Executive Summary

For the Report:

Challenges and Alternatives for Employer Pay-or-Play Program Design: *An Implementation and Alternative Scenario Analysis of California's "Health Insurance Act of 2003" (SB 2)*

For the
California HealthCare Foundation
and the
California Managed Risk Medical Insurance Board

Project Team Led by the
INSTITUTE FOR HEALTH POLICY SOLUTIONS

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Acknowledgments

This is the executive summary of a larger report entitled *Challenges and Alternatives for Employer Pay-or-Play Program Design: An Implementation and Alternative Scenario Analysis of California's "Health Insurance Act of 2003" (SB 2).* The overall study, which also produced several Supplements that explore particular issues in greater detail, was funded by a grant from the California HealthCare Foundation (CHCF), an independent philanthropy committed to improving California's health care delivery and financing systems. The lead organizations for the study were the Institute for Health Policy Solutions and the RAND Corporation. Rick Curtis, president of the Institute for Health Policy Solutions, served as the project director.

Ed Neuschler and Rick Curtis, of the Institute for Health Policy Solutions, were the principal authors of this executive summary, which captures the important points of the larger report. The principal writer of the main report was Ed Neuschler (IHPS), who also worked with RAND on the public budget and other implications of the alternative scenarios. Rick Curtis (IHPS) served as project director, identified alternative scenarios, provided substantive guidance for the project as a whole and the final report in particular, and developed some subsections of the report and the executive summary. Lynn Taylor (IHPS) orchestrated development of the outline for the final report and prepared Supplements B on Benefit Design and C on Cost Management Strategies, in addition to serving as project coordinator. Rafe Forland (IHPS) provided sections of the main report dealing with administrative issues.

Drs. Kanika Kapur and M. Susan Marquis of the RAND Corporation developed the data base and estimation model, conducted the quantitative simulation analysis on the implications of SB 2 and alternative scenarios, and drafted Supplements A, H and I describing the simulation process and results. In addition, Dr. Kapur authored Supplement E, Risk Adjustment Methods and Their Relevance to "Pay-or-Play." Stephanie Teleki and Cheryl Damberg of the RAND Corporation authored Supplement F on quality measurement and monitoring.

Pat Butler, J.D., Dr. P.H., prepared Supplement D on ERISA implications and drafted the legal considerations section of the main text. The authors wish to recognize the considerable contributions from other members of the project team, including Bob DiPrete, consulting senior fellow at IHPS, who was project lead and principal author of the report on stakeholder interviews (Supplement G) and provided valuable suggestions on earlier drafts; Jim Mays of the Actuarial Research Corporation, whose insightful input was invaluable to conduct of this analysis; and Tom Davies, who provided substantive guidance and assistance regarding large-employer purchasers in California. In addition, discussion presented here reflects the insightful observations of the many policy analysts, program managers, employers and health insurance experts interviewed for this project.

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Table of Contents

EXECUTIVE SUMMARY

Project Purposes

In spring 2004, the California HealthCare Foundation (CHCF) selected the Institute for Health Policy Solutions (IHPS), in collaboration with the RAND Corporation, to conduct an in-depth implementation study and analysis of California's landmark "pay-or-play" legislation: *The Health Insurance Act of 2003* (SB 2). This document summarizes the findings of that research. A larger main report presents the findings in detail.

SB 2 would have required certain California employers to either "pay" the state a fee, which the state would use to cover specified workers and dependents, or "play" by covering their workers directly through employer-sponsored coverage. An employer "pay-or-play" coverage expansion such as SB 2 can work only if there is a viable coverage vehicle for the workers of "pay" employers. This study focused principally on the State Health Purchasing Program (SHPP)—the purchasing pool SB 2 would have established for this purpose.

More specifically, the purpose of this study was to highlight critical SB 2 design and implementation issues for consideration by California's Managed Risk Medical Insurance Board (MRMIB), which was to operate the SHPP, and to identify and assess alternative scenarios for implementing SB 2. A key focus of the study was intended to be program policies and state administrative issues related to viability of the state purchasing pool. After SB 2 was overturned by referendum (Proposition 72 in November 2004), the project was revised to put more emphasis on alternative policy design scenarios and their implications and less on administrative implementation details.

Despite its overturn by a narrow margin, the passage of legislation intended to expand employment-based coverage provides a unique opportunity to assess and to evaluate the implementation issues and challenges presented by such coverage expansions.

This report is intended to assist decision-makers in the design of manageable, effective and sustainable coverage expansions for workers and their families. It is most obviously pertinent to "pay-or-play" approaches similar to SB 2. However, much of the analysis here can help inform a range of other approaches involving one or more of the important features of SB 2: employer-financed coverage (and related ERISA issues); health insurance purchasing pools; premium subsidies for low-income populations; and/or individual mandates.

The specific questions addressed by this study include:

- Who are the people and businesses that would be affected by SB 2?
- Can the state-administered purchasing pool be designed to be self-supporting?
- If not, what additional subsidies would be needed to make the pool financially viable?
- What are the state budget implications of SB 2 for the Medi-Cal and Healthy Families programs?
- What are the key program policy, structure and administrative considerations in setting up the pool?

Key SB 2 Provisions and Requirements

SB 2 would have required specified employers to either: (a) "pay" a fee to the state so that their workers and, in some cases, dependents could be covered through a State Health Purchasing Program (SHPP)—or "purchasing pool"—established under the Act, or (b) "play" by directly providing health coverage.

For Employers

"Large" employers—those with 200 or more employees in California—would have been required to either pay the applicable fee for eligible workers and dependents, or directly cover them. Medium employers (50 to 199 employees) would have been required to do so for workers but not for dependents. Generally, employers would have to make available and contribute at least 80% of the premium for coverage that met certain standards. (Because SB 2 would have limited "low-wage" worker contributions to 5 percent of their wages, employers would sometimes have had to pay more than 80% of the SHPP fee or premium for these workers.) But employers could also offer other coverage and contribute a lower percentage to that coverage (e.g., their current plan).

