Final Report

DRAFT

Wisconsin Department of Health Services
Division of Health Care Access and Accountability

Wisconsin's Small Group Insurance Market

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1 Introduction

Wisconsin's small businesses, like most small businesses throughout the United States, struggle to meet the rising costs of providing health insurance to employees. According to the Congressional Budget Office, health care spending will account for about 17 percent of gross domestic product in 2009—approximately $2.6 trillion—and is projected to grow to nearly 20 percent by 2017.[1] As the cost of health care continues to rise, more and more small business employers are unable to afford to offer health insurance coverage for their employees—an occurrence that is compounded under the United States' current economic situation. Those employers that continue to offer coverage are faced with unpredictable insurance costs from year to year, never knowing when an employee will incur health expenses that will substantially increase the whole company's insurance costs. Also, in an effort to keep insurance costs low, many small business employers shop for a better priced health insurance plan from year to year, an often time-consuming and complex process. For example, according to the Kaiser 2007 Employer Health Benefit survey, 66 percent of businesses with less than 200 employees shopped for a new health plan in the past year. Of these, 25 percent changed insurance carriers and an additional 23 percent changed the type of health plan offered.[2]

In Wisconsin, only 41 percent of small business employers offer health insurance to their employees—in contrast to 98 percent of large business employers.[3] Wisconsin small business employers report that one of the biggest barriers to offering health insurance is cost, and those employers that do offer it find the marketplace to be complicated and confusing. Within the small business health insurance market, there is a large variation in premium prices and an inconsistency in how premium rates are determined for each small business. This is primarily due to the State's relaxed rules around premium rate setting.

To address these significant and growing challenges of the small group insurance market, the State of Wisconsin proposed creating a connector-mechanism (the Connector) to link small businesses with private health insurance plans. One of the functions of the Connector would be to provide information on premium rates and insurance plans to prospective small businesses. However, in order for the Connector to succeed, the rules around how premium rates are determined would need to be reformed in order to simplify the pricing formula and reduce premium price variability throughout the market.

To evaluate the impact such a proposal would have on the market, Wisconsin's Department of Health Services asked Gorman Actuarial, LLC and Dr. Jonathan Gruber, an economist from the Massachusetts Institute of Technology (MIT), to study the effects of various rating reforms coupled with the introduction of a Connector. In order to complete this study, Gorman Actuarial, LLC conducted a comprehensive survey of the state's small group market in 2007. Using the survey results, Gorman Actuarial, LLC analyzed the impact on premium prices due to various rating reforms. Dr. Gruber then modeled the effect these price changes would have on the small group market. The results from Dr. Gruber's modeling indicated that by implementing select reform measures, a net savings of approximately $309 million dollars in health care costs—over 20 percent of health care premiums—could be generated.

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[1] Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December 2008.

[2] The Kaiser Family Foundation and Health Research & Educational Trust, "Employer Health Benefits 2007 Annual Survey."

[3] Agency for Healthcare Research and Quality (AHRQ), Center for Financing, Access and Cost Trends. 2006 Medical Expenditure Panel Survey (MEPS)-Insurance Component.

Prior to Gorman Actuarial, LLC's survey, no comprehensive dataset had existed on Wisconsin's small group insurance market. Therefore, the results of this survey provide the State with a unique and invaluable set of information. The U.S. Department of Health and Human Services' Agency for Healthcare Research and Quality (AHRQ) produces an annual report on the insurance market for each of the 50 states and the District of Columbia called the Medical Expenditure Panel Survey (MEPS). MEPS is widely regarded as the most reliable data source available on the health insurance marketplace; however, its definition of small businesses (1 to 49 employees) conflicts with the definition set forth by Wisconsin state statute (2 to 50 employees). As a result, MEPS leaves the State with only an approximation of the small business landscape. Other data sources, such as information collected annually by the Wisconsin Department of Health Services' Bureau of Health Information and Policy and the Office of the Commissioner of Insurance, only look at broad categories of the health insurance marketplace and do not focus specifically on the small group market.

This report provides a comprehensive overview of Wisconsin's small group market using data sources that include the results of Gorman Actuarial, LLC's survey of the small group insurance market. It also outlines the Department of Health Services' proposed reforms to the market and presents the results of Gorman Actuarial, LLC's rate reform analysis, as well as Dr. Gruber's modeling. The final reports Gorman Actuarial, LLC and Dr. Gruber submitted to the Department of Health Services are included as appendixes.

