June 2006

High cost of insurance outweighs other barriers for mid-size firms

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Support for this report was provided by the
California HealthCare Foundation.

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Support for this report was provided by the California HealthCare Foundation.

The views expressed in this report are those of the authors and do not necessarily represent the UCLA Center for Health Policy Research, the Regents of the University of California, or The California HealthCare Foundation

Citation: N Pourat, J Ripps. *High Cost of Insurance Outweighs Other Barriers for Mid-Size Firms.* Los Angeles, CA: UCLA Center for Health Policy Research, 2006.

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Introduction

The continued decline of employment-based coverage in California and more than 6.6 million uninsured residents are major reasons for concern, since health insurance is the primary means by which healthcare for employed persons and their families is financed in the state. Although employers continue to offer coverage at high rates, fewer and fewer employees are eligible for this coverage.[1] California employers have different advantages in the provision of health insurance to their employees depending on their firm size. California Law AB 1672 provides regulatory protections for the state's small employers (50 or fewer employees), such as guaranteed issue[2] and restricted premium rate bands[3], while large employers generally have the advantage of their size and the ability to negotiate for comprehensive packages of benefits at favorable rates.

Unlike large and small firms, California's mid-size groups are thought to be particularly vulnerable due to lack of regulatory protection and lack of negotiating power. These firms typically purchase insurance on their own, without the benefit of purchasing coalitions or associations. The prices they are charged typically reflect some combination of the group's past claims experience and insurance company "manual" rates – rates reflecting the insurance company experience with the appropriate segment of its pooled insurance risks. It is not clear whether lack of rating protections significantly reduces mid-size firms' ability to offer an attractive choice of health plans to their employees.

Understanding the barriers facing mid-size firms in offering their employees coverage options is further complicated by the inconsistent definitions of which employers are "mid-size." In research and reports, mid-size is defined as narrowly as having 51-100 employees, and as broadly as 51-999 employees. This lack of agreement makes it difficult to define the nature of the group health insurance market for mid-size employers with respect to many key characteristics: premium rates, the content of benefits packages, the type of health plans offered, and take-up rates among the employees of these firms. For the purposes of this brief, mid-size employers are defined as firms with 51-250 employees, except as otherwise noted. The lower bound coincides with the upper end of the size of employers subject to laws protecting the small-group market, and the upper bound was chosen to include firms that are too small to have their rates based solely on their own experience, but are large enough for their historical data to have some credibility.

Currently, no regulatory mandates are targeted exclusively at mid-size firms in California. The only such mandate, SB 2, was signed into law in 2003 and later struck down by voters in 2004. SB 2 would have required employers of 50 or more employees to provide employee health insurance or to pay into a state-funded purchasing pool for their coverage. SB 2 was strongly opposed by many mid-size and large employers and related interest groups in service and retail industries, which cited increased operating costs, consequent inability to compete, and subsequent loss of jobs.

This brief characterizes California's mid-size market and explores whether there are viable options for enhancing the current market dynamics and improving the ability of mid-size firms to provide affordable health insurance to their employees. The first section describes key characteristics of insurance coverage in this market. The second section reports on a series of interviews with various stakeholders in this segment to identify viable options for market reform.

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1 ER Brown, SA Lavarreda, T Rice, JR Kincheloe, MS Gatchell. The State of Health Insurance in California: Findings from the 2003 California Health Interview Survey. Los Angeles: UCLA Center for Health Policy Research, 2005.

2 Under AB 1672 a health insurance carrier must "affirmatively offer, market and sell" all of its small group health insurance products to all small employers (up to 50 employees) in each geographic region in which the insurance carrier sells such products to any small employer.