For Workers

SB 2 also would have effectively entailed an "individual mandate" for workers. The employer was required to withhold the worker's share of premium for all eligible workers, i.e., those who worked at least 100 hours per month for that employer and have worked for that employer for at least three months. While large employers were also to withhold worker contribution amounts for dependents, it appears that workers could have avoided this by simply not reporting their dependents to the employer.

The "Pay" Pool Must Be Self-Supporting

For a range of reasons, including unique legal, procedural and budget considerations in California, SB 2 would have required the state purchasing pool to rely exclusively on the fees charged employer groups that used the pool. The pool would have had access to no other sources of revenue, and was not to provide subsidies for low-income populations beyond those already eligible for Medi-Cal and Healthy Families. These constraints would create a number of difficult, interrelated challenges for the creation of a viable pool. In order to address such challenges, MRMIB was given latitude to determine what factors would be used to determine the fee any given employer would pay.

Analyzing the Effects of SB 2

A primary focus of this project was to determine whether the SHPP pool (the "pay" option under SB 2) could be designed to be viable financially, and to identify program design elements that might support a viable pool. We also looked at state budget implications for the Medi-Cal and Healthy Families programs.

Alternative Pool Design Scenarios

To understand how alternative program designs would affect the SHPP pool's financial viability, size, composition and cost, we developed alternative "scenarios" to describe a range of policy approaches to implementing SB 2. Our intent was to illustrate the major alternative approaches available to MRMIB. Because it was uncertain whether the SHPP pool could be self-supporting under the bill as enacted by the legislature, and because it was known from the outset of this project that SB 2 would not become law unless it was upheld by the voters in the November referendum, we developed and considered several scenarios that complied with SB 2 and several that differed from SB 2 in certain respects.

The scenarios are outlined schematically in Exhibit ES-1. They vary primarily by how the SHPP fee would be structured and by whether or not additional subsidies or outside funding would be available to help support the pool. But we also considered two different benefit levels: a "mainstream" package set at the 75th percentile of the current employer market, and a "lean" benefit package set at the 10th percentile. (Both would comply with SB 2.)

We developed three scenarios that fully complied with SB2. Under these scenarios, the SHPP pool would charge a per-capita fee, and no outside funding or additional subsidies would be available to the pool.

A. Scenario A would use "flat community rating," i.e., the fee would vary only by geographic location.

B. Scenario B would use "age rating," i.e., the fee would vary by geographic location and the average age of the workers in the employer group.

C. Scenario C would use "health rating," i.e., the fee would vary by geographic location and by both the age and health status of the workers in an employer group.

We examined each of these scenarios twice: once using the "mainstream" benefit package and once using the "lean" benefit package.

Given the challenge of designing the program to be self-sufficient while keeping administrative costs reasonable, we also developed and analyzed three alternative scenarios that went beyond SB 2 by providing broader subsidies towards coverage in the pool. One such scenario would make subsidized coverage available only for low-income workers whose employers participated in the SHPP pool. This subsidy approach could help the SHPP pool's viability by making it attractive to employers with many low-risk, subsidy-eligible workers. By doing so, it could make the SB 2 pool viable without the need to adjust each employer's fee for the health status of its workers.

In addition, we tested two other approaches that would rely on "outside funding"—i.e., funding from sources other than SHPP-participating employers and workers—to help support the SHPP pool. One approach would provide lower SHPP fees for low-wage employer groups. The other would simply offset losses due to the high-risk profile a pool with flat rates would likely experience; we examined two variants of this approach.

D. Under Scenario D, "Subsidies and Healthy-Families-type Plans for All Low-Income People in the Pool," the SHPP pool would charge a per-capita fee that varied by geographic location and the average age of the worker in the employer group. In addition, however, substantial subsidies would be provided toward the worker's share of the fee for all low-income workers and dependents enrolled in the SHPP pool, but not for people who had direct employer coverage (unless they were eligible for Medi-Cal or Healthy Families under current rules). Subsidized workers and dependents would enroll in plan(s) similar—both in benefits and in relative premium levels—to existing Healthy Families plans. (In this report, we refer to such plans as "Healthy Families-type plans.")

E. Under Scenario E, "Percent of Payroll," the SHPP pool would charge employers a fee calculated as a percentage of their average wage. As modeled, the percentage would range from 10 percent to 14 percent, increasing with the average wage of the employer's workforce. The worker's fee would be a percentage of their own wages, ranging from 2.5 percent to 3.5 percent, increasing as the worker's wage level increased.

F. Under Scenario F, "High-Risk Employer Pool," two variants were developed. Like the high-risk pool MRMIB operates for individuals, both would use outside funding to offset pool losses (i.e., costs in excess of fees charged to participating employers).

   - Under Subscenario F1, "100% of Average, No Age Adjustment, Mainstream Benefits," the SHPP pool would charge a flat per-capita fee that varied by geographic location only, as in Scenario A. The fee would be set equal to expected market-wide average costs, i.e., the expected average cost for all workers in the SB 2 universe. The "mainstream" benefit package would be offered.
   - Under Subscenario F2, "125% of Average, With Age Adjustment, Lean Benefits," the SHPP pool would charge a per-capita fee that varied by both geographic location and the average age of the workers in the employer group (i.e., "age rating"), as in Scenario B. The fee would be set at 125 percent of expected market-wide average costs. The "lean" benefit package would be offered.

