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April 26, 2006

# SENATE HEALTH BILL WOULD PREEMPT STATES' SMALL GROUP RATING RULES

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On March 15, 2006, on a party-line vote, the Senate Health, Education, Labor and Pensions Committee reported out S. 1955, the "Health Insurance Marketplace Modernization and Affordability Act" (HIMAA), which could be brought to the Senate floor as early as the first week of May. This brief analysis examines how S. 1955 would significantly affect states' small group rating rules and the impact that this could have on the ability of employers (and their workers) to obtain health insurance in the small group market.

## What Are Small Group Rating Rules?

Traditionally, the health insurance market is divided into three components: the small group market, the large group market, and the non-group (or individual) market. State insurance laws, including rating rules that apply to the health insurance premiums that insurers can charge, can and generally do vary within a state for each of these three market components.[2] Due to severe premium fluctuations in the small group market in the late 1980s and early 1990s, most states adopted small group rating rules during those years in order to stabilize the market.

### Small Group Defined

The small group market is generally defined as including firms with 2 to 50 employees, although a few states count self-employed groups of one as a small group, and some states define small groups as firms with up to 100 employees.

### Two Types of Rating Approaches

Generally, state legislatures have adopted two types of rating rules that apply in the small group market: "adjusted community rating" and "rating bands."

The basic principle of adjusted community rating is that a single rate applies to all small groups in the market, with very limited adjustments allowed for specified "case characteristics" such as the age

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[2] These state rules do not apply to groups that are self-insured.

of a firm's workers. In contrast, the basic principle of rating bands is that, *in addition* to variation for case characteristics, rates also can vary based on workers' health status.

The difference between the highest premium rate and the lowest premium rate that small groups can be charged for the *same* health insurance plan is much larger under rating bands than under adjusted community rating. For example, if the only case characteristics that insurers may consider in varying premiums are workers' age and gender and the allowable state limit on the variation in rates between the highest and lowest premiums, based on age and gender, is three to one, then allowing rating bands of two to one based on health status will result in an overall difference between the highest and lower premium rates of six to one (3 x 2 = 6). In other words, the small employer that has the oldest and least healthy workers and whose workforce is disproportionately comprised of women could be charged a premium rate of $1,200 per person per month when the group with the least expensive age and gender characteristics and the best health status is paying $200 per person per month for the same health insurance coverage.

Under both regulatory schemes, the insurer sets a base rate for a particular set of case characteristics. (The base rate is the lowest rate that can be charged for a group with the same case characteristics. For example, if the only permitted case characteristic is age, then the base rate would be the rate charged the firm with the youngest workforce.) The group's actual premium rate is then determined by rating the group up based on those specific case characteristics of the group that insurers can take into account in setting premiums under state law. Allowable case characteristics often include age, gender, industry type, geographic area, family composition, and group size. Under rating bands, there is an additional upward adjustment for the group's health status.

**An Example of How Rating Bands Work**

- Assume that a state permits insurers to vary health insurance premiums based on three "case characteristics": age, gender, and firm size.
- Then assume that the allowable variation between the highest and lowest premiums based on these factors is 3:1 for age, 1.5:1 for gender, and 1.2:1 for firm size.
- So far, the difference between the highest and lowest premium rate that can be charged is 5.4:1 (3 x 1.5 x 1.2 = 5.4).
- Now assume that the allowed variation based on health status can be as much as 2:1.
- Under these assumptions, the highest premium rate that may be charged a small group with the worst case characteristics and health status can exceed the lowest rate that a small group is charged for the same health insurance plan by more than 10 times, or 10.8:1 (5.4 x 2 = 10.8).
- If the lowest premium charged is $100 — calculated on a per-person-per-month basis — the highest premium can thus be set as high as $1,080.

## Existing State Small Group Rating Laws

Forty-nine states have adopted some rating rules in the small group market. (Hawaii and the District of Columbia are the exceptions.) As noted above, states adopted small group rating rules to prevent wildly fluctuating rates and to promote stability in the market. Prior to the enactment of small group rating rules, many small employers were hit with enormous, unaffordable rate increases

when a single employee became ill, which could result in some employers being priced out of the market.

Thirty-seven states use rating bands in their small group markets, while ten states have adopted adjusted community rating.[3] Most states that use rating bands — which permit premium variation based on health status — also allow insurers to vary premiums, within prescribed limits, based on case characteristics like the age and gender of firms' employees and on firm size.[4]

## The Federal Small Group Rating Rule that S. 1955 Would Set

S. 1955 would require the Secretary of Health and Human Services to issue a regulation to implement new national rating rules, which the bill would set. The new national rating rules would establish broad parameters that would allow great variation in premium rates among small firms.[5]

Once the regulation was issued, it would preempt the existing state small group rating rules.[6] Small group rating rules in virtually every state would be affected.