3 AB 1672 limits premiums a small business can be charged to within 10% of the insurance carrier's standard rate.

Highlights of mid-size market characteristics

Firm Characteristics

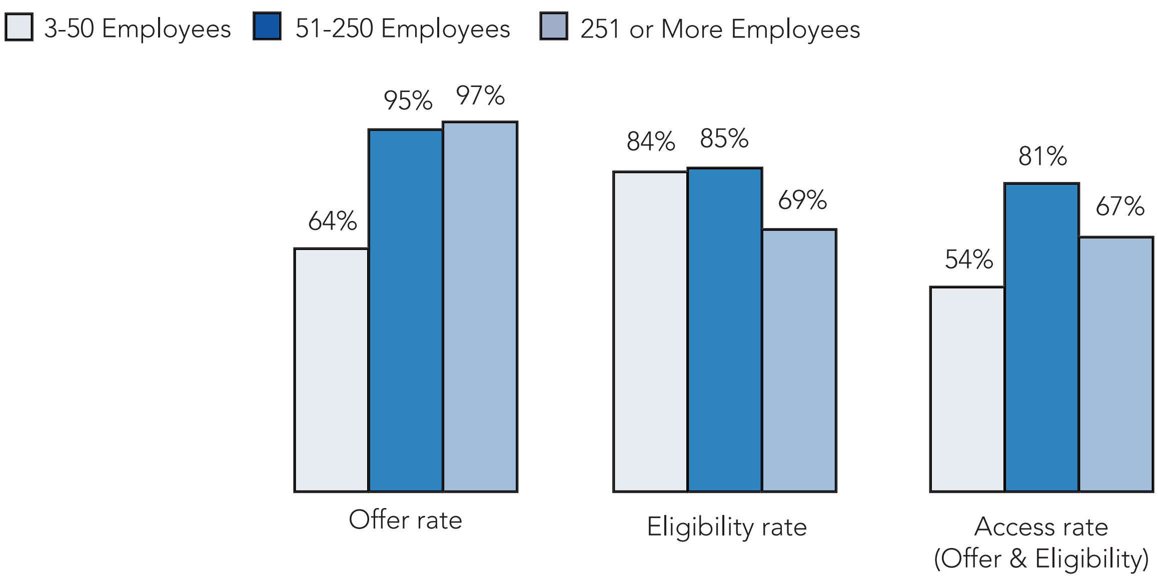
The mid-size market is a relatively small sector, consisting of 6% of California firms and 17% of California employees. Mid-size firms are most often concentrated in the service industry (39%), the dominant industry in California and one with a historically low rate of insurance coverage. However, a slightly smaller proportion of mid-size firms are in the service industry than either small firms (44%) or large firms (40%). Mid-size firms report employing a lower percentage of part-time workers on average (12%) than either small firms (19%) or large firms (24%). Similarly, mid-size firms have a lower proportion of low-income employees (those earning $20,000 annually or less) on average (15%) than large firms (21%), but about the same as small firms (17%). Fourteen percent of mid-size firms self-insure and are thus not subject to state mandates. In contrast, 7% of small firms self-insure and 38% of large firms do so.

Offer, Eligibility, and Take-up Rates

Health insurance "offer rates" of mid-size firms, or the proportion of employers that offer health insurance to their employees, closely resemble those of larger firms (95% vs. 97%) and are substantially higher than those of small firms (64%). However, the percentage of employees eligible for coverage in mid-size firms – "eligibility rate" – is higher than in large firms (85% vs. 69%) and about the same as in small firms (84%).

Examining employee access to insurance by size of firm (combined offer and eligibility rates) reveals that the employees' access to employment-based insurance coverage within mid-size firms is high: 81% of employees in mid-size firms are offered and are eligible for insurance coverage. In contrast, 54% of small-firm and 67% of large-firm employees have access to insurance coverage (Exhibit 1).