   The source of the outside funding in Scenario F might be state general revenue, or it might be an assessment, charge or tax on all employers subject to the pay-or-play mandate, whether they enrolled in the SHPP pool or provided coverage directly. Such a charge might be implemented either as a separate fee or by making the SB 2 credit for "playing" employers less than the SHPP fee by the desired amount.

Database and Simulation Model

Simulating the effects of SB 2 required comprehensive information on businesses in California as well as on their employees and dependents. Because no single existing database provided all of the necessary information, RAND relied on multiple data sources to create a synthetic database that describes employers and their employees in California in 2003. Using this data base, RAND then developed a behavioral simulation model to analyze the effects of the alternative SB 2-implementation scenarios.

Exhibit ES-1: SB 2-Compliant and Alternative Scenarios Examined

Scenario	Pool Fee for "Pay" Employers	Pool Benefit Level	Additional Funding or Subsidies*	Simulation Results
SCENARIOS WITHIN SB 2 CONSTRAINTS				
SB 2-Compliant with Different Fee Structures [Scenarios A, B, C]	Variants tested: Per capita fee adjusted for: [A] geography only, [B] geography and age, [C] geography, age and health status.	Each variant tested with "Mainstream" benefits (e.g., $100 deductible), then with "Lean" benefits (e.g., $1,000 deductible.)	None	Pool financially viable only with health-status adjustment to fee (with either "mainstream" or "lean" benefits).
SCENARIOS BEYOND SB 2 CONSTRAINTS				
Subsidies and Healthy-Families-type Plans for All Low-Income People in Pool [Scenario D]	Per capita fee adjusted for geography and age.	"Lean" for non-low-income; Healthy-Families-type plans for subsidy recipients.	Subsidies for all low-income workers and dependents who enroll in Healthy-Families-type plans through the pool.	Pool viable with no additional funds. Pool fees are sufficient to fund premiums and subsidies.
Percent of Payroll [Scenario E]	Sliding-scale percent of payroll/ wages; lowest fee = 12.5% for worker-only coverage.	"Lean"	Outside funds cover fee short-fall. Also, subsidies for low-income workers + dependents.	Requires over $1 billion in additional funds to cover shortfall.
High-Risk Employer Pool (Outside Funds Cover Pool Losses) [Scenario F]	Two per-capita variants tested: [F1] = market-wide average cost, adjusted for geography only. [F2] = 125% of average cost, adjusted for geography and age.	Respective benefit levels: [F1] "Mainstream" [F2] "Lean"	Outside funds cover excess cost. Could be all-employer assessment.	Additional funds needed to cover fee shortfall: [F1] Over $5 billion. [F2] Less than $40 million.

* Beyond Medi-Cal/ Healthy Families eligibles.

Note: Full simulations were not completed for Scenarios F1 and F2, which are related to Scenarios A and B, respectively.

Qualitative Analyses

In addition to the quantitative analysis, the report also assesses other policy design issues that could not be examined using the simulation model. These include issues such as: the pool's market role and its ability to exert purchasing power and to use various cost containment strategies; the feasibility of worker choice of plans; whether or not to offer dependent coverage through the pool for employers that are not required to provide it; administrative issues related to state implementation, including premium assistance; and legal considerations.

Results of the Quantitative Simulation Analysis

How Many of the Uninsured Would SB 2 Have Reached?

We estimate that SB 2 would have covered 26.4 percent of California's uninsured population under its "pay-or-play" mandates for employers with 50 or more workers. (About one-third of California's uninsured have no worker in their family. Another 40 percent are in working families not covered by SB 2.)

Although most workers are employed by firms subject to SB 2, almost all such businesses in California already provide health benefits to at least some of their workers. Therefore, most of the coverage increase resulting from SB 2 would have come from participation of workers employed by firms that already offered coverage but who had themselves been ineligible for or declined that coverage.[1]

Scenarios That Comply with SB 2

We analyzed the three scenarios that fully complied with SB 2. We found that:

Finding: Neither flat community rating nor age rating would lead to a viable pool under SB 2 without external subsidies to maintain pool solvency [Scenarios A and B]. Without health rating, the pool would suffer adverse selection and could not be self-sustaining. That is, adjusting an employer's fee for the age composition of its workers would not adequately account for the differences in health plan costs among larger employers. Therefore, employers who chose to pay the fee would generally be those employer groups whose health costs would exceed the fee charged by the pool. Thus, we found, fee revenues would be inadequate to cover pool costs, and the higher the fees were set, the more expensive the profile of employers that would chose to pay them. (In Scenario F, we also explored the amount of additional funds that would be required under an SB 2 pool without health rating to offset the losses due to the "high-risk" profile that a pool without health rating would likely experience. These results appear below.)

Finding: Health rating is theoretically viable but administratively cumbersome and legally risky [Scenario C]. The pool would be financially stable and self-supporting without subsidies if it used the health status of each employer's workers in addition to workers' age and geographic location in establishing the fee for that employer group. However, the pool would be relatively small—less than 3 percent of SB 2-covered workers—and health rating would likely compromise the viability of the pool in other ways.

The general expectation under a "pay-or-play" construct like SB 2 is that all employers subject to the requirements would be told what their applicable fee would be, and each employer would then choose to "pay" the fee or, instead, "play" and provide employer-sponsored coverage directly. But to do this, the state would need to require all employers subject to SB 2 to annually provide health-status information on their workforce—an unwieldy and burdensome process that would also raise nettlesome confidentiality issues and related legal problems.

Alternatively, rather than be told their fee automatically, employers might have to apply to the pool in order to find out what their applicable "fee" would be. This approach could allow the pool to obtain pertinent risk-related information, just as a health plan does from applicant employers in the current market. But this approach would also be more vulnerable to a federal ERISA preemption challenge, because opponents could argue that it was simply a thinly disguised mandate that employers provide coverage, with the public pool as one optional vehicle to fulfill the mandate.[2] (See the legal implications section of the full report.) All told, it seems highly unlikely that the state could successfully adopt health rating for new "pay" employers.

