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Human Resources Division

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The Honorable John D. Dingell
Chairman, Committee on Energy and Commerce
House of Representatives

The Honorable Ron Wyden
House of Representatives

In response to your request, GAO is currently assessing state-level small group health insurance market reforms. In light of current congressional consideration of potential federal small group market reform, you asked us to briefly summarize our preliminary findings on this ongoing work and any earlier work we completed related to this issue.

Small Group Reforms Will Raise Costs for Some and Reduce Costs for Others

GAO initially identified the developing crisis of affordability and availability of health insurance for small firms in a 1990 report to the Committee on Energy and Commerce—Health Insurance: Cost Increases Lead to Coverage Limitations and Cost Shifting (GAO/HRD 90-68). In recent testimony before the Subcommittee on Health, House Committee on Ways and Means, we discussed serious problems caused by underwriting and rating practices in the small group health insurance market.[1]

In our earlier work, we pointed out that while reforms addressing availability and equity in the small group market were needed to deal with these problems, these proposed reforms would not address several key issues. The rating reforms will narrow the range of health insurance premium costs among firms; they do not reduce premiums overall. By requiring the inclusion of high-cost individuals into group plans, the recommended reforms will cause those currently paying the lowest premiums to pay

[1]Private Health Insurance: Problems Caused by a Segmented Market, GAO/T-HRD-91-21, May 2, 1991.

more in order to cover the high-cost individuals. Excluding expensive individuals from insured groups lowers costs for others purchasing insurance. With costs increased for some insured and decreased for others, what remains unclear is how much more (or less) health insurance will be purchased for the employees of small businesses.

Reforms Do Not Address Underlying High Cost Growth

The reform proposals neither stop nor reduce the rising cost of health care, the major reason small businesses give for not providing health benefits.[2] Health care cost inflation has components outside the realm of insurance reform. For example, a portion of costs originating within the insurance industry—the high cost of overhead for small businesses' health insurance—is not addressed.

Most States Have Already Enacted Small Group Market Reforms

Our ongoing work on state reform initiatives reinforces these conclusions. We found that many states have recently implemented small group market reforms—including rating and underwriting reforms, elimination of mandated benefits, and subsidies.

Forty-three states have legislated at least one of the following regulatory reforms: (1) limiting rating practices and restricting premium prices, (2) mandating guaranteed issue that requires insurance companies to cover all persons in an insured group, (3) requiring continuation of coverage for those already insured, and (4) requiring disclosure of insurance practices. These reforms improve the availability of health insurance regardless of an individual's health status by limiting coverage exclusions and waiting periods, prevent employer "churning"[3] of

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[2]W. David Helms, "Problems With Employment-Based Insurance: Implications of the Robert Wood Johnson Foundation Health Care for the Uninsured Program," National Health Policy Forum, December 16, 1991.

[3]Churning occurs where low-cost groups migrate from one insurer to another in order to obtain lower premiums. This migration occurs because first year premiums are lower than subsequent years due to the wear-off of preexisting condition exclusions and the development of new conditions by the covered group.

insurance companies, and narrow the differences between rates for insured groups and individuals.

While these reforms address the problems related to availability of health insurance, they have an ambiguous effect on problems related to cost. Blue Cross recently performed an analysis of 6 of its plans which showed that rating proposals that allowed rating adjustments only for demographic variables would result in rate increases for about half of its subscribers—the other half would experience decreases.

To address problems related to affordability, nearly half the states have given insurers greater flexibility in designing lower-cost insurance plans, generally by waiving mandated benefits. While these mandate-free plans were offered with lower premiums, in many cases these plans with waived mandates also involved higher co-payments and deductibles. Therefore, it is not clear how much of the price reduction was due to eliminating mandates as opposed to increasing consumers' out-of-pocket payments. Mandates were often estimated to account for less than 10 percent of total claims cost.

Approximately one-quarter of the states have gone further and also provide direct subsidies or tax credits to reduce premiums for small firms. State-subsidized plans, which reduce premiums up to 50 percent have had few takers. A recent study showed that only about 3 percent of uninsured small firms added insurance in response to a 50 percent premium subsidy.[4] Even when fully implemented, the authors estimate that this subsidy would only expand coverage to 16.5 percent of currently uninsured small firms.

Response to Small Group Market Reforms Marginal, But Conclusive Judgments Cannot be Made

It may be too early to judge fully the success of these reforms—many were legislated by states during or after 1990. But, the early response has shown that these reforms have induced few small businesses to provide health benefits to their employees. States also continue to be concerned that the reforms lowering prices for high-risk

[4]Thorpe, Kenneth; Hendricks, Ann; Garrnick, Deborah; Donelan, Karen; Newhouse, Joseph; "Reducing the Number of Uninsured by Subsidizing Employment-Based Health Insurance," Journal of the American Medical Association, Vol. 267, No. 7, February 19, 1992.

individuals will generate increases in premiums for the larger part of the small group market. Unfortunately, there is no data on the net effect of these reforms on average premiums and levels of coverage, and it is not easy to develop these estimates given the complexity of the state efforts.

State Insurance Departments May Not Have Sufficient Resources to Enforce New Regulations

Finally, you asked us to comment on whether our prior work on state insurance departments suggests that they have adequate resources to assure regulatory compliance with a comprehensive small business reform proposal. None of GAO's earlier work on the capacity of state insurance departments focused on their role related specifically to health insurance. However, earlier GAO work indicated that some states may not allocate sufficient resources to effectively deal with their primary objective of assuring insurance company solvency.[5] Many states also have not adopted key standards established by the National Association of Insurance Commissioners for long term care insurance. GAO expects that these questions regarding the adequacy of resources would be magnified if states were given added responsibilities to monitor the functioning of the health insurance market.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, it will be made available on request.

If you have any questions regarding this letter, please call me at (202) 275-5470.

Edward A Densmore

for Lawrence H. Thompson
Assistant Comptroller General

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[5]Insurance Regulation: Problems in the State Monitoring of Property/Casualty Insurer Solvency, GAO/GGD-89-129, September 1989.