Exhibit 1. Access Rate* to Health Insurance Coverage in California Firms by Size of Firm, 2005

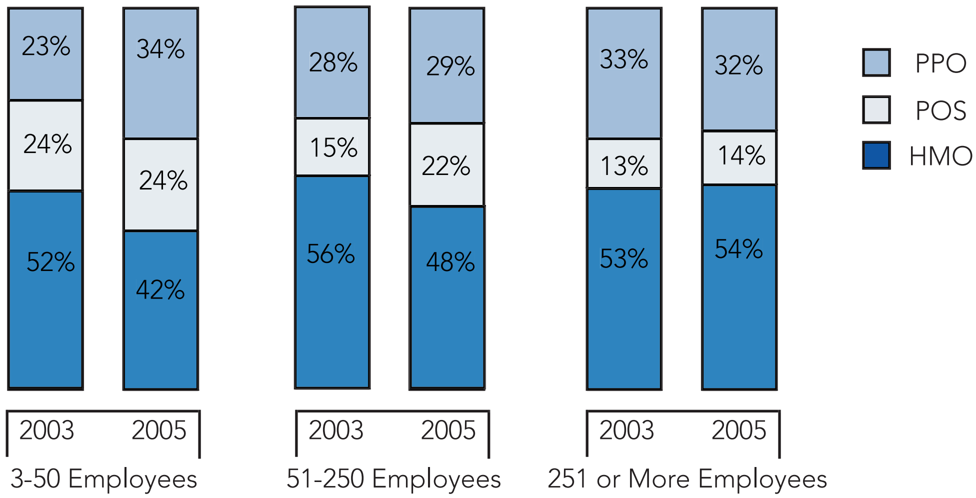


Source: Authors' analysis of the 2005 CHCF/ HSC California Employer Health Benefits Survey.
*Combined offer and eligibility rates.

Eligibility, Dependent Coverage, and Plan Choice

The eligibility criteria for employees of mid-size firms – waiting time for eligibility and eligibility of retirees, part-time, and temporary workers – fall somewhere between those of small and large firms. Coverage of dependents, measured as percent of employees with family coverage, is higher in mid-size firms (54%) than in small firms (42%), and similar to large firms (52%).

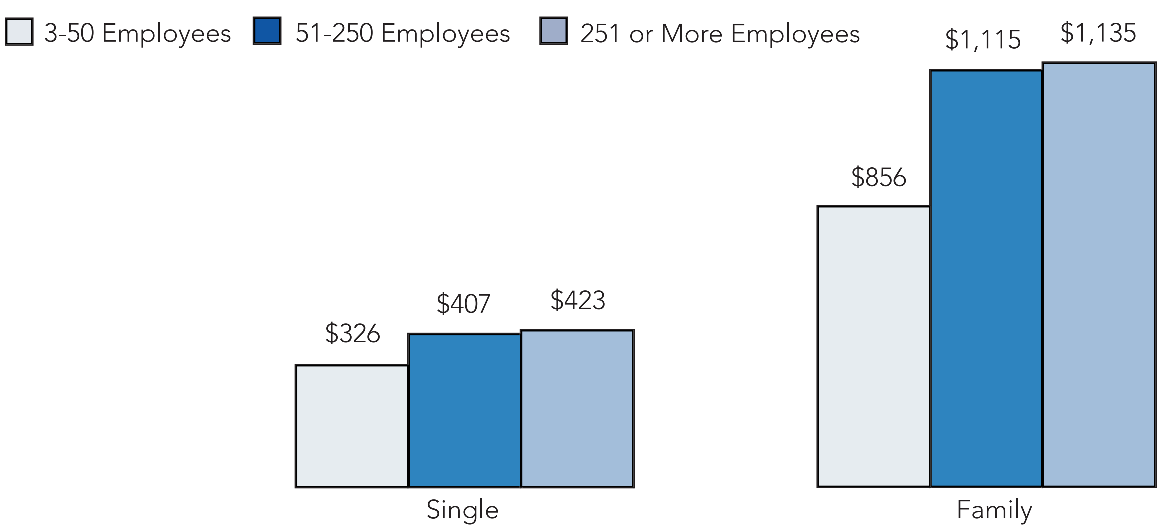
Exhibit 2. Distribution of Employees by Type of Plan and by Size of Firm, California, 2003 to 2005



Source: Authors' analysis of the 2005 CHCF/ HSC California Employer Health Benefits Survey.
Note: A very small proportion of California employees are reported to have conventional fee-for-service coverage, ranging from 0.1% to 0.3% in 2005. These data are not shown here.