Scenarios That Go Beyond SB 2

In addition to these problems with health rating, our burden analysis indicated that, in the absence of subsidies for low-wage employee groups, the cost burden they would bear would be highly disproportionate relative to their pay. (For almost half of low-wage businesses—compared to one-quarter of all businesses—the increase in the employer contribution toward health insurance would exceed 5 percent of total compensation costs.) Therefore, we developed and analyzed the alternative scenarios (D, E and F) that would provide broader subsidies towards coverage in the pool. We found that:

Finding: Subsidizing low-income workers in the pool would make the pool viable without additional funds [Scenario D]. Subsidizing low-income (under 200% FPL) workers' share of the pool fee, where the employer participated in the pool and the low-income worker and dependents enrolled in Healthy-Families-type plans, would make the pool viable by making it attractive to employers with many normal-risk workers.[3] (SB 2 would have limited fee subsidies to workers or dependents eligible for Medi-Cal or Healthy Families.[4]) The pool's fee would be based on the "lean" benefit package made available to non-low-income pool enrollees.

This subsidy approach would make the pool viable without adjusting each employer's fee for the health status of its workers (that is, using age rating but not health rating). Under these conditions, the pool would enroll about 15 percent of SB 2-covered workers. The cost of subsidies for low-income workers and dependents could be financed within the pool, without additional funds. (Our estimate assumes that Healthy-Families-type plan rates would be comparable to those projected under the proposed expansion of the Healthy Families program to include parents.)

Finding: A percent-of-payroll approach, while attractive to low-income groups, would require additional funds [Scenario E]. This approach would provide lower fees for low-wage employer groups by setting the pool fee as a graduated percentage of payroll. Doing so would make the pool attractive to low-income groups that would bring to the pool a number of lower risk workers. However, the pool could <u>not</u> be self-financing under this approach.

Fees would not be sufficient to sustain the pool because employers would choose to "pay" any given percentage-of-payroll fee only if their costs to offer coverage directly ("play") would be higher than the fee. Those whose direct-coverage costs would be lower than the fee would generally choose to "play" rather than "pay" the fee. Thus, unlike a universal payroll-tax program, where the percentage amount can be set to cover program costs, the costs for those choosing to pay an optional percentage-of-payroll fee would always exceed the revenues from the fee.

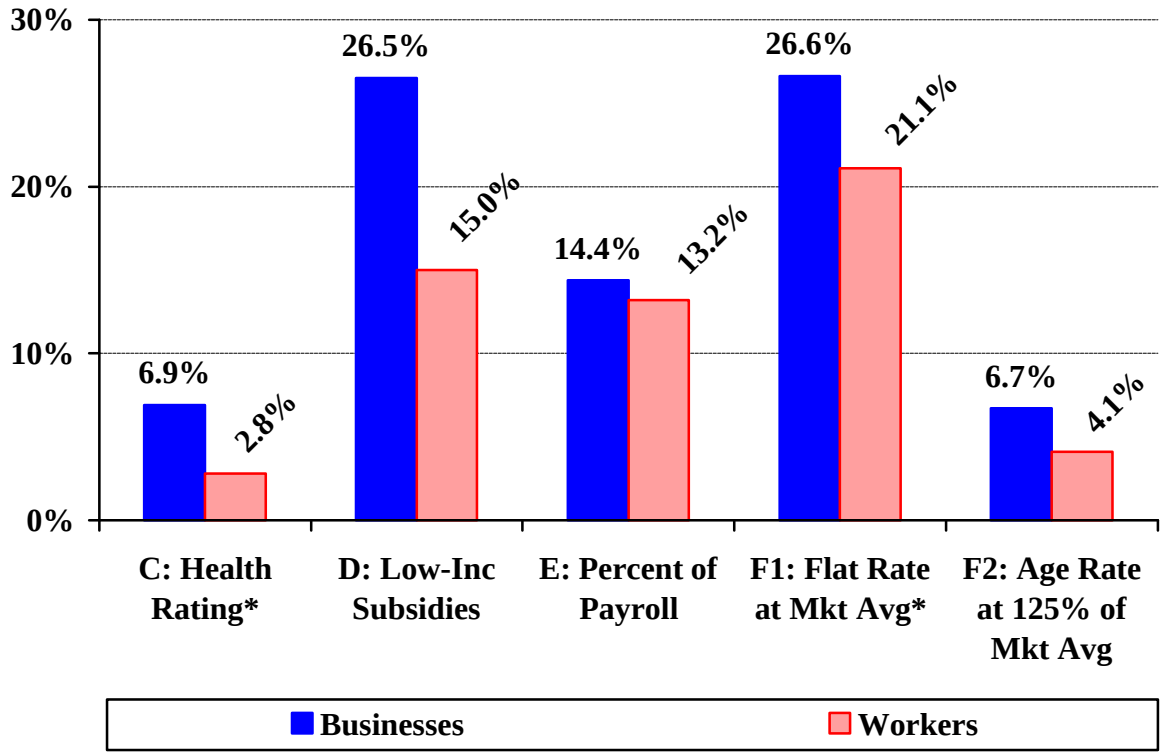
With the minimum fee for single coverage set at a significant percentage of payroll (12.5% to 17.5% for single coverage), about 13 percent of SB 2-covered workers would be enrolled in the pool, and the outside subsidies required would be substantial—in excess of $1 billion. If the fee was set significantly lower than this level, the outside subsidies needed would be much greater.

