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Self-Insurance: The ObamaCare Escape Hatch

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Key Points

- Texas businesses that self-insure employee health benefit plans can obtain affordable stop-loss coverage that makes self-insurance a viable option.
- The Legislature should resist efforts to regulate stop-loss insurance and exempt such coverage from premium and maintenance taxes in order to make it more affordable to small employers.
- Lawmakers should pass legislation that allows individuals to self-insure under state authority and thereby avoid costly ACA penalties and mandates.

Introduction

The Patient Protection and Affordable Care Act (ACA) requires most Americans to have health insurance by March 31, 2014, or else pay a penalty. Those not insured through an employer-sponsored health plan must obtain individual coverage, which must comply with a host of regulations and include certain essential health benefits in order to be eligible for federal subsidies on the exchanges. In addition, the law requires employers with more than 50 employees to offer their workers affordable health insurance beginning in 2015 or 2016, depending on the size of the employer.

These mandates, along with rules restricting how much insurance carriers can vary rates based on age and health status, have driven up the cost of individual and small group coverage significantly, both in Texas and nationwide. Prior to the ACA, a 27-year-old man in Dallas, for example, could find catastrophic coverage for about $69 a month. But now the lowest-cost catastrophic coverage available in the Dallas area on the federal ACA exchange is $173 a month—a 150 percent increase.[1] Proponents of the ACA claim these higher costs are offset by subsidies, and while that is true for some people with lower incomes, or older individuals, young people in their late 20s and early 30s who earn more than about 250 percent of the federal poverty limit (FPL)—about $29,000 a year—are not eligible for subsidies on the exchange and must pay the entire cost of the premium out-of-pocket.

This presents a problem both for uninsured working young people and also for many small firms that employ fewer than 50 people. Such companies tend to have younger employees, who will face significant cost increases by purchasing individual coverage on the exchanges, just as small employers will face cost increases if they choose to cover their employees through the ACA's small business exchange.

But there are ways for both small businesses and individuals to opt-out of ACA-mandated coverage while maintaining a form of health coverage that fits their particular needs. For individuals to do so Texas lawmakers must pass legislation authorizing individual self-insurance under state authority. Small employers will need Texas lawmakers to resist the temptation to impose restrictions on stop-loss insurance, as some states are beginning to do, and take the additional step of exempting stop-loss coverage from premium and maintenance taxes. This will make stop-loss plans more affordable to small employers.

Lawmakers should employ both of these tactics—legislative action to empower individuals and small businesses, and legislative restraint to protect small firms—in Texas' ongoing effort to resist the ACA and create a market-driven health care system.

ERISA and Self-Insurance

Unlike fully insured health plans, self-funded or self-insured health plans bypass traditional insurance coverage and instead pay directly for the cost of employees' medical claims. Because such plans are not technically insurance—employers typically pay for claims from a reserve fund established for that purpose—they are not subject to state insurance regulations or federal ACA insurance regulations but are instead regulated under the 1974 Employee Retirement Income Security Act (ERISA).

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The flexibility ERISA affords has long been an inducement for corporations to self-insure, especially since they are able to spread risk among a large pool of employees and absorb unforeseen high-cost claims. Often self-insuring firms will hire major insurance companies to manage their self-insured plans as third-party administrators. Last year, 83 percent of all covered employees at large firms were enrolled in self-funded or partially self-funded plans, compared to only 16 percent of employees at small firms (one to 199 employees).[2]

But as smaller firms realize the costs associated with the ACA's insurance mandates and regulations, many are exploring self-insurance as an escape hatch from the federal health care law, and insurers are now making stop-loss coverage available to firms with as few as 10 employees.[3] Traditionally, stop-loss coverage helped limit firms' financial risk by covering large or unexpected medical bills after a certain dollar amount, or "attachment point," had been reached either by a single employee or by all the employees on the health plan (aggregate stop-loss). Combining a self-insured plan with stop-loss coverage enables small employers to evade ACA requirements to provide expensive, benefit-rich plans that include things like maternity coverage and mental health, and instead offer more limited benefits tailored to their employees.

Protecting Self-Insurance from the ACA

The move toward self-insurance faces growing opposition from ACA proponents who fear that if a large number of smaller firms opt to self-insure, it will significantly reduce the number of younger, healthier people seeking coverage on the exchanges, which will in turn drive up the cost of exchange plans. Because of this, some states have explored ways to regulate self-insurance. However, because the plans themselves fall under ERISA, states cannot regulate them directly—although that has not stopped them from trying.