The proportion of employees of mid-size firms in HMO plans is higher (48%) than in small firms (42%) and lower than in large firms (54%) (Exhibit 2). The percentage of employees in HMOs has decreased among mid-size firms since 2003 (56%), with more employees now enrolled in point-of-service (POS) plans than in 2003. The small firms also have reduced enrollment in HMOs, but have increased enrollment in PPOs. This distribution has not changed among large firms. The great majority of mid-size firms (82%) offer a choice of health plans to their employees, a proportion that is lower than for large firms (93%) but higher than for small firms (43%).

Exhibit 3. Single and Family Monthly PPO Premiums by Size of Firm, California, 2005



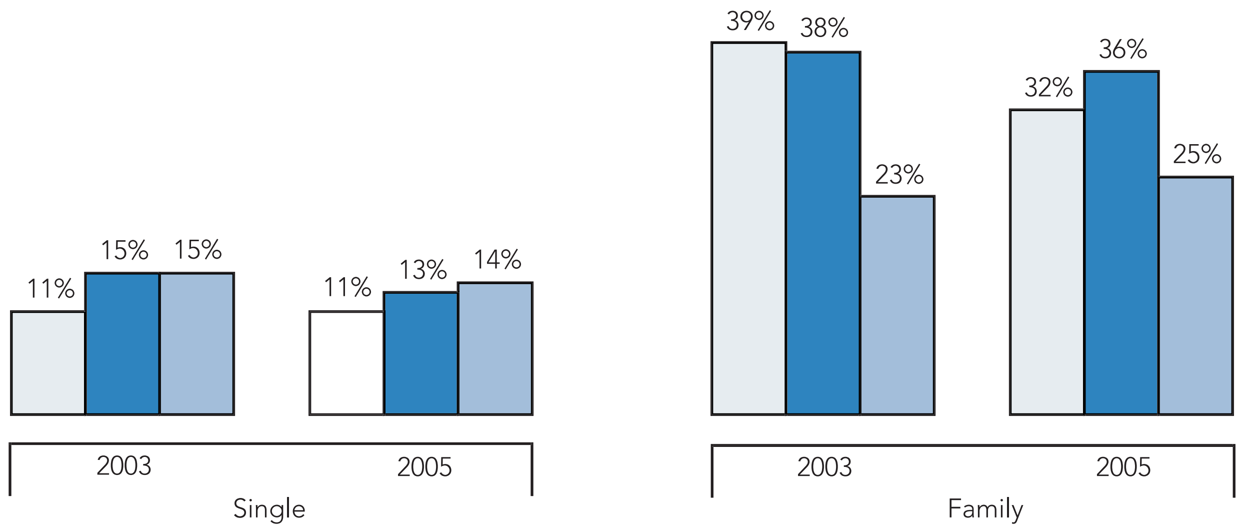
Source: Authors' analysis of the 2005 CHCF/ HSC California Employer Health Benefits Survey.

Premiums, Benefits, and Cost-Sharing

Total monthly premiums have increased for firms of all sizes from 2003 to 2005, with mid-size firms experiencing premium increases within the range of small and large firms. A closer examination of average premiums paid by type of plan reveals that mid-size firm premiums for single and family PPO plans are higher than small firms' premiums and similar to large firms' premiums (Exhibit 3). The HMO and POS premiums of mid-size firms do not differ significantly from those of small and large firms.

A review of the overall employee share of premiums for all plan types in 2005 shows that employees of mid-size firms pay 36% of the premium for family coverage, a larger share than employees of small (32%) or large (25%) firms (Exhibit 4).

Exhibit 4. Percent of Monthly Premiums for Single and Family Coverage Paid by Employees by Size of Firm, California, 2003 to 2005



Source: Authors' analysis of the 2005 CHCF/ HSC California Employer Health Benefits Survey.

