

**CALIFORNIA DEPARTMENT OF INSURANCE**

**INITIAL STATEMENT OF REASONS**

**October 23, 2012**

**WRAPPING OF SMALL EMPLOYER HEALTH INSURANCE POLICIES  
(REG-2011-0028)**

**INTRODUCTION**

The Department of Insurance (“Department”) proposes to add to Title 10, Chapter 5, Subchapter 2 of the California Code of Regulations the new Article 2, titled “Small Employer Health Insurance,” consisting of Sections 2233.1 to 2233.5.

The proposed regulations implement, interpret, and make specific the various provisions of the Small Employer Health Insurance Reform Act, Chapter 1128, Statutes 1992 (A.B. 1672), commencing with Insurance Code Section 10700 (hereinafter “A.B. 1672”).

**DESCRIPTION OF THE PUBLIC PROBLEM**

A.B. 1672 requires insurers to not discriminate among small employers in the sale of health insurance policies. Insurers must offer all their policies or “benefit plan designs” (“BPD”) to all small employers in a particular geographic area.

Specifically, the anti-discrimination section provides:

Each carrier, except a self-funded employer, shall fairly and affirmatively offer, market, and sell all of the carrier's benefit plan designs that are sold to, offered through, or sponsored by, small employers or associations that include small employers to all small employers in each geographic region in which the carrier makes coverage available or provides benefits.

Insurance Code Section 10705(b)(1) (emphasis added).

Subsection (c) specifies that “[e]ach carrier shall make available to each small employer all benefit plan designs that the carrier offers or sells to small employers or to associations that include small employers. . .” Insurance Code Section 10705(c).

Similarly, agents and brokers representing health insurers have a responsibility to inform small employers of insurers’ obligation to sell all of the BPDs the insurer offers and to provide rate and benefit information as well as summary brochures on any BPD offered by an insurer they represent. Insurance Code Section 10705(e).

But despite these non-discrimination (guaranteed-issue) requirements, many insurers prohibit the sale of certain health insurance policies to small employers who combine (“wrap”) such policies with employer-funded Health Reimbursement Arrangements (“HRAs”) or other methods for reimbursing employees for their out-of-pocket medical expenses. Other insurers permit small employer wrapping, but only with certain policies that may be priced significantly higher or include fewer covered benefits.

Certain insurers have imposed their wrapping restrictions on employers as well as agents and brokers by requiring employers to sign an agreement that they will not wrap policies unless they buy a policy designated by the insurer for wrapping (and priced higher) and requiring agents and brokers to agree in their appointment contracts that they will not sell policies other than those “approved for wrapping” to an employer that wraps. In some cases, insurers have terminated agents and brokers who have violated these “no-wrap” rules.

Some insurers argue that they prohibit wrapping or charge higher premiums for wrapping because claims data show higher utilization of covered benefits by employees who have wrap plans provided by their employers. They contend that an employee that benefits from an employer that uses wrapping to assist employees with their out-of-pocket medical expenses has “less skin in the game” and will therefore be less hesitant to seek covered medical services, increasing claims and insurer costs.

The brokers and agents assert that an insurer may not restrict a small employer’s ability to pay for employees’ deductibles or other costs under the policy. They maintain that if an insurer wants to sell a policy to small employers, it has to sell the policy to all small employers, including those that wrap, and at identical premium rates.

A.B. 1672 requires modified community rating that limits the ability of insurers to vary rates among different insureds. If some small employers wrap, increased medical claims costs would likely be passed on to all small employers. This might cause small employers who do not use wrapping to subsidize those that do.

The proposed regulations balance the non-discrimination and guaranteed issue requirements of A.B. 1672 against the concern that wrapping may increase medical claims costs and premiums for all small employers, even those that do not wrap. The regulations achieve this balance by requiring the following:

- Insurers that restrict wrapping must set forth the wrapping restrictions in the benefit plan design.
- Insurers that prohibit wrapping must provide actuarial documentation to the Department establishing that wrapping increases medical claims payments by the small employers.
- Insurers that permit wrapping but charge more for policies that may be wrapped must provide actuarial documentation to the Department establishing by clear evidence (a) the extent of increased claims payments by employees of small employers that wrap, and (b) that the increased premium accurately reflects the extent of increased claims payments.

- All information an insurer submits to the Department to support restrictions on wrapping and premium differentials will be made public.
- For every “no-wrap” policy, an insurer must provide a wrapping option. A small employer therefore will be able to purchase a policy identical in all respects to the “no-wrap” policy except for the availability of wrapping and the premium.

## **SPECIFIC PURPOSE AND REASONABLE NECESSITY FOR THE REGULATIONS**

The specific purpose of each proposed regulation and the rationale for the Department’s determination that each regulation is reasonably necessary to carry out the purpose for which it is proposed is set forth below.

### Proposed Adoption of Section 2233.1. (“Definitions”).

The purpose of this section is to define certain terms used in the proposed regulations. It defines “BPD,” “HRA,” “restrict wrapping” and “wrapping” to provide greater clarity.

These definitions are reasonably necessary to eliminate confusion as to what is meant by these four terms so that referenced sections of the statute may be implemented, interpreted, and made specific in a manner that is clear, uniform, and understandable. Without such definitions, these terms might be open to several different meanings. These definitions are necessary for clarity and uniformity in the implementation of Insurance Code Section 10705 and other provisions of A.B. 1672.

### Proposed Adoption of Section 2233.2. (“Restrictions on Wrapping”).

The purpose of this section is to specify that insurers may restrict wrapping, but only under certain conditions: they must set forth the wrapping restrictions in the benefit plan design (BPD) and comply with subsections 2233.3 through 2233.5 of these regulations.

