TESTIMONY DELIVERED BY

MICHAEL W. FERGUSON, CHIEF OPERATING OFFICER

SELF-INSURANCE INSTITUTE OF AMERICA, INC. (SIIA)

California State Senate Health Committee Hearing -- SB 1431

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My name is Michael Ferguson and I serve as chief operating officer for the Self Insurance Institute of America, Inc. (SIIA). SIIA is a non-profit trade association whose members include self-insured employers and their business associates including third-party administrators (TPAs) and stop-loss insurance carriers. SIIA's membership includes organizations based in California and/or that provide products and services to self-insured employers in the state.

I am testifying today in opposition to SB 1431 for two reasons. First, it would make it more difficult for smaller employers in California to provide health insurance to their employees by effectively eliminating the self-insurance option.

The other reason is that this legislation, if enacted into law, would likely be preempted by federal law.

I would also like to use the opportunity to help you and your committee members better understand medical stop-loss insurance and to address the stated rationale for this legislation.

Smaller Employers in California Deserve Options to Provide Health Coverage

Surveys show that group health insurance premiums paid by small firms are as much as 18 percent greater per employee than those paid by larger companies. And like most other states, California's health insurance marketplace offers little competition and therefore costs continue to rise. Therefore, it is not surprising that an increasing number of smaller employers are considering self-insurance as an alternative to absorbing increased costs or dropping coverage.

While self-insurance may not be a viable option for many smaller employers because their balance sheets are not strong enough or due to workforce instability, an increasing number of smaller employers are operating successful self-insured group health plans. These plans provide cost containment advantages and they are often customized to meet the specific needs of the plan participants.

Instead of paying insurance premiums to health insurance carriers, self-insured employers pay health care claims as they are incurred.

In addition to retaining the financial risk, these employers also retain most of the legal risks associated with their health plans in accordance with the Employee Retirement Income Security Act (ERISA).

For well over a quarter century since passage of ERISA, qualified employers of all sizes successfully have self-funded their employee health plans. In 2010, more than 77 million workers and their dependents were covered by self-insured plans, which represents about one third of the private health care marketplace.

With the help of qualified professional service providers such as underwriters, accountants or TPAs, employers can be evaluated objectively to determine whether they are viable candidates for self-insurance. The most important consideration is whether employers have sufficient positive cash flow in order to pay incurred claims. Employers should also recognize that self-insurance is a long term risk management strategy that requires ongoing proactive involvement by plan

sponsors to consistently achieve the twin objectives of controlling costs while providing quality health benefits.

Medical stop-loss insurance is a critical component for most self-insured employers as such insurance provides a financial reimbursement mechanism should actual health care claims exceed pre-determined levels. SB 1431 imposes new regulatory restrictions on stop-loss insurance in a way that it would no longer be available with policy terms appropriate for smaller employers and therefore subject them to unacceptable financial risk. Quite simply, if employers cannot retain stop-loss insurance with terms consistent with their financial risk transfer needs they are not able to self-insure.

Specifically, SB 1431 would prohibit stop-loss insurance policies sold to employers with 50 or fewer employees that include specific attachments points lower than $95,00o among other restrictions. In layman's terms, that means that an employer could not seek financial reimbursement for claims associated with individual plan participants until they have paid at least $95,000 in claims costs.

It's important to be clear that self-insured employers are financially responsible for all eligible health care claims so it's not accurate to say that an employer's

financial liability is "capped" at the stop-loss attachment levels. To put a finer point on it, stop-loss carriers do not pay individual health care claims.

With these clarifications, it is not appropriate for the state of California to substitute its judgment for that of individual employers and their professional advisors to determine appropriate financial risk transfer arrangements. If an employer determines it is prepared to take on the direct financial risks associated with providing health benefits for their employees, the state should not intervene through restricting access to stop-loss insurance.

While we agree with many industry stakeholders who have correctly concluded that a $95,000 minimum specific attachments point requirement is too high for virtually all smaller employers (and many larger employers), for the policy reasons just mentioned SIIA believes this regulatory approach is misguided regardless of what attachment points are proposed.

It's also important to point out that the legislation erroneously assumes that stop-loss insurance "covers" individual plan participants. This is contractual liability insurance and the policy is issued to the employer or the plan, but never directly to individuals. As such, the legislation is flawed from a definitional basis.

Adverse Selection Prohibited Under Current Laws

So why are we even considering this legislation? It is our understanding that California's insurance commissioner has embraced the canard that the growth of smaller self-insured health plans will result in adverse selection within the health care market place and in turn will compromise the success of the health insurance exchanges provided for by the Affordable Care Act.

This view is based on the belief that self-insured plans "cherry pick" – or cover only healthy workers. But that's not true.

Current federal and state laws prohibit plan sponsors—whether insured or self-insured—from enrolling only the most favorable health risks in their plans. There is no evidence that self-insured plans as a group have any different health status characteristics from insured plans as a group. U.S. Department of Labor reports confirm that self-insured plan membership – like insured plans – are made up of a broad cross-section of participants with health risks that mirror workforce risks seen in larger populations.

A recent Rand Corporation study concluded it is “unlikely” that small employers who self-insure will have a major impact on the future cost of healthcare in state exchanges.

The study stated “the self-insurance option will reduce enrollment in the small business exchanges somewhat, but it will not have a substantial impact on exchange premiums.” More to the point, RAND concluded that it did not expect the popularized “death spiral” phenomenon to occur based on currently available market data.

In the post-ACA world, employers severely impacted by high health costs should continue to have the option to seek alternatives to double-digit annual premium increases – and for small employers – access to a self- insurance option will depend on large part on a viable stop-loss insurance market.

SB 1431 Subject to ERISA Preemption Challenge

In addition to the compelling policy arguments against SB 1431, the legislation if enacted also likely violates federal law and would therefore expose the state to litigation.

It is well established that state mandated benefit laws do not apply to ERISA self-insured health plans. This is because such laws are preempted—or superseded—by federal law. The mandated attachment points of SB 1431 also are preempted. Simply stated, this is because they affect the terms and conditions of ERISA regulated employee benefit plans.

The rationale that attachment points can be regulated as “insurance” is based on an inaccurate assumption that ERISA’s “savings” clause, which exempts state insurance regulation from federal preemption, permits such regulation. This legal analysis has been consistently rejected by federal courts-- and the U.S. Supreme Court has declined to review.

State laws that focus on what is known as the “business of insurance” typically oversee the financial ability – or solvency – of carriers to pay claims. Such regulation also applies to market conduct, consumer rights, claims appeals and disclosure requirements. While some states have attempted to regulate stop loss within its insurance oversight role, the courts have rejected such attempts that impose requirements when they relate to self- insured group health plans.

There is no question that SB 1431's provisions would impact impermissibly on the benefit risk structure, terms and conditions, and administration of ERISA plans. These provisions affect the fundamental underlying benefit structure of self-insured plans – they clearly "relate" to ERISA plans – the critical prerequisite to a federal preemption challenge. For these reasons, SIIA has concluded that legislation would not withstand a legal challenge.

Conclusion

In the post ACA-world, escalating costs surely will represent a predictable outcome of health reform. As employers continue to face higher costs and expanded regulatory requirements, many employers—and particularly small employers – will seek more cost-efficient funding methods to better manage their plans and control costs.

As in the past, self-insurance offers a viable solution for qualified small employers. We urge you to allow California employers of all sizes to choose the self-funding option by saying "NO" to SB1431.

Thank you for the opportunity to present SIIA's views to this committee and I would be pleased to address any questions or comments you may have.