Mid-size groups provide coverage for basic services such as annual obstetric/gynecological visits, prenatal care, prescription drugs, periodic health exams, and well-baby care, at very high rates (from 97% to 99+%) – and rates similar to both small and large firms. Mid-size firms less frequently cover benefits such as chiropractic (72%) and acupuncture (60%). These rates are higher than in small firms (59% and 36%, respectively), and not statistically different from such coverage in large firms (74% and 57%, respectively). Cost-sharing for services by employees of mid-size firms differs slightly from that of small and large firms. However, the overall pattern does not indicate significant differences in cost-sharing structure by firm-size.

Mid-size market stakeholder experiences and opinions

Although the data indicate that most mid-size firms offer health insurance, some mid-size firms may face difficulties due to their claims experience or face other barriers not identified by survey data. A series of interviews with stakeholders, including health plan executives, brokers, purchasing alliance representatives, advocates, and regulators, were conducted to explore these issues.

The majority of stakeholders – consisting mostly of brokers and purchasing alliance representatives – reported that mid-size firms with poor experience are either unable to obtain a quote or have difficulty obtaining an affordable quote for health insurance. These respondents commented that some carriers declined to provide a quote or offered a limited selection. Mid-size firms with 50-100 employees were reported to be more likely to experience such a barrier than mid-size firms with 101-250 employees. Lack of negotiating power and rate volatility were also mentioned by some regulators and brokers as barriers for mid-size firms. Other barriers identified were more general to the U.S. healthcare system, such as high costs of healthcare and cost shifting between public and private payers.

No one pointed to major barriers unique to mid-size firms with respect to geographic area or industry. However, firms in industries with high rates of low-wage workers were identified by some interviewees as experiencing difficulties in obtaining health insurance for their employees. Most stakeholders reported that a variety of health coverage options or plans existed for mid-size firms, but the range of choices was considered to be more similar to that available to small rather than large employers.

Self-insurance is an option for mid-size firms, though most reported this to be a more feasible option for firms with 100 or more employees. Mid-size firms were not perceived to face different underwriting criteria, cost-sharing requirements, or participation requirements than small or large firms.

Most stakeholders did not recommend expanding or modifying purchasing coalitions as the solution for barriers in obtaining health insurance coverage by mid-size firms. These coalitions were deemed ineffective because the group rates offered under such arrangements are likely to be higher than for those of mid-size firms with good past experience. It was predicted that firms with good past experience would choose to purchase health coverage on their own, which would lead to increased prices for those left in the purchasing pools. Other stakeholders thought purchasing coalitions might be useful, but expressed the same reservations.

Extending current small-group legislation to mid-size firms was suggested by most respondents –including brokers, purchasing alliance representatives, regulators, and access-to-healthcare advocates – to give these firms greater access to obtaining coverage. Price stability due to standardization of offered plans and increased transparency in rates were less frequently identified to be advantages. Most respondents considered disadvantages of such legislation to be primarily potential rate increases for firms with good experience, with subsequent increases in self-insurance by such firms and consequent deterioration of the mid-size insurance pool. Decreased carrier participation, decreased diversity in benefit design, and unnecessary intervention were also mentioned as disadvantages.

Mid-size market challenges and options

Currently, mid-size firms do not seem to face major obstacles that lead to an inability to provide health insurance to their employees. Overall, mid-size firms provide a higher rate of access to insurance, 81% (combined offer and eligibility rates), for their employees than both small and large firms. This is due, at least in part, to their low proportion of part-time and low-income workers.

