler, Principal and Consulting Actuary with Milliman,* only 7.5% of employers with 50 or less employees purchase stop-loss insurance. While the use of stop-loss insurance by small employers is severely limited, the availability of that coverage is crucial to those that do. [1]

Fully-Insured

Most employers purchase group health insurance for their employees through a fully-insured health plan, like CIGNA or Aetna. The employer shops for the appropriate, affordable coverage and then pays an established monthly premium per enrollee. The health insurance provider then pays the claims and absorbs the risk. These plans are regulated by state law through the Department of Managed Care or the Department of Insurance, subject to federal law including the Affordable Care Act (ACA). Employers that purchase health insurance (with or without employee contributions) are considered "fully-insured."

Self-Funded Plan, ERISA, and the Affordable Care Act

Under the federal Employee Retirement Income Security Act of 1974 (ERISA) employers may choose to self-fund. Self-insured plans must comply with fiduciary standards, reporting and disclosure requirements. ERISA also prescribes procedures to handle denied claims, recourse options and an ability to sue to recover entitled benefits. Employers that choose to self-fund, pay for the enrollees' (and if applicable, their dependants) health expenditures out of general assets or through a trust. The employer bears the risk for unexpectedly high claims. States cannot regulate self-insured plans established per ERISA. However, the states can regulate third-party insurance products sold to ERISA plans.

The ACA intentionally subjects self-insured plans to only certain provisions, such as the removal of the lifetime cap and subjects those plans to the transitional reinsurance fee. Consistent with the President's philosophy to allow consumers to keep the plans they currently have, the ACA anticipated the role of stop-loss insurance to remain as it is in order to preserve some aspects of current practice.

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[1] See Robert Bachler, FSA, FCAS, MAAA *Policy Characteristics in the Employer Medical Stop-Loss Market*, Milliman Client Report (2013) pg. 4.

Prudent Employers Purchase Stop Loss Insurance to Protect from Large Unexpected Claims

To help mitigate the financial risk of unexpected high claims, employers purchase stop-loss insurance. This type of insurance is like re-insurance, it is indemnity coverage that a wise employer will purchase to pay claims in excess of normal, expected claims. Stop-loss insurance can be purchased to cover claims over a certain amount for each individual plan member (specific stop-loss) or for the aggregated expected health claims of all covered members (aggregate stop-loss). An employer can choose one or both attachment points when purchasing coverage. The attachment point is the point at which the stop-loss insurer will reimburse the employer for paid claims. The self-insured employer remains liable to the employee and medical service provider to pay the claim; the stop-loss insurer is liable to the self-insured plan only.

For example if an employer has a specific attachment point at $20,000, and an employee's claim is $30,000, the employer is responsible for the entire amount, but may seek reimbursement from the stop-loss insurer for $10,000. If the same employer has an aggregate attachment calculated at $100,000 and the claims for all members reached $115,000 (not including any amount reimbursed under the specific attachment point), the employer would be reimbursed for $15,000.

Benefits of Self-Insurance for Small Employers

While self-insurance is not for everyone, sometimes it's the only choice that makes sense. For some employers, they may not be able to afford coverage other than through a self-funded arrangement, and other employers may have special needs that only a self-funded or partially self-funded plan can address. Although capital intensive, this option has the potential to provide employers with more predictability in their overall business costs as well as providing the potential benefit of controlling claims costs through wellness initiatives. This is achieved through improved employee health status and overall productivity. Employers have greater access to claims data that provide feedback on the type and potential causes of claims. They have the incentive and ability to tailor wellness programs to their workforce, thereby improving employee health and also improving the bottom line.

Ironically supporters of **SB 161** contend that self-insurers may take on TOO MUCH risk and become insolvent or go bankrupt. A study sponsored by the *US Department of Labor, and conducted by the RAND Corporation* evaluated firms that both self-insured and had fully-insured plans. During the economic downturn there was no statistically significant change between the scope of benefits offered or cost sharing

between these two different plans. Additionally the *RAND* study found no examples of firms that became insolvent because of the direct risks of self-insuring.[2]

The Attachment Points in SB 161(Hernandez) Are Too High and Will Disproportionately Impact Small Employers

Arguably, employers that self-insure should assume a significant portion of the financial responsibility for claims, and bear a substantial amount of risk. **SB 161** attempts to expose small employers to excessive risk by increasing the specific and aggregate attachment points to levels that provide little or no protection for employers from catastrophic losses. The bill proposes specific attachment points at $65,000 per claim. A small employer therefore would be responsible for the first $65,000 of the claim before the stop-loss insurance would start reimbursing the employer.