Finding: A community-rated pool at average market prices would require significant outside funding [Scenario F1]. Some key SB 2 supporters appear to have envisioned a pool that would provide "mainstream" benefits at a community-rated fee equal to the market-wide average cost for workers in the SB 2 universe. Our analysis shows that this approach would result in a large pool—covering about 21 percent of all SB 2-covered workers—and would require about $5 billion in funding, beyond the fees paid by SHPP participants, to cover the pool's losses.

Finding: A "high-risk pool" approach would require only modest additional funding but would be less expensive than direct coverage for relatively few employer groups [Scenario F2]. If neither health rating nor $5 billion in subsidies were acceptable, the SHPP fee could be held at 125 percent of age-adjusted average cost for the "lean" benefit package across the SB 2 universe with only a modest external subsidy of less than $40 million [Scenario F2]. Under this approach, the pool size's would be about 4 percent of SB 2-covered workers, because relatively few larger employer groups have average costs much more than 125% of age-adjusted market norms.[5] The external funds could come from a number of possible sources. If they were raised by imposing a per-worker "fee" on all employers subject to SB 2, whether or not they participate in the SHPP pool, the fee would total less than $5 per worker per year. However, it should be noted that the intended role for the pool under SB 2 was not what it would be here: a residual high-risk pool.

The number of businesses and workers participating in the SHPP pool would vary under alternative scenarios, and is summarized in Exhibit ES-2.

Exhibit ES-2: Percent of Businesses and Workers Participating in the SHPP Pool under Alternative Scenarios



"Businesses" include private businesses and all governmental units—local, state, and federal. However, we treat all state government workers as employees in one business, and all federal workers as employees in one business. (Although the federal government would not be subject to SB 2's requirements, federal workers are included in our counts of workers; they would continue to be covered by FEHBP.)

Note: Scenarios A and B are not shown because the pool was not viable under these scenarios.

* Under Scenario F1, the "mainstream" benefit package would be offered. Under all other scenarios shown here, the "lean" benefit package would be offered. Scenario C was also tested using the "mainstream" benefit package, but the size of the pool barely differed and therefore is not shown.

Source: RAND SB 2 Simulation Model.

Discussion: Subsidies and "Healthy-Families-type" Plans for Low-Income Workers [Scenario D]

Perhaps the most important of the above findings is that no additional funds would be needed under Scenario D to provide subsidies to all low-income workers and dependents who were willing to enroll in Healthy-Families-type plans through the pool. Rather, we estimate net savings because employer fees would be more than sufficient to cover the costs of Healthy-Families-type coverage for those workers.

This result depends critically on the assumption that Healthy-Families-type coverage for low-income adults could be obtained at premium rates equivalent to those projected under the proposed expansion of the Healthy Families program to include parents. (These rates are also consistent with Healthy Families premium amounts for children, given the normal relationship between coverage costs for parents and children.)

Whether these rates would be "scalable" to such larger populations is not known. However, such extensions would seem more feasible if, as specified in Scenario D, the plans would be open only to low-income workers and dependents, many of whom would otherwise be uninsured. Providers who often accept lower reimbursement rates from these plans would be more likely to accept additional patients at these lower rates if the additional patients were also low-income. Similarly, community clinics and other providers who operate on such payment rates would be more likely to be accessible to additional low-income populations (rather than other populations), and would benefit where previously uninsured patients would now have coverage.

But even if rates turned out to be somewhat higher, that difference could be paid for through the state budget savings that would accrue from the use of employer-financed coverage for Medi-Cal and Healthy Families recipients, as discussed next.

Medi-Cal / Healthy Families Budget Implications

Although under SB 2 the SHPP pool was intended to be self-supporting and "off budget," SB 2 nevertheless would have had important implications for the state's budget, because many working families eligible for the Medi-Cal (Medicaid) or Healthy Families (SCHIP) programs would have been affected by SB 2's coverage mandate. In addition, SB 2 would have required that the worker's (or dependents') share of the pool fee or employer-plan premium be refunded to workers who were found eligible for the Medi-Cal or Healthy Families programs—a process called "premium assistance" (discussed further below).

In general, having employer coverage available to these families would have reduced state spending; but in some cases larger enrollment could have increased spending. Using the simulation model, we examined how these two offsetting effects would likely play out.

We assumed that, under SB 2, Medi-Cal and Healthy Families enrollment of workers and dependents covered by SB 2 would have gone up significantly—by about 65 percent—as low-income families sought to take advantage of premium assistance. Nevertheless, we found that state Medi-Cal and Healthy Families spending on this population would have gone down. Outside the pool, providing "premium assistance" and supplemental coverage to people enrolled in employer coverage (as also required under SB 2) would be substantially less expensive than providing direct public coverage. Inside the pool, the employer's SHPP fees would be more than enough to pay the entire cost for providing public coverage.[6] In effect, funding of coverage for Medi-Cal and Healthy Families recipients eligible for employer coverage under SB 2 would be largely shifted from the public to the employers of low-income workers.

The expected savings in state costs for Medi-Cal and Healthy Families in 2003 (the year on which our simulations were based) would exceed $200 million per year under all scenarios examined.[7] Exhibit ES-3 summarizes the estimated net cost to the state's budget of the

alternative scenarios, including both the impact on state Medi-Cal/Healthy Families spending and the other funding (if any) needed to sustain the pool under each scenario.

Exhibit ES-3: Net Effect of Alternative Scenarios on State Spending, 2003 (in millions)

Scenarios	Effect on State Share of Medi-Cal/ Healthy Families	Additional Funds Needed to Cover Fee Revenue "Shortfall"	Net Effect on State Spending
C: "SB 2 with Health Rating"	**$227.2 Savings**	**No additional subsidies or "outside" funds.**	**$227.2 Savings**
D: "Subsidies and Healthy-Families-Type Plans for All Low-Income Workers in Pool"	**$255.5 Savings**	**Pool fees cover premium and subsidies within pool***	**$255.5 Savings**
E: "Percent of payroll" (Min @ 12.5%)	**$255.6 Savings**	**$ 1,359.8**	**$1,104.2 Cost**

* We assume any fees not needed to pay subsidies would be retained by the SHPP and would not be available for other state purposes. Therefore, they would not further increase state budget savings. This is in part to prevent the SHPP fee from being considered a tax under California law. (See discussion of legal consideration in the full report.)