2 Employer-Based Health Insurance in Wisconsin

Seventy-four percent of Wisconsin residents received health insurance through employers in 2006, including about 76 percent of working-age individuals (aged 18 to 64).[4] Among small businesses, however, employer-based health insurance coverage was significantly lower—only 41 percent of small businesses in Wisconsin offered insurance to their employees, with 53 percent of employees electing to receive coverage. In contrast, 98 percent of large businesses in Wisconsin offered insurance to their employees, with 57 percent of their employees choosing to enroll in a health plan.[5] Nationally, Wisconsin ranked 25th among the 50 states and DC in percent of small business employers offering health insurance.[6]

2.1 Wisconsin Small Business Employers

Wisconsin state statute defines a small group employer as one with 2 to 50 permanent employees working at least 30 hours a week.[7] Data from MEPS indicated that in 2006, there were

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[4] Wisconsin Department of Health Services, Division of Public Health, Bureau of Health Information and Policy. *Wisconsin Health Insurance Coverage, 2006* (PPH 5369-06). November 2007.

[5] AHRQ, 2006 MEPS-Insurance Component.

[6] Ibid.

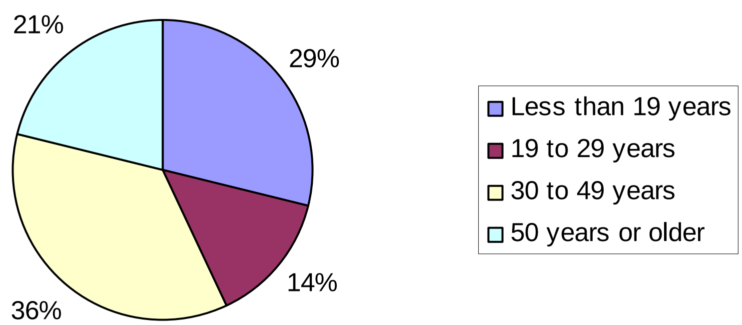
[7] Currently, all states limit employer groups in the small group market to 50 employees. Thirteen states have also elected to merge the non-group and small group markets. Wisconsin has the flexibility under federal law to expand its definition of the small group market through changes in its state statute. Specifically, federal law defines the small group market as employers with 2 to 50 employees. However, the law further states that "state law may expand the definition of the small group market to include certain coverage that would otherwise, under the Federal law, be considered coverage in the large group market or the individual market." 42 CFR section 144.102.

101,909 private-sector establishments with less than 50 employees (1 to 49 employees) in Wisconsin employing approximately 29 percent of private-sector employees—about 702,000 individuals.

According to data collected by Gorman Actuarial, LLC, in 2007, there were approximately 28,000 small group employers that bought health insurance in Wisconsin and about 200,000 employees and 390,000 members receiving health insurance through these employers—a total that data indicates to be declining.[8]

Gorman Actuarial, LLC reported that most of the businesses offering health insurance were small—the average size was 7 employees and about 60 percent had less than 5 employees. Of those employees receiving health insurance through their employers, 53 percent were male and 47 percent were female. The average member age was 34 years (see Figure 1).

Figure 1: Percent of individuals receiving insurance through small businesses by age, 2007.



Source: Gorman Actuarial, LLC.

2.2 Wisconsin Small Business Insurance Market

About 45 insurers wrote in Wisconsin's small group market in 2007. Of these insurers, 12 wrote for about 76 percent of the market.

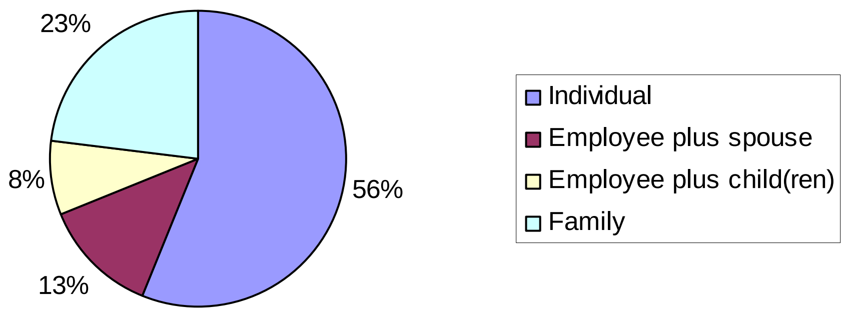
In 2007, for all businesses offering insurance, 96 percent of employees were enrolled in managed care or defined network type health plans—45 percent of employees in health maintenance organizations (HMO), 33 percent in point-of-service plans (POS), and 18 percent in preferred provider plans (PPP). Four percent of employees were enrolled in traditional fee-for-service plans (FFS), also know as indemnity plans.[9]

[8] Gorman Actuarial, LLC, 2007.

