Arizona State Senate
Issue Brief
June 22, 2010

Note to Reader:

The Senate Research Staff provides nonpartisan, objective legislative research, policy analysis and related assistance to the members of the Arizona State Senate. The *Research Briefs* series, which includes the *Issue Brief, Background Brief* and *Issue Paper,* is intended to introduce a reader to various legislatively related issues and provide useful resources to assist the reader in learning more on a given topic. Because of frequent legislative and executive activity, topics may undergo frequent changes. Additionally, nothing in the *Brief* should be used to draw conclusions on the legality of an issue.

SMALL BUSINESS HEALTH INSURANCE

INTRODUCTION

Overview

Health insurers include numerous types of organizations and the structure of the insurance issued by these organizations, including the scope, duration and choice of benefits offered, varies. Examples of health insurers include disability, group disability and blanket disability insurers, health care services organizations (also known as health maintenance organizations, or HMOs) and hospital and medical service organizations.

Small businesses in Arizona may purchase any type of private health insurance that they can obtain at an affordable price. Because small businesses cannot spread their risk, and thus their costs, over a large number of individuals, the per person costs to insure their employees are often higher than comparable costs for large employers. Small businesses may also have a difficult time absorbing increases in health insurance costs. Furthermore, small businesses often do not have the same bargaining power when negotiating rates and do not have the manpower to devote to the administration of a health insurance benefit. These factors may dissuade small businesses from offering health insurance. The Kaiser Family Foundation reports that, in 2009, 98 percent of U.S. employers with over 200 workers offer health insurance, while 46 percent of firms with 3 to 9 workers offer coverage.[1]

What is a Small Business?

The federal Small Business Act defines a small business as "one that is independently owned and operated and which is not dominant in its field of operation." Based on this definition, the U.S. Small Business Administration (SBA) has developed standards for what is considered a small business in any given industry. According to the Arizona Department of Commerce, the most common standard across all industries is 500 employees;

[1] This figure does not mean that 98 percent of employees in firms with over 200 workers have health insurance coverage; coverage may be limited to full-time employees only or have other restrictions that make certain employees ineligible for coverage.

this is the definition the SBA uses in its small business research. In 2006, the most recent year for which data is available, the Census Bureau reports that 97 percent of Arizona businesses had 500 or fewer employees and thus met the federal definition of a small business.

Arizona statute has several varied definitions of small businesses. In statutes related to health insurance, the most common definition of a small business or small employer is a business with 50 or fewer employees. The Census Bureau does not collect data on the number of businesses with 50 or fewer employees but does report data on business size that is reflected in *Table 1* and *Table 2* below. Although the majority of businesses in Arizona have fewer than 20 employees, more than half of Arizona workers are employed by firms with more than 500 employees.

Table 1

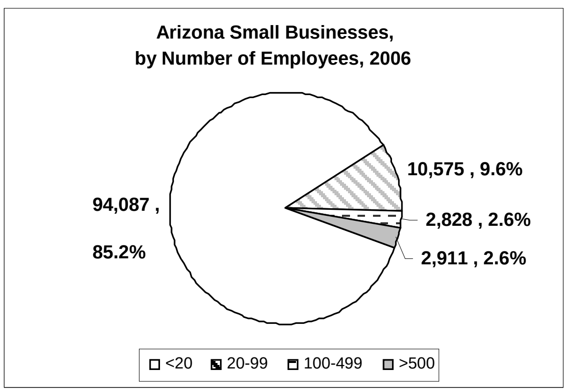
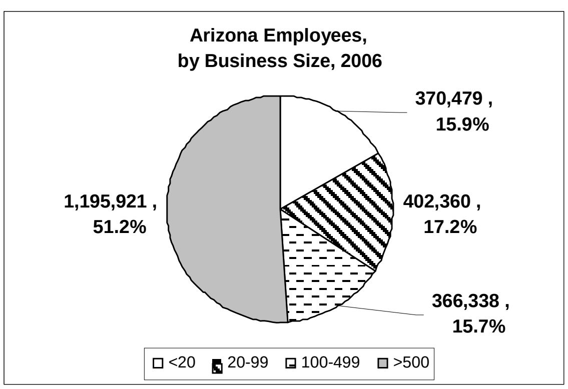


Table 2



To increase the affordability and availability of health insurance for small businesses, Arizona has developed several options, which are discussed below.

ACCOUNTABLE HEALTH PLANS

The Department of Insurance (DOI) reports that any Arizona health insurer that wants to offer group health insurance must also qualify as an accountable health plan (AHP). AHPs are statutorily required to offer at least one health plan to small employers (known as a "guaranteed issue" requirement). Effectively, this requires any insurer that offers coverage to medium and large-sized employers to also offer its health benefits plan to small employers, if those employers agree to pay the premiums offered.