Source: RAND SB 2 Simulation Model

Other Issues and Challenges

Without Subsidies Unique to the Pool, the Pool Would Not Be Large Enough or Cohesive Enough To Be in a Strong Negotiating Position with Health Plans

The SHPP pool would face the same dilemma faced by any optional purchasing pool:

- A pool cannot use "market clout" to negotiate with health plans unless it has a large, cohesive membership that health plans can reach only through the pool.

To have a cohesive membership, there needs to be some compelling reason for people to obtain and retain health insurance through the pool rather than directly from health plans.

Health plans generally have little desire to shift private employer contracts to a government pool, or to help create a very large purchaser with more bargaining clout out of separate employer groups. In general, they can better control the risk profile of their own enrollment and related premiums, avoid losses and position themselves to realize higher margins by dealing directly with employers, particularly if the health plan is already well-established in the employer market. Therefore, health plans could not be expected to help the SHPP pool become large by voluntarily offering better rates to the pool than they offer to employers directly. But the SHPP could not avoid contracting with health plans, because SB 2 gave it neither the authority nor the financial wherewithal to self-insure.

To overcome health plans' reluctance to offer the pool favorable rates, the SHPP would need to offer some compelling reason for employers to obtain and retain health insurance through the pool rather than directly from health plans. But the pool created by SB 2 would not benefit from the natural membership cohesion enjoyed by very large employers like FEHBP for federal workers or CalPERS for state workers. Simply stated, whether healthy or sick, workers obtain coverage through their large employers because the employer contribution is available only for coverage through that venue. This creates an attractive (i.e., relatively healthy) pool of people that health plans can reach only by contracting with that employer group.

Under SB 2, however, any employer that might pay the fee and place its workers in the SHPP pool could also contract directly with a health plan. Thus, the SHPP pool would likely be in a much weaker negotiating position vis-à-vis health plans, and every health plan would have a strong incentive not to give the pool a lower price than it would make available to the same employer directly.

We estimate that under SB 2, which provided no outside funding or broader subsidies through the pool, the SHPP pool, with about 470,000 total enrollees, would be less than half the size of CalPERS, which covers about 1,200,000 lives. It would be unlikely to be large enough or cohesive enough to be in a strong negotiating position with health plans.

However, this would change if low-income or low-wage workers could obtain subsidies through the pool that they could not obtain in the outside market. In this case, employers with a significant number of such workers would have a reason to want pool coverage. That, in turn, would reduce risk selection problems and put the pool in a better negotiating position. That is, a given health plan could reach an attractive group if, and only if, it contracted with the pool.

As discussed earlier, the pool might be able to achieve this at no cost to the state if it could obtain participation of Healthy-Families-type plans that would offer Healthy-Families-equivalent coverage to low-income pool participants at comparable-to-Healthy-Families rates. Given the uncertainties involved, however, a sensible approach for future consideration might be to give MRMIB the authority to pursue such a possibility, including the ability to pilot-test this approach on a limited basis.

If the SHPP pool were structured so that it had cohesion (as in Scenarios D and E), it would be in a strong negotiating position with plans. In this case, it could employ the kinds of negotiating and contracting strategies used by very large groups such as General Motors, CalPERS, and the large-employer purchasing alliance at the Pacific Business Group on Health. Supplement C to this report, "Cost Management Strategies and Examples for the Pool," profiles the purchasing approaches used by these and some other noteworthy purchasers. It is also worth noting that MRMIB itself has obtained remarkably good value from health plans participating in Healthy Families, as documented by our estimate for Scenario D.

Offering Worker Choice of Carriers and Benefits

Offering a choice of competing health plans (carriers) through the SHPP pool could be highly desirable both as a way to improve the pool's attraction and retention rate and as a cost-containment strategy. To what extent multiple health plans would be willing to contract with the

pool at an attractive rate, however, cannot be predicted in advance. Or, even if multiple plans were willing to contract, the pool might determine that contracting with a single health plan would better enable it to achieve its cost containment goals. (This decision would be influenced by the expected size of the pool and its likely risk profile.)

Health plan choice would most likely be a source of cost discipline if workers had to pay the additional cost of a more expensive plan. But employers choosing to "pay" the SHPP fee, i.e., choosing not to administer employer-sponsored coverage, would be highly unlikely to want to "play" a role in administering differential payroll withholding and fee payments for different worker choices. And, even if they were willing to do so, withholding and collecting differential worker payments would greatly increase administrative complexity for the state as well as for employers. It would also be burdensome for the SHPP to develop a separate system to bill and collect such payments directly from individual workers. It might, therefore, make sense to consider the option of having more expensive health plans bill workers directly for the portion of the premium not paid by the SHPP. Health plans already have administrative systems in place for individual billing and collection, e.g., for COBRA extensions. To address health plans' concerns about risk selection, the pool would likely need to implement a risk-adjustment instrument and mechanism, such as those currently used by PacAdvantage (the small-employer pool formerly run by MRMIB as the HIPC). (See Supplement E.)

Offering workers a choice of benefit levels or designs could also help to make the SHPP pool more attractive to employers whose workers did not all value health insurance equally. The administrative difficulties for the pool and for employers would be similar to those involved in offering workers choice among competing carriers, but the risk selection potential would likely be even worse. Therefore, it might be wiser to leave administration of benefit-upgrade choice, enrollment and premium collection up to the participating health plan chosen by the worker. But the pool would still have to establish program rules governing benefit upgrades in order to minimize adverse selection against some plans due to risk skimming plan-design strategies by other plans.