[9] State of Wisconsin, Office of the Commissioner of Insurance, *Health Insurance Coverage in Wisconsin,* 2007. Data on employers in the small group market only is not readily available.

Gorman Actuarial, LLC, found that for 2007 in Wisconsin's small group market most policies sold were individual, or employee-only, policies (see Figure 2).

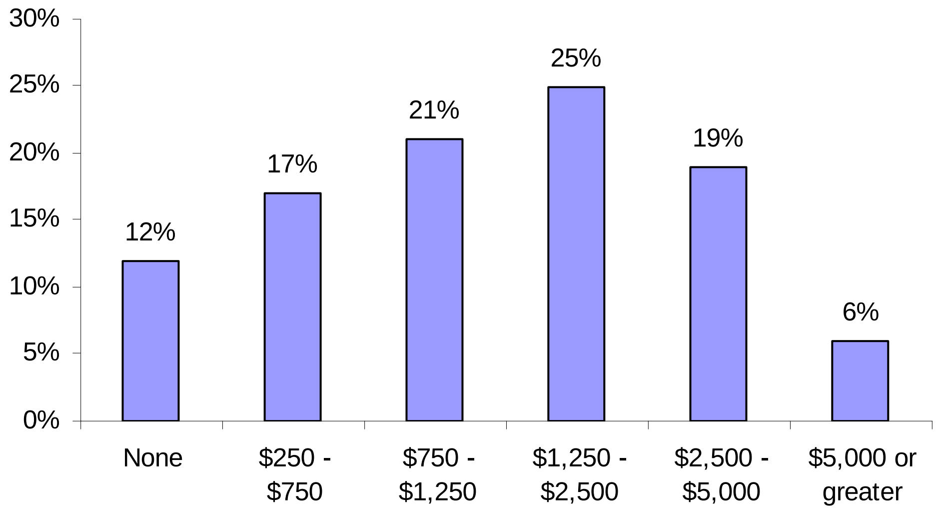
Figure 2: Percent of polices sold in Wisconsin's small group market by type, 2007.



Source: Gorman Actuarial, LLC.
Notes: The average size of an employee plus child(ren) group was 2.6 individuals. The average size of a family was 4.1 individuals.

Many of the plans offered in the small group market have the same benefit packages but vary in cost-sharing and deductibles. According to Gorman Actuarial, LLC, the average deductible for the small group market in 2007 was estimated at $1,500 for an individual policy. Fifty percent of the small group market purchasing individual policies was enrolled in plans with deductibles less than $1,250 for individual policies; however, 6 percent had plans with deductibles of $5,000 or more (see Figure 3).

Figure 3: Percent of small employer groups purchasing individual policies by plan deductible, 2007.



Source: Gorman Actuarial, LLC.

Federal and state statutes establish certain requirements to which all insurance plans writing in the small group market must adhere. These requirements are different than those for policies being sold in the individual and large group markets (businesses with 51 or more employees). Specifically, health insurance plans sold to the small group market in Wisconsin must feature certain mandated benefits, automatic renewal of group coverage each year, and guaranteed issue (that is, insurers are required to make plans available to all employers who apply). However, there are no requirements on how much employers must contribute towards their employees' health insurance or how many employees must participate in a health plan. Wisconsin state statute allows for health insurers to write in the contracts they have with small businesses minimums for employer contributions and employee participation, and most health plans do.

Instead of participating in the health insurance market, some employers have established self-funded plans—that is, the employer assumes some or all of the financial risk associated with providing coverage. Some insurers will not allow small employer groups to establish a self-funded plan because they feel the employers are too small to absorb the risks. According to the Employee Retirement Income Security Act (ERISA), self-funded plans are exempt from mandated benefits. There is limited information available on self-funded plans; Wisconsin's Office of the Commissioner of Insurance does not collect comprehensive data on these plan types and Gorman Actuarial, LLC excluded self-funded plans from their survey and analysis. MEPS offers some insight: according to 2006 MEPS data for Wisconsin, approximately 13 percent of private-sector establishments with less than 50 employees that offer health insurance self-fund at least one plan and approximately 18 percent of employees in these private-sector establishments are enrolled in such plans.