So-called "fair share" laws have been cropping up for almost a decade, since Maryland first passed the Fair Share Health Fund Act in 2006. The law, subsequently struck down by a federal appeals court, would have forced employers with more than 10,000 employees—in this case, Wal-Mart—to contribute a certain percentage of their state payroll to its employee health plans or else pay the difference to a fund supporting the state's Medicaid program. Retail Industry Leaders Association (RILA) challenged the law and argued that it was in effect a mandate to increase funding for a self-insured plan covered by ERISA, and that ERISA therefore preempted the statute.[4]

Different versions of "fair share" laws have been attempted in more than 20 states and localities, with varying outcomes. San Francisco's Health Care Security Ordinance (HSCO) was passed in 2008 and requires employers with 20 or more employees in San Francisco to spend a minimum amount on health benefits, whether or not the employer is self-insured or fully insured. The ordinance survived an ERISA challenge in the Ninth Circuit,[5] but the issue remains unclear.

A 2012 Texas Supreme Court ruling grappled with the question of whether stop-loss insurance sold to self-funded employee health plans is considered "direct health insurance," and therefore subject to state regulation, or "reinsurance," and not subject to regulation. The court reasoned that because an employer that self-funds a health benefit plan for its employees is not considered an insurer under the Texas Insurance Code, stop-loss insurance does not involve the reallocation of risk between two insurers and therefore must be considered "direct health insurance," subject to state regulation.

The importance of the ruling, for the purposes of this paper, is the court's recognition that stop-loss insurance "does not involve two insurers and is therefore not reinsurance. It is instead direct insurance in the nature of health insurance because the stop-loss policies are purchased by the plans ultimately to cover claims associated with their health-care expenses."[6] The decision affirms that self-insured plans are not fully insured plans, and the purchase of stop-loss coverage does not justify treating them as though they are.

This presents something of a problem for ACA proponents seeking to impose insurance-like regulations on self-funded plans not subject to the ACA's myriad rules and mandates. Indeed, the Center for American Progress has noted that, "[t]he availability of stop-loss insurance for small businesses poses a threat to the fully insured small-group market and to small business employees and the exchanges." The group has called on federal regulators to enact regulations that would discourage businesses from self-insuring or strip self-funded plans of the freedom to operate outside the ACA's regulatory regime.[7]

Efforts to discourage self-insurance predate the ACA. Fearing that the proliferation of self-insurance could significantly reduce premium tax income in the states, the National Association of Insurance Commissioners (NAIC) in 1994 adopted nonbinding model state legislation, the Stop Loss Insurance Act, which included a minimum specific attachment point of $20,000 and other restrictions designed to discourage the sale of stop-loss coverage to small firms. In the years since, the NAIC's model legislation has been adopted only by a handful of states and has not been updated. An effort in 2012 to revise the model bill and increase the minimum attachment point to $60,000 was rejected by the full NAIC committee, although NAIC's ERISA working group is currently developing a white paper that addresses the effect of self-insurance on the small group market.

In the context of the ACA, the purpose of imposing such restrictions on stop-loss coverage is to prevent small employers from self-funding health benefit plans and instead funnel workers into the ACA exchanges. A number of states are considering legislation to limit stop-loss coverage, including Utah, California, Colorado, Idaho, Rhode Island, and North Carolina. Most of the bills under consideration in these states include minimum attachment points ranging from $20,000 to $40,000, which would effectively make stop-loss coverage impractical and unaffordable for small businesses. Because state insurance law cannot be applied to self-funded employee benefit plans, which are regulated under ERISA, the primary means states have to regulate such plans is by regulating stop-loss insurance. If states prohibit stop-loss from being sold to smaller firms, or set the attachment point so high that small firms cannot afford the coverage, states can effectively stop small employers from self-insuring and force them into the ACA exchanges.

California, a liberal state fully committed to facilitating the implementation of the ACA, has led the way in this effort. In October 2013, California passed a law (SB 161) that severely limits the ability of small employers—those with 1 to 100 employees—to self-fund employee benefit plans. The specifics of the law are important, as they offer a glimpse of what lawmakers in other states might try to impose on stop-loss carriers as a way to prevent small employers from self-insuring:

- Stop-loss insurers are prohibited from issuing coverage with deductibles of less than $35,000 for policies beginning in 2014, increasing to $40,000 in 2016.
- Aggregate attachment points must not be less than the greater of:
  - $5,000 x the number of group members
  - 120 percent of expected claims
  - $35,000 (increasing to $40,000 in 2016)
- Stop-loss coverage cannot exclude any employee or dependent eligible for coverage under the employee benefit plan—a practice known as "lasering," which excludes high-cost employees from stop-loss policies.

Fortunately, Texas has not pursued similar policies and currently has no rules regarding attachment points or other regulations on stop-loss coverage. Indeed, the Texas Insurance Code is largely silent about what constitutes stop-loss coverage. Although stop-loss premium and maintenance taxes are assessed in the Texas Insurance Code, stop-loss insurance is not specifically named as such.