The addition of this section is necessary to ensure that insurers that choose to restrict wrapping disclose wrapping restrictions to prospective policyholders and others, and do so only when they have demonstrated that they have met the other requirements of these regulations.

### Proposed Adoption of Section 2233.3. (“Supporting Data”).

This section requires insurers that are proposing to charge higher premium rates for a policy that does not restrict wrapping than for a policy that restricts wrapping to provide data to the Department of Insurance showing both the extent of expected increased claims payments resulting from wrapping, and that the higher premium rate is proportionate to those increased claims payments.

It also requires that insurers that restrict wrapping provide actuarial data to the Department establishing that wrapping increases claims payments and the extent of that increase.

These data requirements are necessary for the Department to assure that insurers are not overcharging small employers for health insurance or otherwise restricting small employers' health insurance options without justification. Thus, insurers can price for wrapping only if they meet a high standard of proof to show that wrapping increases utilization, to document the extent of that increase, and to demonstrate that the specific higher pricing correlates with the amount of increased utilization.

Proposed Adoption of Section 2233.4. (“Information to Be Made Public”).

This section requires all information submitted to the Department in connection with these regulations -- including information supporting restrictions on wrapping and premium differentials due to expected increased claims payments resulting from wrapping, as well as all portions of BPDs addressing wrapping -- be available to the public. It also specifies that the Department will rely only upon public information in considering a submission made pursuant to these regulations.

This requirement is reasonably necessary to ensure full transparency regarding the information submitted to Department to support wrapping restrictions or premium increases. Such transparency will help to ensure the accuracy of the information provided to the Department, and inform all stakeholders as to the basis for the insurers' utilization claims.

Proposed Adoption of Section 2233.5. (“Discrimination in Issuance of Small Employer Health Insurance Policies Prohibited”).

This section prevents insurers from discriminating against small employers that elect to wrap by requiring every BPD that places restrictions on wrapping to provide an option that allows for wrapping. It further establishes that any differential in premium rates between the options that restrict or do not restrict wrapping must be supported with actuarial data, as required under subsection 2233.3.

It also establishes that this requirement shall become operational 90 days after the effective date of the regulations, so that insurers have sufficient time to come into compliance.

The purpose of this section is to make specific the guaranteed issue of small employer policies requirement of A.B. 1672, as described above.

**IDENTIFICATION OF STUDIES**

The Department has relied upon the Economic Impact Assessment (EIA) prepared pursuant to Government Code Section 11346.3(b) in proposing the proposed regulations. A copy of the EIA is included in the rulemaking record.

There are no other technical, theoretical, and empirical studies, or similar documents relied upon in proposing the adoption of the proposed regulations.

## **SPECIFIC TECHNOLOGIES OR EQUIPMENT**

Adoption of these regulations would not mandate the use of specific technologies or equipment.

## **REASONABLE ALTERNATIVES TO THE PROPOSED REGULATIONS**

The Department must determine that no reasonable alternative considered by the agency or that has otherwise been identified and brought to the attention of the Department of Insurance would be: 1) more effective in carrying out the purpose for which the regulations are proposed, 2) would be as effective and less burdensome to affected private persons than the proposed regulations, or 3) would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

The Department has considered and rejected two reasonable alternatives to the proposed regulations:

### Alternative 1: Prohibit All Wrapping Restrictions by Insurers

Under this approach, insurers would be required to market, offer, and sell all small employer policies on a “guaranteed issue” (non-discriminatory) basis to small employers that wrap without a corresponding increase in premium to account for greater utilization stemming from wrapping.

A major disadvantage to this approach is that requiring insurers to provide policies for small employers that wrap without a corresponding increase in premium to account for greater utilization would likely cause insurers to raise premiums for all small employers. This would cause small employers who do not wrap to unfairly subsidize those who do.

### Alternative 2: Require Insurers to Develop and File Mirror Health Insurance Policies (Separate Benefit Plan Designs) That Allow Wrapping for Any Policy That Prohibits Wrapping

Under this alternative, the regulations would require insurers to develop and file separate BPDs that allow wrapping for every policy that restricts wrapping. The new products would be required to be identical in nearly every respect except for premiums, and the restriction on wrapping.

This approach would impose a significant administrative burden on insurers by requiring them to (1) modify summary benefit and rate guides, (2) provide additional benefit summaries, certificates of insurance, and other policy documents, and (3) perform duplicate actuarial reviews.

The more modest option approach taken in the proposed regulations would allow insurers to file a premium rate applicable to wrapping as an option to be added to existing wrapping-restricted policies, giving small employers that choose to wrap the full selection of policies available to small employers in that geographic area.

For these reasons, the Department has determined that that neither of these alternatives would be more effective in carrying out the purpose for which the regulations are proposed, as effective and less burdensome to affected private persons than the proposed regulations, and more cost-effective to affected private persons and equally effective in implementing A.B. 1672 as the proposed regulations.

#### **ADVERSE IMPACT ON SMALL BUSINESS**

The Department has determined that the proposed regulations will have no adverse impact on small business. Insurance companies are not small businesses pursuant to California Government Code Section 11342.610(b)(2).

#### **PRE-NOTICE DISCUSSIONS**

The Department conducted a pre-notice public discussion of the proposed regulations on January 26, 2012 pursuant to Government Code Section 11346.45. Interested and affected parties were given an opportunity to present statements or comments with respect to the proposed amendments. The Department considered these statements and comments in drafting the proposed regulations.

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