2.3 Rating Practice in Wisconsin Small Business Insurance Market

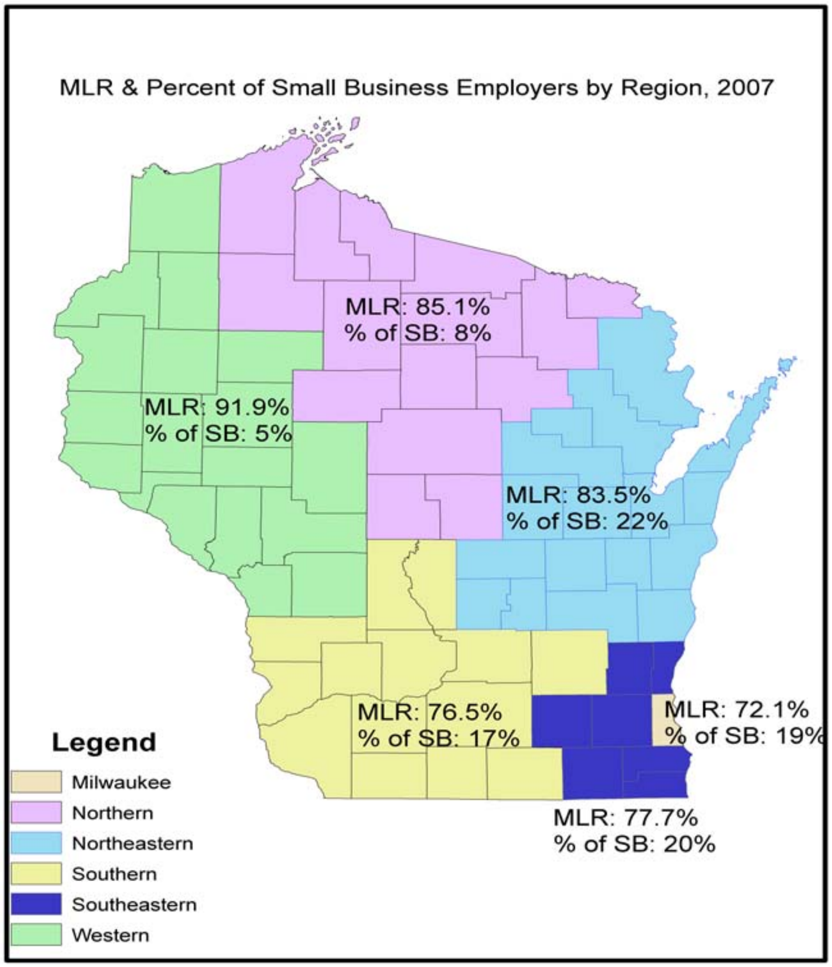
In Wisconsin there is little regulation and oversight over the premium rates insurers charge to small employers and their employees resulting in wide variation among rates throughout the state. In the current marketplace, rate adjustments based on health status (including occupation and claims history) are limited to a 15 percent annual increase and policies can vary by no more than +/-30 percent of the midpoint for similar policies. However, Wisconsin places no limits on adjustments made based on case characteristics (e.g., age, sex, geography, group size). As a result, the highest rate charged in the small group market in Wisconsin could be about 28 times, or about 2,689 percent, the lowest rate.[10] For example, an individual policy sold to a small business with a deductible of $1,250 could have a monthly total premium (including both employer and employee contributions) of anywhere from about $46 to about $1,285 simply depending on the make-up of the small business employees' medical status and case characteristics.[11]

The effect of little oversight over premium rates can also be seen in the insurer's medical loss ratios (MLR). MLR is the proportion of an insurer's incurred claims to earned premiums over the reporting period—or more simply described as the amount of insurance premium dollars that go towards medical care. The total MLR for the small group market in Wisconsin in 2007 was 78.4 percent. However, this percentage ranged from 72.1 percent for the Milwaukee area, where 19 percent of Wisconsin's small businesses are located, to 91.9 percent for the western part of the state, where 5 percent of small businesses are located (see Figure 4).

[10] Gorman Actuarial, LLC. Analysis is based on the rate adjustments made by insurers to policies bought by small businesses in 2007.

[11] Gorman Actuarial, LLC, 2007.