According to *Milliman* the median specific deductible for groups with 50 or fewer covered employees was **$35,000**. [3]

Milliman also shows that only less than 0.1% of groups with over 1,000 covered employees have a specific attachment point less than $75,000. Therefore, **SB 161** is requiring an employer of 50 employees or less to take on a level of risk similar to or greater than that of employers with over 1,000 employees. This is not reasonable, because the claims experience of a small employer will fluctuate more dramatically, and the fluctuation in cost to the employer would be increased to an intolerable level at a $75,000 specific attachment point. A small employer is very unlikely to have the financial resources to absorb the kind of fluctuation that could occur at such a high attachment point. [4]

Furthermore, a panel at the National Association of Insurance Commissioners (NAIC) last November decided not to pursue a revision of the current recommended specific stop loss attachment point of $20,000. The panel -- the ERISA Working Group, a subcommittee of the NAIC's Health Insurance and Managed Care Committee -- rejected a stop-loss motion during a session in Washington. The working group considered an increase to the specific attachment point of $60,000. The motion failed by a 10-8 vote.

Overwhelmingly, the most reliable studies and opinions recommend a specific attachment point that falls within a range of **$20,000 to $40,000**. These proposals reflect the best practice and good policy of spreading risk to ensure solvency but retaining sufficient risk to encourage good insurance practices. To remain

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[2] *Employer Self-Insurance Decisions and the Implications of the Patient Protection and Affordable Care Act as Modified by the Health Care and Education Reconciliation Act of 2010 (ACA) Sponsored by the U.S. Department of Labor,* Rand Health. Pg 28

[3] *Milliman*, supra at 1.

[4] Id at pg. 9.

consistent with the President's approach to "grandfather plans that currently and successfully provide health benefits, the most appropriate attachment point would reflect the lower range of current practice, $20,000. Raising that point to $30,000, a 50% increase to the current NAIC Model Act and the highest attachment point in the nation, would likely eliminate some currently existing plans, but at the same time discourage new entrants to self-insurance only seeking to avoid higher premiums in the small-group market.

The Proposed Aggregate Attachment Points are Unreasonable

According to **SB 161**, the proposed aggregate attachment point is the greater of these three alternative amounts:

(1) Thirteen thousand dollars ($13,000) times the total number of covered employees and dependents.
(2) One hundred twenty percent of expected claims.
(3) Sixty-five thousand dollars ($65,000).

The lowest would be $13,000 per covered person and dependents.

SB 161 would put the aggregate attachment point to at least $13,000 person. This attachment point would put an employer's costs at 300 % of expected costs. The likelihood that an employer ever has costs in excess of 300% is extremely small. Requiring coverage at such a high level would put almost zero risk on the insurer which does not result in real insurance coverage.

At What Point is Self-Insurance Real?

Industry stakeholders agree that true self-insurance imposes a significant portion of risk onto the employer. Several "tests" have been proposed at triggered points for determining if self-funding is real. According to *William Lane of Heartland Actuarial Consulting, LLC* an independent health actuary, one such "test" is whether or not the small employer is reinsuring 50% or more of its expected claims. Another such "test" is whether or not the small employer has an actual cost that exceeds the expected cost by 10% in at least one year out of ten. [5]

Heartland, which studied the prior bill **SB 1431 de León (legislative session 2011-2012)** which is identical to **SB 161 Hernandez,** analyzed employer risk under the NAIC Model Act with the current limits of $20,000 for the specific attachment point and a percentage limit on the aggregate attachment point of 120%. A small employer assumes 50% or more of all expected claims under a wide variety of circumstances with these limits. On average, in four to five years out of a ten-year

[5] William R. Lane, FSA, MAAA Principal. Heartland Actuarial Consulting, LLC, Memorandum, *Proposed Changes to the NAIC Stop-Loss Insurance Model Act As They Relate to Small Employers (50 Employee or Less)* pg. 2

period, an employer will be assuming "true risk" by paying more than 110% of expected claims. [6]

According to *Heartland,* if the specific attachment point were set at $30,000 and the aggregate attachment point was set at 120% of expected claims, without any further limits, it would achieve or exceed these results for groups with ten employees and ten dependents, on average for the four ACA "metal" plans. The 50% reinsurance test would be under 50% reinsured in some cases and over 50% reinsured in other cases, but the linear average would be less than 50% reinsured. This same set of model act limits would typically produce losses for the employer of 10% or higher in five years out of ten. In other words for a ten employee and ten dependent small employer, these limits would satisfy the above "tests." [7]

Applying these same limits to a small employer with twenty-five employees and twenty-five dependents it would result in a lower percentage of claims reinsured. Thus, this "test" would be passed more easily. These limits, applied to this larger small employer would typically produce losses of 10% or greater in four or five years out of ten, depending on the plan design. Hence, this "test" would remain easily satisfied.