Despite these advantages, certain subgroups of mid-size firms may face challenges to the provision of health insurance for their employees, specifically mid-size firms in service, retail and wholesale industries and those with high percentages of low-income employees. Stakeholders in this market report difficulties in obtaining reasonable quotes for mid-size firms with poor experience. These difficulties seem to also be concentrated in industries with higher rates of low-income employees. Non-regulatory options to reduce the difficulties of mid-size firms in obtaining affordable insurance, such as self-insurance or purchasing coalitions, may not be feasible or desirable for these firms. Self-insurance is more feasible for firms with 100 or more employees and currently not common among mid-size firms. Purchasing coalitions' effectiveness is dependent on participation rates of mid-size firms with favorable group experience, which is likely to be limited because such firms may be able to obtain lower premium rates on their own than they could obtain through the coalition.

Regulatory options can include legislation similar to California law AB 1672, which prohibits insurance carriers from denying health insurance coverage to small firms or cancelling such coverage, limits exclusion of preexisting conditions to a maximum of six months, requires premiums to fall within a pre-specified percentage of a standard age-rated premium for a given benefit design, and establishes a purchasing pool. These provisions might address the challenges faced by some mid-size firms in providing coverage to their employees by fostering greater access and price stability.

However, there are drawbacks to such regulatory options. A basic requirement for a successful health insurance pool is the broad participation of groups with favorable as well as unfavorable risk characteristics. Mid-size firms at the high end of the mid-size spectrum (100+ or 150+) and good past group experience can self-insure to avoid such regulation. Generally, insurers establish premium rates for mid-size firms using a combination of the experience of the firm requesting a quote and the experience of their other mid-size clients. A movement to self-insurance by firms with good experience could lead to degradation of the overall risk profile of insured mid-size firms and further increase premium rates.

These criticisms are not dissimilar to those aimed at AB 1672 prior to its implementation, yet the requirements imposed by AB 1672, including the establishment of the Health Insurance Plan of California (HIPC), did not appear to lead to adverse selection, but rather to improved price competition among plans.[4] However, AB 1672 affected only small firms, for which self-insurance is generally not a practical option. If regulatory options similar to AB 1672 were extended to the mid-size market, they would be more likely to be effective if they targeted smaller mid-size firms, where self-insurance is less of an option. Extending the small-group guaranteed-issue requirements and rate-band requirements to groups of 51-100 employees might be beneficial, but should be done independently from the small-group legislation. The needs and characteristics of groups with 51-100 employees are different from those with fewer than 51 employees; thus, insurance carriers should have the choice of providing health insurance to small or mid-size groups rather than being required to provide insurance to both groups if they wish to offer products to either. The consequences of regulatory extensions should be carefully weighed to determine whether such extensions are constructive.

The major barrier to coverage in California's mid-size group health insurance market is not unique to the mid-size market; it is the cost of the insurance, driven in turn by the overall high cost of healthcare experienced by firms of all sizes. If health insurance costs continue to increase at rates above general inflation, further erosion in rates of employment-based coverage are to be expected for all firms, with a greater impact on firms most sensitive to premium increases.

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4 Buchmueller TC. Managed competition in California's small-group insurance market. Health Affairs, March/April 1997; 16(2): 218-228.

Methodology

The information contained in this brief was obtained through several sources. A thorough review of the existing literature on provision of health insurance by California firms was conducted. Data from the California HealthCare Foundation (CHCF) / Center for Studying Health System Change (HSC) California Employer Health Benefits Survey: 2005 and the California HealthCare Foundation (CHCF) / Health Research and Educational Trust (HRET) Employer Health Benefits Survey: 2004 were analyzed. Existing state-level regulations and health mandates were reviewed, and seven regulators in five states – California, Minnesota, New York, South Carolina and Washington – were interviewed. Furthermore, stakeholders in group health insurance for mid-size groups in California, including three consumer advocates, four representatives of purchasing alliances, seven insurance brokers, and eight health plan executives – for a total of 29 stakeholders, including the seven regulators – were interviewed. Separate structured interviews were conducted with pre-notification letters between January and March, 2006.

Acknowledgement

Supported by the California HealthCare Foundation, based in Oakland, California. The authors wish to thank E. Richard Brown and Steven Wallace at the UCLA Center for Health Policy Research for their thoughtful editorial comments on this brief.

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