Figure 4



Source: Gorman Actuarial, LLC.

Appendix I summarizes all of Gorman Actuarial, LLC's survey results of Wisconsin's small group insurance market.

3 Reforming Wisconsin's Small Business Health Insurance Market

To address the significant and growing challenges of the small group insurance market, the State of Wisconsin proposed creating the Connector, a web-based mechanism that would connect small businesses with private health insurance plans. The Connector would provide information on premium rates and insurance plans to prospective small businesses supplying employers with the tools to efficiently purchase quality, affordable health insurance coverage. However, in order for the Connector to succeed, rating reforms would need to be implemented, in order to simplify the formula used to set premium prices and reduce variability in premium prices across the market. In total, the State surmised these reform measures would lead to a more stable and transparent marketplace, with lowered costs for small businesses.

During the design process, the State found that other measures would also be needed to ensure these proposed reforms had a positive impact on small businesses. These other measures included:

- imposing a participation mandate for the Connector,
- moving broker fees to outside of the Connector interface,
- requiring employers to establish section 125 plans, and
- introducing managed competition by requiring insurers to bid to offer their plan.

3.1 Reforming how insurance is purchased: the Connector

One of the central features of the State's reform proposal would be the creation of the Connector, a website which employers would use to receive easy to understand information on available health plans and make a selection on the plan they would like to purchase for their employees. Specifically, through the Connector:

- Plans would provide information about the plans they have to offer, including information on benefits covered, deductibles, and other cost-sharing; and
- Small business employers would indicate how much they plan to contribute towards the cost of each of their employees' health insurance and choose a plan from among those offered that best meets the needs of their employees.[12,13]

This would be a change from the current marketplace in which employers complete a detailed, complex application form and then submit it, either themselves or through an insurance broker, to individual health insurance plans for evaluation and premium pricing.

3.1.1 Participants: employers and brokers

The State determined that insurance plans available to small businesses would have to be limited to the Connector in order to keep premium costs low. In other words, if small business employers wanted to offer insurance to their employees, they would have to purchase it through the Connector. This measure would increase the purchasing power of small businesses and deter any potential for adverse selection that might occur under a voluntary arrangement.

Currently, almost all small business employers use an insurance broker or agent to help them purchase health insurance.[14] The rates brokers charge for their services may vary from anywhere from 2 to 8 percent.[15] For some employers, health insurance is part of a comprehensive insurance package that they purchase from a broker. Brokers could be a valuable resource for generating interest and facilitating participation in any reform model. Therefore, the State

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[12] Contract details, such as premium payment and questions about benefits, would be handled directly between the insurers and small businesses. The Connector or the State would not be involved in such transactions.

[13] The Connector could also be designed so that employees directly select the plan they would like. Under this scenario, employers would indicate through the Connector that they would like to offer insurance to their employees and the amount they would like to contribute towards their employees' health insurance. Then, employees, rather than employers, would select a plan from among those offered that best meets their needs.

[14] Correspondence with Wisconsin Association of Health Underwriters on December 9, 2008.

[15] Conwell, Leslie Jackson. "The Role of Health Insurance Brokers: Providing Small Employers with a Helping Hand," Center for Studying Health System Change Issue Brief: No. 57, October 2002.

determined that brokers would be allowed to enroll employers in health plans through the Connector; however the Connector would not have the capacity to facilitate exchanges of any service fees charged by the broker. Commission fees brokers charge for their services would have to be handled outside of the Connector interface.

3.1.2 Section 125 plans

The State determined that if all employers established Section 125 plans for their employees to use towards covering health-related costs, up to $130 million annually would be available in savings to Wisconsin taxpayers.[16] Therefore, the State included requiring employers to set up Section 125 plans as part of its reform proposal. Section 125 plans would allow employees to pay health insurance premiums on a pre-tax basis. Also, employers would not pay taxes on the portion of their wages that employees contribute to health insurance premiums.

3.2 Reforming how premiums are set: rating reform

In order for the Connector to succeed, premium prices for small businesses would need to be equalized. The State determined the best way to accomplish this would be through reforming the rules for setting premium rates. Specifically, the State wanted to move from the current environment in which there were little constraints around how insurers set premium prices, to a situation in which there were some limitations on how much premium prices could vary.

