



# Health Insurance 101:

## *How Private Health Insurance Markets Function Nationally and in Illinois*

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# Health Insurance Markets

- Everyone needs medical care sometime, and the most common way to pay for it in this country is through private health insurance.
- While most Americans have some type of private health insurance coverage, the different types of health insurance coverage and how they work can be confusing and difficult to understand.
- This briefing is designed to explain health insurance basics in layman's terms, and also provide you with contact information for resources in Illinois who can provide you with additional information and assistance.

# Role of the Health Insurance Producer

- This briefing has been prepared through a collaboration of the professional staff at the Arlington, Virginia offices of the National Association of Health Underwriters (NAHU) and officers of the Illinois State Association of Health Underwriters (ISAHU) who as licensed producers in our state assist both individuals and employers purchase and manage health insurance products and related services.
- Producers in Illinois are represented by ISAHU as well as by IAIFA (Illinois Assn. of Insurance & Financial Advisors), the FPA-IL (Financial Planning Association of Illinois), and the PIIAI (Professional Independent Insurance Agents of Illinois).
- Members of all the associations noted assist their clients with their health insurance needs. Our members' clients range from sole proprietors to Fortune 500 companies.

# Role of the Health Insurance Producer

- In addition to selling the insurance products, producers often help their clients, particularly the small employers, with all sorts of employee benefit issues, including assistance with claims processing, COBRA administration, privacy issues, and more.
- Most of our members are independent health insurance agents or consultants, and many are small-business owners themselves.
- Our associations' two top public policy goals are:
  - Reducing the number of uninsured Americans through private market solutions; and
  - Making sure that state-level private health insurance markets are as vibrant and competitive as possible.

# Health Insurance Coverage in the United States

- In the United States, this is the breakdown of how people receive their health insurance coverage:
  - 54% through their employer or the employer of a family member
  - 5% purchase individual insurance coverage
  - 13% receive Medicaid
  - 12% receive Medicare
  - 16% are uninsured

■ Source: Kaiser Family Foundation

# Health Insurance Coverage in Illinois

- In Illinois, this is the breakdown of how people receive their health insurance coverage:
  - 58% through their employer or the employer of a family member
  - 6% purchase individual insurance coverage
  - 9% receive Medicaid
  - 12% receive Medicare
  - 1% receive other public coverage
  - 14% are uninsured

■ Source: Kaiser Family Foundation

# Employer Group Health Insurance Coverage

- The majority of Americans have group health insurance coverage through either their employer or the employer of a family member.
- Many people don't realize that health insurance is issued differently for different types of employers, and that since insurance is regulated at the state level, health insurance requirements for the different types of employers can vary significantly from state to state.

# Employer Group Health Insurance Coverage

- Millions of Americans work for small employers, which for health plan purposes, are generally those with 50 employees or less.
- Millions of other Americans get their health employer-sponsored health insurance coverage through large employers. Generally, for health plan purposes, those are business with more than 50 employees.
- The requirements for the issuance of coverage to large groups are different than for small groups, and the way that rates are determined is also different. <sup>8</sup>

# COBRA, state continuation, and portability

- In addition to employed people who have group health insurance, millions of people who lose their group health insurance coverage, due to a job change, a divorce, job loss or other reason are able to keep their group coverage, at least temporarily.
- Most people who are able to continue their group health insurance benefits are eligible to do so according to federal Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) legislation.
- However COBRA does not apply to all employers, and many states, including Illinois, have mandated continuation of coverage options for people who are not covered by COBRA or that in some cases supersede COBRA.
- Also, many people leaving group insurance for the individual market have federally mandated group-to-individual health insurance portability benefits.

# HIPAA Small Group requirements

- The federal Health Insurance Portability and Accountability Act of 1996 (HIPAA) requires that all small group health plans:
  - Be issued on a guaranteed basis, no matter what health conditions members of the group have.
  - Be guaranteed renewable, unless there is non-payment of premium, the employer has committed fraud or intentional misrepresentation or the employer has not complied with the terms of the health insurance contract.
  - Impose no more than a 6-month look-back/12-month exclusionary period for preexisting conditions on enrollees that do not have prior creditable coverage.
  - Give employees credit for prior coverage regarding preexisting conditions, as long as there is no more than a 63-day break in coverage.

# Small Employer Health Plans

- In Illinois, small employer health plans are defined as plans covering employers with 2-50 employees.
- In the Illinois small group health insurance market rates are determined by the health status of a group. Under SEHIRA (the Small Employer Health Insurance Rating Act) rates may vary by plus or minus 25 percent of the indexed rate after considering a group's health profile.
- In 40 states, including Illinois, the law permits small group health insurance carriers to determine their rates using a process known as medical underwriting. The other 10 require either community rating or modified community rating.<sup>14</sup>

# Small Employer Health Plans

- When small group plans are medically underwritten, employees are asked to provide health information about themselves and their covered family members.
- When determining rates, insurance carriers use the medical information on these applications. Sometimes they will request additional information from an applicant's physician or ask the applicants for clarification.