For another example of the specific numbers relative to small groups, the *Milliman Report* used by the NAIC indicates the following results for small groups:

> At a specific stop-loss attachment point of $30,000, the employer would be expected to pay out of pocket 60% of all the employees medical costs for an ACA Bronze Plan; 64% of all medical costs for ACA Silver Plan; 67% of all medical costs for ACA Gold Plan; and 70% of all medical costs for ACA Platinum Plan. Stated another way, for a Silver Plan with a $30,000 specific aggregate attachment point, according to *Milliman,* the employer would pay out of pocket 100% of all their employee medical costs for 97% of their employees. This results in the employer only being reimbursed by the stop-loss carrier for very large claims incurred by a very small portion of their employees and dependents. This is exactly how stop-loss insurance is designed to work and provides conclusive evidence that such plans are real self-insurance. [8]

Self-Insurance Will Not Compromise The Insurance Exchange

The *RAND* study suggests that the likelihood of self-insuring after ACA is small. Even with stop loss insurance, self-insurance remains risky for small firms. Only if

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[6] Id

[7] Id

[8] Id at pg. 4-5

comprehensive stop-loss is readily available at a specific attachment point of $20,000 does the study indicate there will be an increase in self-insurance, but only by 5% from current levels. Therefore, as the study suggests, **IF** adverse selection does occur, it will not be substantial enough to cause death-spiraling or destabilization in the market.[9]

Additionally, critics argue that excluding the self-insured pool would create uneven risk in the market place, particularly within the exchange. However as part of the ACA's requirements, methods will be implemented to allocate insurance risk. This will be done through reinsurance, risk corridors, and risk adjustment. The purpose of these reforms is to protect against risk selection and market uncertainty as insurance changes and the exchange is implemented. Each state must establish a transitional reinsurance program to help stabilize premiums. Administrators of self-funded plans will be required to contribute to this program.

Unintended Consequence of SB 161 (Hernandez)

Naturally, larger employers can take on more risk than a smaller employer. Forcing a smaller employer of 50 employees or less to take on the same risk as an employer with 1,000 employees or more will force smaller employers to drop coverage. Employers moving forward will not offer coverage and individuals will choose not to enroll. Therefore, eliminating the option to self-fund will actually lead to an increase in the total number of uninsured. [10]

In summary, putting the specific attachment point at $95,000 puts the employer at very serious financial risk. This would make self-funding an unrealistic option for small employers who need flexibility in coverage. In any given year, a small firm that self-insures is at greater risk for experiencing a catastrophically high health expenditure that could lead to financial problems. According to *RAND*, the risk that a small firm of 50 employees or less exceeds their expected claims, is roughly 20%, therefore it's essential that a small firm be insured against this kind of catastrophic loss with stop loss insurance it can reasonably afford.[11] The ACA exempted self-funded insurance from the exchange. Clearly the intent of the ACA was not to impact this option for small employers. Self-insurance was left as an option because it's important for small business to have a choice.

Small employers should have the opportunity to select the most appropriate, affordable health care coverage for their employees and this bill seeks to eliminate the option of self-insurance as an option. In this new era post-ACA, there will be alternatives to the state run exchange, and self-funding should be one of them. However, **SB 161 Hernandez** would severely limit, if not eliminate, this choice entirely for small business.

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[9] *Rand, supra, at pg. 52, 57-58.*
[10] *Rand*, supra at pg. 56
[11] *Rand*, supra at pg. 4

Summary of Proposed Specific Attachment Points

$95,000	• Recommended by the Department of Insurance (based on employers with 3 to 199 employees and a national medical premium inflation rate that is 1.4% higher than the appropriate California equivalent.) • SB 1431 as passed out of Senate Health (died on the Assembly Inactive File).
$60,000	• NAIC Study performed by Milliman for 0.85% Probability Sample to update Model Act (rejected by NAIC). • SB 1431as passed out of Assembly Health Committee (died on the Assembly Inactive File).
$45,000	• SB 1431 as passed out of Assembly Appropriations (died on the Assembly Inactive File).
$40,000	• Recommended by NAIC-funded Consumer Representative Timothy Stoltzfus Jost (also advocates outright prohibition.
$35,000 to $20,000	• Current median specific attachment point for groups with 50 or fewer covered employees ($35,000). • NAIC Model Act adjusted according to the Consumer Price ($30,194) • NAIC Study performed by Milliman for 2.43% Probability Sample ($20,000 to $30,000). • Recommended by Heartland Study ($20,000 to $30,000). • Current NAIC Model Act ($20,000)