Gorman Actuarial, LLC proposed five scenarios that limited how much premium prices were allowed to vary by placing restrictions on the factors insurers could use to determine premium prices. These scenarios—or rating formulas—allow premium prices to be adjusted based on factors that include age/gender, case size, geographic region, and/or health status. In addition, some of the proposed rating formulas place restrictions on the amount of variation allowed for adjustments based on any of these factors, as well as the overall premium price.

For example, Table 1 lists one of Gorman Actuarial, LLC's proposed scenarios in which premium prices could be adjusted based on factors that include age/gender, case size, and geographic region, but not health status.[17] However, the amount of variation allowed for adjustments based on age/gender and case size, as well as the overall premium price, would be limited. For example, when determining the premium price for a small business based on the age/gender make-up of the employees, the premium price would be limited to 4 times or 300 percent of the lowest premium price for a similar small business in the market.

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[16] Dr. Gruber, 2007.

[17] This scenario in which rate adjustments are allowed based on factors that include age/gender, case size, and geographic region, but not allowed based on health status, is known as modified community rating.

Table 1: Current rating formula and proposed rating scenarios with restrictions by factor

Factor	Current Rate Bands	Allowed percentage difference between lowest and highest rate based on current rate bands	Proposed Rate Band	Allowed percentage difference between lowest and highest rate based on proposed rate band
Age/gender	7:1	600%	4:1	300%
Case size	1.31:1	31%	1.2:1	20%
Geographic region	1.63:1	63%	None	No limits
Health status	1.86:1	86%	Not allowed	Not allowed
Overall rate	27.89:1	2,689%	4.8:1	380%

Note: Current rate bands were determined by Gorman Actuarial, LLC' based on their analysis of the small group market.

Gorman Actuarial, LLC also analyzed all of the scenarios to determine the impact each would have on current market premiums. For example, for the scenario presented in Table 2, Gorman Actuarial, LLC found that 20 percent of small businesses would experience a premium rate decrease of more than 20 percent—with the average decrease being 27.9 percent; while 23 percent of small businesses would experience a premium rate increase of more than 20 percent—with the average increase being 28 percent (see Table 2).

Table 2: Impact on premium rates for scenario presented in Table 2

Premium rate change	Average rate increase	Percent of groups experiencing rate change
Decrease more than 20%	-27.9%	20%
Decrease between 0% and 20%	-8.9%	22%
Increase less than 10%	5.0%	16%
Increase between 10% and 20%	14.9%	19%
Increase more than 20%	28.0%	23%

Appendix II details all of Gorman Actuarial, LLC's proposed rating scenarios and the impact each of these rating scenarios would have on current premium prices.

3.2.1 Plan Bidding Process

The State also sought to introduce managed competition into the market as part of its reform proposal in order to decrease costs, bring about price stability, and make more cost-effective plans available to small businesses.

To start, it was conceived that the Connector would feature three tiers of insurance plans—Platinum, Gold, and Silver. Within each tier, the plans would be actuarially equivalent, allowing the specific benefit packages for each plan to differ as well as their premiums. This arrangement would encourage innovation in plan design leading to a high degree of choice between and within tiers. Plans in the Gold tier would reflect the average actuarial value—or average benefit package—of plans currently offered by insurers to the small group market. Plans in the Platinum tier would reflect a more comprehensive benefit package than those offered under the Gold tier; while plans in the Silver tier would reflect a less comprehensive benefit package than those offered under the Gold tier.

Once a year, insurers would be invited to bid to have their plans offered through the Connector. Each submitting insurance company would have to include a bid for at least one plan under each of the three tiers—for a total of a minimum of three bids. The benefit package to be offered under each tier would be assigned an actuarial value and the bids insurers submit would have to equal these actuarial values. This process would create a managed competition environment in which insurers would be competing to offer their best price on benefit packages for small businesses.

4 Impact of reform measures

The overall impact of these reform measures is best understood through the modeling completed by Dr. Gruber for the State. Specifically, he modeled the impact the following reform measures would have on the small group market:

- the creation of a Connector-type purchasing system,
- the introduction of managed competition through the insurance plan bidding process, and
- the implementation of stricter rating practices.

To complete his modeling, Dr. Gruber worked with the following assumptions:

- there would be an estimated 7 percent reduction in overall premiums due to the introduction of managed competition through the insurance plan bidding process and requiring insurance broker fee transactions to occur outside of the Connector; and
- the adopted rating reform would be a modified community rating, similar to the one detailed in Table 2.