If state lawmakers wanted to make it easier and more affordable for small businesses to self-insure and obtain stop-loss coverage, the Legislature could define stop-loss coverage in statute and exempt it from all state premium and maintenance taxes currently assessed under Subtitles B and C of Title 3 of the Insurance Code.

Individual Self-Insurance

The ACA authorizes the Department of Health and Human Services (HHS) to regulate health insurance issuers, which it defines as, "an insurance company, insurance service, or insurance organization (including a health maintenance organization, as defined in paragraph (3)) which is licensed to engage in the business of insurance in a State and which is subject to State law which regulates insurance."[8] Therefore, if a state licenses an entity as a "health insurance issuer," the federal government is generally obliged to recognize the entity as such.

This is the concept behind HB 2732, a bill passed by the Texas House in the 83rd legislative session but which failed to pass the Senate. The bill created a mechanism for individuals to self-insure as "dedicated personal insurers" by authorizing a savings-based approach to health insurance that satisfied the ACA's individual mandate without forcing Texans to bear the high cost of exchange coverage or pay a penalty for not purchasing insurance.

As part of the requirement for obtaining a limited certificate of authority as a dedicated personal insurer, an applicant would have had to set aside a significant amount of capital—$100,000, with certain exceptions. For someone younger than age 24, the capital requirement was $10,000; for those between age 24 and 32, $20,000, plus an additional $10,000 a year for every year after age 24. In addition, the certificate of authority created by the bill stipulated that only the individual, the individual's spouse and dependents would be covered by the policy issued under the certificate.

An amended draft version of the bill makes important changes to HB 2732, most notably in its capital requirements.[9] Instead of stipulating a dollar amount, the draft bill requires only that the self-insurer deposit at least 8 percent of their adjusted gross income annually, up to $60,000, after which no further deposits are required. The 8 percent threshold mirrors the ACA's affordability provision, which exempts individuals unable to obtain coverage if the cost of the premium exceeds 8 percent of their income.

Just as self-insured plans are regulated by ERISA rather than by HHS or by state insurance codes, so too would individual self-insurance be exempt from most ACA and state regulations—namely, because such coverage is not insurance at all but rather a savings program for health care that is authorized and regulated by the state.

Conclusion

The unworkability of the federal health care law has laid bare not only the misguided approach of the federal government's bureaucratized vision of American health care, but also the defects in the pre-ACA system, which relied too heavily on health insurance arrangements that consistently drove costs up without improving health care quality or providing adequate protection from financial risk.

Now, the staggering costs of the ACA are becoming apparent to individuals and businesses alike, as millions of Americans face canceled plans, more costly options on the exchanges, and onerous mandates on employer-sponsored plans. It is long past time to explore news ways of paying for health care, and the reforms proposed in this paper offer Texas lawmakers a path forward for the Lone Star State. Instead of capitulating to the demands of Washington, D.C., Texans should have the opportunity—if they so choose—to pay for health care on their own terms and run their businesses as they see fit. ✯

Endnotes

[1] John Davidson, "The High Cost of ObamaCare Mandates in Texas' Individual Health Insurance Market," Texas Public Policy Foundation (Oct. 2013) 3. Because catastrophic exchange plans are not eligible for subsidies, the cost increase will be absorbed entirely out-of-pocket by the policy holder.

[2] 2013 Employer Health Benefits Survey, Kaiser Family Foundation (20 Aug. 2013).

[3] Christopher Weaver and Anna Wilde Mathews, "One Strategy for Health-Law Costs: Self Insurance," *The Wall Street Journal* (27 May 2013). UnitedHealth is offering stop-loss coverage to firms with as few as 10 employees in some markets, while Humana is offering it as few as 26 employees and Cigna Corp to as few as 25 employees in 26 states. UnitedHealth and Humana previously restricted stop-loss coverage to larger groups.

[4] *RILA v. Fielder*, 435 F. Supp. 2d 481 (D. Md. 2006).

[5] *Golden Gate Restaurant Association v. City and County of San Francisco*: 546 F.3d 639 (9th Cir. 2008).

[6] *Texas Department of Insurance v. American National Insurance Company, et al.*, 410 S.W.3d 843, 18 (Tex. 2012).

[7] Maura Calsyn and Emily Oshima Lee, "The Threat of Self-Insured Plans Among Small Businesses," Center for American Progress (19 June, 2013) 9.

[8] 42 USC 300gg-91.

[9] "Understanding the Dedicated Personal Insurer Act," Self Insured Americans, Inc. (Nov. 2013).