Dependent Coverage Issues

SB 2 did not require medium employers to contribute toward coverage of their workers' dependents. Employers that elected to "play" (provide coverage directly) could and, since most do so now, presumably would offer dependent coverage and contribute some portion of the cost. If the pool did not give such employers a way to offer and contribute toward dependent coverage, it could find itself at a competitive disadvantage in the medium-employer market.

Allowing medium employers to offer dependent coverage through the pool without making any contribution towards it would be problematic due to the great potential for adverse risk selection (i.e., the risk that only workers who knew their dependents were in need of care would be willing to pay the full fee necessary to cover them). The minimum employer contribution the pool would require as a condition of offering dependent coverage should be determined in consultation with the pool's participating health plan(s). Fifty percent, a typical market minimum for worker-only coverage, would seem to be a reasonable starting position for the pool.

State Administrative Systems and Fee Options for the Pool

A fundamental administrative issue is raised by the fact that SB 2 directed that the existing system for collecting unemployment insurance (UI) taxes be used to collect SHPP fees. Unless the SHPP charged a flat per-capita fee, the existing state system for collecting UI taxes from employers would likely need considerable modification and augmentation. For example, California's Employment Development Department (EDD) does not now collect data on the birth date or age of workers. Thus, existing systems would have to be modified to collect workers' birth dates if SHPP fees were age-rated. And, if SHPP fees were health-rated, an extensive new data collection and fee-quoting system would have to be developed, which would not logically be housed at EDD.

In addition to fee determination and collection, the SHPP or other agencies of state government would have to undertake a wide range of administrative functions in order to operate the "pay" pool. These are discussed briefly in the full report.

Premium Assistance

For workers or dependents who were enrolled in the Medi-Cal or Healthy Families programs, SB 2 would have required that their share of the SHPP fee or employer-plan premium be refunded to them by the pool or the applicable public program. In addition, for those enrolled in employer coverage, wraparound coverage would have had to be provided to assure that they received all benefits available under those public programs.

Such a premium assistance program would be very difficult and expensive to administer, and SB 2 would have done little to create an environment conducive to streamlined administration, particularly for people with direct employer coverage. This is so because "play" employers outside the pool would need to offer only one plan choice that complied with contribution and benefit standards under SB 2. But these employers could, and we anticipate many would, offer other options, such as their current plans. These other plans could often be more cost-effective for state premium assistance purposes, because they would often have better benefits and lower cost-sharing than the employer's SB 2-compliant plan. The salient point for premium-assistance administration is that employer contributions and patient cost-sharing amounts would vary across these plans. So, each employer plan would have to be evaluated individually for cost-effectiveness.

Another concern is that SB 2 required premium refunds to be provided promptly, so that low-income workers would not have to wait to be "made whole." But it also sought to keep employers—who handle payroll deduction for the worker's contribution that would be refunded—from knowing any information affecting their workers' eligibility for Medi-Cal or Healthy Families. This prohibition would seem to preclude consideration of potentially more efficient ways of handling premium refunds.

Traditional approaches to administering premium assistance would require substantial state, as well as employer, staff time and resources to handle the extremely large volume of public-program eligibles who would have been affected by SB 2 (about 540,000 currently enrolled families, plus up to 330,000 additional families). New approaches more appropriate to the goals

and scale of the initiative should be considered. These might include using the state tax withholding system to administer premium refunds. And, because the vast majority of California firms offer at least one insured plan, the state could use insurance rules to improve access, continuity and administrative efficiency under premium assistance.

For example, to improve the cost-effectiveness of premium assistance, the state could require standard coverage tiers under all group plans to include separate tiers for "plus one child." To greatly simplify the process of "benchmark comparisons" and cost-effectiveness analysis, the state might require carriers to submit information comparing all their group benefit plans to state premium-assistance benchmarks.

Although SB 2 required that Medi-Cal and Healthy Families provide supplemental coverage for premium assistance recipients, advocates expressed concern over the differences between employer plans and public programs in provider networks and payment policies and over the discontinuities in care and access that would result. These concerns might be addressed if group carriers were required to offer upgraded plans to public eligibles (only) to avoid the need for separate wraparound coverage. As long as the state paid plans for these upgrades (which it would use and pay for only where cost-effective for the state), employers should not be affected.

Successful design and implementation of such rules could greatly reduce the administrative cost and burden of premium assistance for employers and the state, and facilitate cost-effective coverage of low-income families.

Legal considerations

In addition to the policy issues discussed in this report, "pay-or-play" constructs like that in SB 2 raise several legal issues. Foremost is the potential that ERISA, the federal pension and benefits law, may preempt any state's law with an impact on private employer-sponsored plans. These types of proposals also face state constitutional issues peculiar to California that are discussed in the main body of the report and in Supplement D.

Based on Supreme Court cases interpreting ERISA's preemption clause, it seems likely that a carefully drafted pay-or-play law could survive an ERISA challenge.[8] Least vulnerable to preemption would be laws that did not require employers to offer coverage but instead credited against the fee an employer's actual costs of coverage (up to the limit of the fee) without imposing conditions on the types of employer plans that qualify for the credit. Such laws seem more defensible than SB 2, which would have waived the fee entirely, but only if the coverage met benefits and premium sharing standards. While SB 2 did have a "back-up" provision without such benefit standards, the minimum contribution standard it would have imposed seems more vulnerable to an ERISA challenge than would be a dollar-for-dollar credit against the fee for whatever contribution was made. And employers would have strong incentives to contribute an amount at least equal to the fee, so as to benefit their workers rather than pay the state any balance.