The analysis Gorman Actuarial, LLC completed indicated that under any rating reform there would be some small businesses that would experience a decrease in premium prices, while other small businesses would experience an increase in their prices. The State determined that one way to help mitigate the negative effects of the rating reform would be to provide a subsidy to those employers that experience a decrease to offset the additional cost. Therefore, Dr. Gruber also modeled several scenarios in which different subsidy amounts were made available to those employers purchasing insurance who would experience a premium increase under the reform.

The results of Dr. Gruber's modeling illustrates how the reform measures coupled with different subsidy amounts—ranging from none to $200 million—would lead to individuals moving from one market to another, as well as the financial impact of these measures and each subsidy amount. In general, Dr. Gruber found that as the subsidy amount increased, more individuals moved onto employer-sponsored insurance and away from Medicaid, the non-group market, and having no insurance. In addition, as the subsidy amount increased, so did the number of small businesses and employees who would be expected to experience a decrease in premiums under the reform measures.

For example, with a $100 million subsidy, Dr. Gruber found that 60 percent of employers and 65 percent of employees are expected to experience a decrease in premiums with the average premium decrease being about 6.2 percent.[18] In general, the small businesses that would experience a decrease in premiums are those with older and sicker employees than the general population, whereas small businesses with employees who are younger and healthier would likely experience an increase in premiums.

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[18] The percentage of employees who experience a rate increase is greater than the percentage of employers who experience the rate increase, which indicates that larger employer groups are expected to experience the highest premium increases.

The reform measures would also lead to individuals moving from one market to another. Specifically, with a $100 million subsidy:

- Employer-sponsored insurance is expected to increase enrollment by 8,000 individuals.
  - 2,000 of these individuals were people who were previously uninsured and 6,000 of them were people previously insured under Medicaid. However, with the reform measures in place, these individuals would find employer-sponsored insurance more attractive than their previous insurance options.
- Less than 1 percent of individuals are expected to drop employer-sponsored insurance and purchase insurance in the non-group market instead—approximately 1,000 individuals.

In total, Dr. Gruber's modeling results indicate that by implementing the reform measures that include a $100 million subsidy and by requiring all employers to establish section 125 plans, a net savings of approximately $309 million dollars in health care costs—over 20 percent of health care premiums—could be generated.

A summary of Dr. Gruber's modeling results can be viewed in Table 3. The top section of Table 3, titled "Total Population Effects," shows how the reform measures coupled with different subsidy amounts results in individuals moving from one market to another. The bottom section of the table, titled "Financial Effects," shows the financial impact of these measures and subsidy amounts.

Table 3: Effect of market reforms

	No Subsidy	$50 Million Subsidy	$100 Million Subsidy	$150 Million Subsidy	$200 Million Subsidy
Total Population Effects (thousands)					
Insurance Market					
Employer-Sponsored	-21	-5	8	20	32
Non-Group	6	2	0	-1	-3
Medicaid	0	-2	-6	-10	-14
Uninsured	15	5	-2	-9	-15
Financial Effects					
Net Change Premium	-4.9%	-5.7%	-6.2%	-7.3%	-8.1%
Percent of Employer Groups Experiencing Decrease in Premiums	50%	55%	60%	64%	68%
Percent of Employees Experiencing Decrease in Premiums	46%	54%	65%	74%	80%

Source: Dr. Jonathan Gruber, MIT.

Appendix III provides a comprehensive description of Dr. Gruber's modeling methodology and results.

5 Conclusion

As health care costs continue to rise, more and more small business owners are unable to afford to offer health insurance to their employees. Those that choose to offer coverage often see such huge rate increases each year forcing them to navigate the complex insurance marketplace annually to ensure they have the lowest cost plan. The survey and analysis completed by Gorman Actuarial, LLC provides unique information on the condition of the small group market in

Wisconsin and supports the need for reform. Dr. Gruber's modeling takes this analysis and combines it with several reform measures proposed by the State to mitigate the significant and growing challenges faced by small business employers. His results provide an important contribution to the discussions on the impact such reform measures could have on the small group market today.

Appendix I – Gorman Actuarial, LLC, "Preliminary Data Analysis of the Wisconsin Small Group Market"

Appendix II – Gorman Actuarial, LLC, "Impact of Pricing Reforms on the Wisconsin Small Group Market"

Appendix III – Dr. Jonathan Gruber, "Final Report: Impact of Small Group Reform in Wisconsin"