In addition, if an AHP offers more than one health benefits plan to small employers, the AHP must offer a choice of all its plans and must accept any small employer that applies for any of the plans and is willing to pay the premium. For the purposes of an AHP, a small employer is any employer that employs at least 2 but not more than 50 employees on a typical business day in one calendar year.

The guaranteed issue requirement applies to insurers that offer most types of coverage, including hospital and medical service corporation policies or certificates, health care services organization contracts, multiple employer welfare arrangements or any other product through which health services or health benefits are provided to two or more individuals; certain types of coverage such as worker's compensation, automobile medical payment insurance and limited benefit coverage are excluded.

In Arizona, health insurers are required to pay a two percent tax on the premiums they collect. However, AHPs are exempt from this requirement on premiums attributable to small businesses. Statute also restricts AHP premiums offered to small businesses; premiums may only vary by 60 percent of the index rate and increases are limited.[2]

According to DOI, there were 39 companies authorized to sell small group health insurance in the state in 2008. According to the most recent data available provided by DOI and health insurers, the top three insurers for small businesses are Blue Cross and Blue Shield of Arizona with 118,236 enrollees, PacifiCare Life Assurance with 85,151 enrollees and United Healthcare with 71,763 enrollees.

Premium Tax Credit and State Subsidy for Small Business Health Insurance

The Legislature established a premium tax credit beginning January 1, 2007, for health insurers that provide individual coverage or coverage for small business with 2 to 25 employees that have been in existence in Arizona for at least one calendar year and have not provided health insurance to their employees for at least six months. For coverage issued to small businesses, the tax credit is the lesser of: 1) $1000 for single coverage or $3000 for family coverage or 2) 50 percent of the health insurance premium. Total credits are capped at $5 million per calendar year (Laws 2006, Chapter 378).

The Department of Revenue determines whether the small business meets the criteria to allow the health insurer to claim the tax credit for providing coverage to the business. Business may only be determined eligible for three years (initial eligibility plus two annual redeterminations). Health insurers are then required to deduct the amount of the tax credit from the premium paid by the small business for health insurance. In this way, the state subsidizes the cost of the small business's health insurance in the amount of the tax credit.

[2] Statute defines a "base premium rate" as the lowest premium rate that could have been charged by an AHP for each rating period and an "index rate" as the arithmetic average of the applicable base premium rate and the highest premium rate that could have been charged under a rating system by the AHP.

"MANDATE-LITE" INSURANCE OPTIONS

Statute provides requirements for health insurance, including mandates to cover specific services or supplies, offer a choice of providers for some services and allow access to certain services without prior authorization. Every mandate does not apply to every type of insurer and the requirements vary for each type of insurer.

Beginning in September 2006, health insurance that is issued to certain small businesses does not have to include specified coverage requirements. Those requirements include mandated coverage for contraceptives and certain medical foods and supplies, provider choice requirements, and prescription drug authorization and nonformulary drug access procedures. Because this type of health insurance is not required to include certain mandated coverage, it is commonly referred to as "mandate-lite."

Originally, the enacting legislation allowed mandate-lite insurance to be issued to businesses that employ 2 to 25 persons and that have been uninsured for at least six months (Laws 2006, Chapter 229). In 2007, the applicability of mandate-lite was expanded to include businesses that employ 2 to 50 persons (Laws 2007, Chapter 263).

As of June 2010, there are two known insurers offering this type of product in Arizona: Blue Cross and Blue Shield of Arizona and Aetna. Blue Cross and Blue Shield of Arizona reports that their small group "mandate-lite" product with a $2,500 deductible costs approximately 42 percent less than their comparable PPO product with the same deductible, and has 253 enrolled small business group members.

HEALTHCARE GROUP

Introduction

In 1981, the Legislature authorized the Arizona Health Care Cost Containment System (AHCCCS) to provide affordable health care coverage to self-employed individuals, small businesses with 50 or fewer employees, including sole proprietorships, and political subdivisions (state, counties, cities, towns, school districts and agricultural districts) within the state. In 1985, the Legislature established Healthcare Group (HCG) as a prepaid guaranteed issue medical coverage program for eligible employers, and the program, administered by AHCCCS, began operation the following year.

Currently, to qualify for the program, businesses must have been in existence in Arizona for at least 60 days and without health insurance for at least 90 days, referred to as the "go bare" period. AHCCCS considers employees who work 20 or more hours per week eligible for the program. Employers with 1 to 5 eligible employees must enroll 100 percent of their employees in HCG or provide evidence that employees who are not enrolled have other coverage. Employers with 6 to 50 eligible employees are required to enroll 80 percent of their employees or provide evidence of other coverage.

Employers may participate in HCG by purchasing health care for their employees and the employee's dependents through the participating AHCCCS health plans. Employers contract directly with the selected health plan and choose the benefit level and cost sharing option suitable for their organization. HCG uses age, gender, health status-related factors, group size, geographic area and community rating to establish premiums. There is no requirement that an employer pay a share of the premiums; employers have discretion regarding how much the employer contributes and how much employees are charged.