Conclusion

A "pay-or-play" employer coverage expansion can work only if there is a viable coverage vehicle for the workers of "pay" employers. SB 2 would have established a pool to be operated by MRMIB for this population. We find it unlikely that the pool could be sustainable and self-supporting under SB 2 as enacted. Doing so would require that the pool's fees be health-rated. But health rating would be administratively burdensome and would raise thorny confidentiality issues and legal problems. In our judgment, health rating for a pay-or-play pool would not, therefore, be realistically feasible.

Alternative pool constructs (scenarios), on the other hand, could achieve a sustainable pool and reduce the financial burden for low-income groups. Specifically, making subsidies for low-income employee groups available exclusively through the pool could obviate the need to adjust employer group fees for the health status of workers. Depending on specific design features, the subsidies could attract enough employers with many normal-risk, low-income workers to make this possible. (Similar approaches could reach uninsured small employer groups, where many uninsured workers are employed.)

One such approach would be to set the fee as a percentage of payroll on a sliding-scale basis [Scenario E]. Doing so would attract employers with many low-wage workers and allow their health coverage costs to be more proportionate to their wages. This approach would attract many low-wage, normal-risk groups. But it would require very substantial external funding to offset the shortfall in fee revenues for the pool, and these funding requirements would outstrip expected state savings on Medi-Cal and Healthy Families from other provisions.

Another approach [Scenario D] would provide premium assistance to all low-income workers and dependents in the pool (under 200% FPL) and enroll them in more comprehensive Healthy-Families-type plans. The pool's standard offering (upon which fees would be based) would be a lean (higher cost-sharing) plan. We found that the pool would be viable without health rating under these provisions, and that no external funds would be required. That is, the pool's "pay" employer fees for a lean commercial plan, plus net sliding-scale contributions from low-income workers, would more than cover the cost for the Healthy-Families-type health plans these workers would be enrolled in.

This scenario assumes that premiums proportionate to those for Healthy Families plans could be extended to low-income workers under 200% of poverty (as was previously planned for parents in the same income range). Because the plans would be asked to serve only a low-income population at these rates, it seems feasible that enough of them would willing be and able to do so.

On the other hand, somewhat higher health plan premiums could well be needed. But even if this was the case, the significant Healthy Families and Medi-Cal savings from the use of employer-financed coverage could be used to fund subsidies for low-income workers and dependents.

Depending on budget realities, workable variations could be designed involving some combination of altered benefit plans or eligibility and subsidy schedules that in turn might alter

the size of the pool. These dimensions are significantly inter-related, and the pool funds available to fund such assistance would depend on actual health plan premiums. Further, health plan premium negotiations and cost experience cannot be accurately predicted.

For these reasons, we recommend that new proposals to extend coverage of uninsured workers and families should grant MRMIB flexibility to design and alter subsidy policies as needed to achieve a viable pool while staying within state budget constraints—essentially allowing them more leeway both in fee structure and benefits as well as external subsidy coordination.

In conclusion, our analysis provides strong evidence to support consideration of a low-income worker subsidy approach in any subsequent efforts to expand employer-financed coverage. If carefully adapted to the relevant variables, subsidies for low-income workers could achieve a viable pool while extending needed financial assistance to low-income groups and avoiding the perils of health rating for the pool. Channeling subsidies through the pool could also give the pool membership cohesion and a healthy risk mix and, therefore, substantially improve its ability to negotiate lower rates with health plans.

Notes

[1] More details about the anticipated effects of SB 2 on employers, employees and coverage can be found in a "Snapshot," developed for this project, at <*http://www.chcf.org/topics/healthinsurance/sb2/*.>

[2] The same analysis would apply if health rating were based on prior ("pre-pool") claims experience rather than on health-status information. Alternatively, the pool might use its own claims experience to produce health-rated fees only when employer groups renewed their participation in the pool. But this approach would do nothing to protect the pool against adverse selection during its critical first year or whenever new groups sought to enter the pool.

[3] That is, employers with many low-income workers would choose the pool because their workers could receive subsidies. The risk distribution of these employer groups—including both subsidized and unsubsidized workers—would be more likely to be "normal" than it would be in the absence of both subsidies and health rating. In the latter case, employers would choose the pool only when their (non-health-rated) pool fee was less than their (health-rated) premium for direct coverage, i.e., when their group had higher-than-average risks.

[4] Under SB 2, premium assistance would also have been available to Medi-Cal and Healthy Families eligibles enrolled in direct employer coverage. All scenarios we examined incorporate this provision of SB 2.

[5] The small proportion of employer groups with average costs above 125 percent of the market-wide average may seem surprising. But note that the question here is the average cost within medium and large employer groups with 50 or more workers each. For any group's average cost per worker to be 25 percent more than the market norm, the group would have to have a large percentage of people with costs well above average.

[6] SB 2 directed that SHPP fees (primarily from employers) be used to pay the state's share of Medi-Cal and Healthy Families costs for eligibles who entered those programs through the pool. Whether the federal government would allow those employer fees to be treated as state revenues for that purpose is uncertain. In our analysis, however, employer SHPP fees were sufficient to offset the entire cost of Medi-Cal and Healthy Families coverage for this population (except, perhaps, under Scenario C, "SB 2 with Health Rating," for which employer fees attributable to Medi-Cal and Healthy Families eligibles were not specifically calculated).

[7] Note that these estimates do not include any offset for the administrative costs of operating a premium assistance system. Such costs could vary greatly, depending on the approach taken to implementing the program.

[8] For a full discussion of these issues, see "ERISA Implications for Employer Pay or Play Coverage Laws," written by Patricia A. Butler, J.D., Dr.P.H. (legal adviser on this project), available at www.chcf.org.