That is because S. 1955 only sets limits on the amount of rate variation between groups with "similar case characteristics." For example, an allowed case characteristic in S. 1955 is age, and S. 1955 would limit the variation in premiums charged small employers with workers of the *same age*. But S. 1955 places *no limits whatsoever* on the degree to which premiums can be varied for firms with *different* case characteristics. A small employer with an older workforce would have a different "case characteristic" than a small employer with a younger workforce and thus could be charged substantially higher premiums. As a result, any limits that S. 1955 may appear to set on variations in

### How Large Could Be the Premium Variation under S. 1955?

- The New Hampshire Department of Insurance has estimated how large the differences could be between the highest premium and the lowest premiums charged to a small group in the same market, using the approach that S. 1955 takes.
- The New Hampshire analysis shows that the highest premium rate could be *more than 25 times* the lowest premium rate charged for the same health insurance coverage and that insurers could use even higher rate differences if actuarial claims data provided a basis for greater variation (*i.e.* if a particular case characteristic such as age was associated with a greater use of health care services than previously estimated by the insurer).

* Memorandum from Alex Feldvebel, Deputy Commissioner, New Hampshire Department of Insurance, to Brian Webb, National Association of Insurance Commissioners, March 13, 2006.

[3] See Mila Kofman and Karen Pollitz, "Health Insurance Regulation by States and the Federal Government: A Review of Current Approaches and Proposals for Change," Georgetown Health Policy Institute, April 2006. Two additional states require their largest insurers to use adjusted community rating.

[4] Kofman and Pollitz, *op cit.*

[5] The national rating rates that S. 1955 would set are based on a model law that the National Association of Insurance Commissioners (NAIC) developed in 1993 but subsequently replaced with an adjusted community rating model law.

[6] Even if the regulation is not issued on a timely basis, insurers would still be exempt from existing state small group rating rules and could always immediately follow the new federal rating standard upon enactment.

premiums could be bypassed through the imposition of much higher rating factors on firms with older workforces. This practice of increasing the premiums of groups of small businesses based on their "case characteristics" is called "rating up."

Another allowed case characteristic is the size of the group. A small group with five employees could be "rated up" and charged much higher premiums than a small group with 49 employees. A similar result could occur with an employer group that is composed of firms whose workforces are made up predominantly of younger women, since gender is an allowed case characteristic with no limit on the degree of variation in premiums allowed based on differences in this characteristic.

An earlier example in this paper showed how premium rates could vary by 6:1 if rating bands were used to vary premiums based on differences in the health status of different firms' workers. That example assumed, however, the presence of state-imposed limits on the degree of variation in premium charges based on age and gender. As noted, S. 1955 places *no* limits on the degree to which insurers can vary premiums based on differences in workers' age and gender. When no limits apply, it is not uncommon to see insurers use a ratio as high as 5:1 based on the case characteristic of age alone. Under S. 1955, if insurers used a 5:1 ratio for age, the rates charged to some small firms could be 12.5 times the rates charged other small firms, when rating band variations based on differences in workers' health status also are taken into account.

Moreover, this 12.5:1 ratio reflects only variations for age and health status. S. 1955 permits unlimited variations based on case characteristics of gender, geography and group size, as well. Based on an analysis by the New Hampshire Department of Insurance, under S. 1955, the premium rates charged some small firms could be as much as 25 times the rates charged other small firms for the same insurance coverage and possibly even higher (see box on page 3).

Although many states use rating bands, the vast majority of states limit the ability of health insurers to increase the rates charged small firms based on age, gender, industry type, geographic area, family composition, and/or group size. Because S. 1955 sets no limits on the variations allowed for case characteristics (except for industry type), the vast majority of state rating laws that apply to the small group market would be preempted.[7] The result would be that the variation in premiums charged to small firms would increase sharply, with many small employer groups experiencing dramatic premium increases.

## Effect of S. 1955 on States and their Small Group Markets

Virtually all state small group rating laws would be preempted. The largest losers under the legislation are likely to be those small businesses that have older, less-healthy workers, as well as those small firms whose workforces are dominated by women of child-bearing age.

Tampering with the existing state laws also would result in serious price fluctuation in the health insurance premiums that small employers are charged, since a firm's characteristics and the health of

[7] For a detailed summary of the state small group rating laws now in place, see Attachment A in Kofman and Pollitz, *op cit.*

its workers can change from one year to the next, especially if a worker develops a medical condition that is expensive to treat.[8]

It also is likely that, due to the bill's preemption of so many state laws limiting variation in the premium rates that small firms can be charged, some small employer groups would be hit with rate increases of such a magnitude that they could be priced out of the market entirely and their workers could become uninsured. Workers who lose coverage as a result may have to rely on the public safety net to access health care. Such an outcome would have obvious implications for state Medicaid and State Children's Health Insurance Program (SCHIP) programs, as well as for charity care. Cost-shifting would ensue throughout states' health care systems.[9]

## Conclusion

S. 1955 would sweep away the rules that most states use to limit the degree of variation in the insurance premiums that small employers are charged. Large premium hikes for certain small employer groups, as well as a high level of price fluctuation, would be virtually certain to result. That would likely lead to more uninsured individuals and consequently could have adverse effects on state health care safety nets. S. 1955 thus poses unnecessary — and unacceptable — risks for states, for small employers, and for workers in small firms.

[8] See, for example, the experience of the state of New Hampshire when it moved from an adjusted community rating system to rating bands similar to those required under S. 1955. Edwin Park, "Lessons from New Hampshire: Senate Health Bill Could Drive Up Health Insurance Premiums for Many Small Businesses," Center on Budget and Policy Priorities, April 26, 2006.

[9] For a discussion of other provisions of S. 1955 that would adversely affect states, see Kofman and Pollitz, *op cit*.