HCG State Subsidies and Program Expansion

According to AHCCCS, HCG's enrollment peaked in 1997, but began to decline when the general health care market started to experience problems because of steep cost increases. As enrollment declined, HCG was left with a membership that was predominantly high acuity, with costly chronic illness management needs. The cost of coverage continued to grow, far exceeding the revenue from premiums. The HCG health plans could not sustain growing program losses. As a result, in FY 2000 the Legislature began to subsidize the program with an appropriation of $8 million to reconcile the health plans' medical costs incurred in excess of premiums collected. Subsidies continued but were cut in half to $4 million in FY 2004.

In 2004, the Legislature made various changes to the HCG program (Laws 2004, Chapter 332). Specifically, the legislation allowed AHCCCS to establish direct provider contracts in areas that do not have sufficient provider networks and allows Children's Health Insurance Program (KidsCare) parents who participate in an employer-sponsored insurance program through AHCCCS, as well as displaced workers who qualify for a federal tax credit for health insurance, to select HCG as an insurance option. The go-bare period was also imposed. With these changes, along with outreach and marketing efforts, AHCCCS began seeking to increase enrollment in HCG. In anticipation of higher enrollment and the enrollment of healthier individuals, the state subsidy for HCG was eliminated beginning in FY 2006.

In 2007 and 2008, in response to continuing program losses, the Legislature enacted legislation to further modify HCG policies and increase financial oversight of the program. Beginning July 1, 2007, enrollment in HCG was capped at 9,800 eligible employer groups and enrollment of new groups was prohibited from September 19, 2007, through July 31, 2008. After that date, enrollment growth was limited to 5 percent annually, with priority given to uninsured groups. Additionally, for instances when a contract does not exist between an HCG contractor and a health care provider, a default HCG reimbursement rate equal to 114 percent of the AHCCCS reimbursement rates was temporarily established (Laws 2007, Chapter 263 and Laws 2008, Chapter 288).

In 2007, the Legislature created the HCG Study Committee to study the financial and operational issues associated with HCG and to identify changes necessary to ensure financial stability (Laws 2007, Chapter 263). Specifically, the Study Committee was charged with examining the feasibility of continuing HCG, establishing a high risk pool or both. The Committee met twice in 2007. In addition, DOI was required to conduct a statutory financial audit of HCG as if HCG were a health care insurer and report the results to the Governor, the Legislature and AHCCCS. The employer group enrollment limit, financial examination requirements, the Study Committee and the use of AHCCCS reimbursement rates were repealed on August 1, 2008.

Laws 2008, Chapter 288, increased the required minimum number of employees in an eligible employer group, from one to two. This had the effect of eliminating sole proprietorships from eligibility for coverage, although eligible groups of one that were already enrolled could remain in the program as long as they continued to meet enrollment requirements. The required "go-bare" period was also reduced from 180 days to 90 days.

The 2008 legislation also imposed certain financial regulation and oversight measures. It prohibited HCG from reimbursing a non-contracted hospital for services, other than emergency medical services, provided to a HCG member at the hospital. The reimbursement rate for emegency medical services would be based on the AHCCCS reimbursement rates and the county in which the service was provided. It required HCG to establish and modify premiums based on actuarial reviews of projected and actual costs, and also required HCG to consider health status-related factors when determining premiums. Finally, it required HCG to establish recognized utilization management control standards and submit quarterly financial reports to the Joint Legislative Budget Committee.

As of October 2009, 4,681 small businesses with a total of 12,680 employees were enrolled in HCG. The average number of employees per small business was 1.7 and the average group size (employees plus dependents) was 2.7; 93 percent of employers enrolled in HCG had 3 or fewer employees.

• *ADDITIONAL RESOURCES* •

- Arizona Department of Insurance
  http://www.id.state.az.us/
- Healthcare Group
  602-417-6755
  www.healthcaregroupaz.com
- Insurance Statutes: Arizona Revised Statutes, Title 20
- National Conference of State Legislatures
  http://www.ncsl.org/programs/health/SmallBusiness.htm
- "*The Number of Businesses in Arizona*," Arizona Department of Commerce, July 2006
  http://www.azcommerce.com/doclib/PROP/NumberofBusinesses.pdf
- *"Statistics of U.S. Businesses,"* U.S. Census Bureau
  http://www.census.gov/econ/susb/
- *"2009 Annual Survey of Employer Health Benefits,"* The Kaiser Family Foundation and Health Research & Educational Trust http://www.ehbs.kff.org/pdf/2009/7936.pdf
- Related Arizona Revised Statutes: A.R.S. §§ 20-2304, 20-2311, 20-224.05, 20-2341, 36-2912, 36-2912.01 and 43-210