# Small Employer Health Plans

- Most state laws concerning small group medical underwriting are based on a National Association of Insurance Commissioners Model and allow groups to be rated “X” percent above or below the **indexed rate**.
  - The indexed rate is determined by averaging the lowest possible rate and the highest possible rate. Most states that have this type of rating system also have a limit on rate increases due to the health status of the group, which is helpful in stabilizing rates over time.
- Even with initial rate fluctuations for a new group, small employer rates in these states tend to be much lower than in states where health status rating is not allowed.
- A group that is rated correctly up front is much less likely to have a very large increase at renewal.
- In order to rate the group correctly, the correct information on the initial application is essential.

# Community Rating

- The alternative to medical underwriting is known as **community rating**.
- Community rating requires insurers to charge all individuals who live in the same geographical area the same exact premium regardless of their age or health status.
  - Example: An employer's cost to insure a healthy 27-year old non-smoking male with no health conditions would be the same as it would be to insure a 55-year old male smoker who is suffering from prostate cancer and a heart condition.

# Modified Community Rating

- A variation on community rating used by some states is called **modified community rating (MCR)**.
- With MCR, health plans may vary the community rate based on limited factors, such as age, gender and/or smoker status.
  - Example: In a state that allows MCR variations for age, the employer would pay more to insure the 55-year old male smoker with cancer and a heart condition. However, the insurer would have to use the same rate when calculating premiums for the healthy 27-year old male as it would for a male co-worker who is the same age but suffers from juvenile diabetes.

# Problems with Community and Modified Community Rating

- State-level MCR laws vary greatly. Some allow for many adjustment factors, but many allow for just a limited few.
- Community rating and modified community rating have a severely negative impact on health insurance rates in all states that employ the mechanism, but the more limited the rate adjustment factors, the more severe the problem.

# Large Employer Groups

- In most states, including Illinois, large employer groups are defined as employers having more than 50 employees.
- Large group health insurance contracts, unlike small group health insurance contracts, do not have to be offered on a guaranteed issue basis.
- Large group health insurance is underwritten based on a number of factors, including employee demographics, participation, and prior claims experience.
- HIPAA mandates all group insurance contracts, including large group contracts, must be guaranteed renewable, unless there is non-payment of premium, the employer has committed fraud or intentional misrepresentation or the employer has not complied with the terms of the health insurance contract.

# Large Employer Groups

- HIPAA also requires all employers to give employees credit for prior coverage for preexisting condition exclusions, as long as there is no more than a 63-day break in coverage.
- Many employer-based health insurance plans are fully insured by a health insurance carrier. The individual states regulate these plans.
- Larger group health plans (usually several hundred employees or larger) may choose to either fully or partially self-insure their group benefit plans.
- Companies that self-insure generally buy a stop loss policy to protect themselves against losses above a certain threshold.
- Self-funded employers also generally contract with either a third-party administrator or a health plan to administer their plans and manage claims.

# Large Employer Groups

- Many employees of companies that self-fund their coverage do not even realize that their plan is self-funded by their employer.
- Self-funded plans are regulated federally by the Department of Labor under the Employee Retirement Income Security Act of 1974 (ERISA). That is why they are sometimes known as ERISA plans.
- Self-funded plans generally are not subject to state level rating laws, nor are they subject to state level health insurance mandates. This is known as the “ERISA preemption”.

# Large Employer Groups

- Self-funded ERISA plans are required to abide by federal requirements and mandates (I.e., HIPAA, federal mental health parity requirements, etc.)
- Stop loss insurance contracts purchased by self-funded employers are still regulated by the state department of insurance.

# More re COBRA

- Most Americans with employer-sponsored health plan coverage have the option of continuing that coverage for 18-36 months at their own cost if they lose their group coverage.
- Federal COBRA legislation applies to companies that employed 20 or more full-time workers in the past year.
- COBRA applies to both private employers and state and local health plans, but it does not apply to Federal government plans and those sponsored by certain church organizations.
- COBRA also does not apply if the company goes out of business, or ceases to offer group health insurance.

# Illinois Continuation of Coverage Provisions

- In Illinois, all employer groups with insured health plans, regardless of size, are required to offer continuation to eligible employees and their dependents for nine months upon termination, provided that termination is not due to theft or the commission of a work-related felony.
- Coverage must also be offered to individuals whose eligibility for employer-sponsored group coverage is lost due to a reduction in hours.
- Individuals must have three months of prior coverage with the group plan to be eligible, and have 60 days to elect coverage. The maximum premium that can be charged is 100% of the group premium.

# Illinois Continuation of Coverage Provisions

- Illinois also has separate requirements to provide continuation rights to divorced or widowed spouses and their dependents who were covered under group plans, as well as the dependent children of deceased employees who do not have rights under the spousal continuation law, and dependent children who reach the limiting age under a group health plan.
- Individuals and their dependents may choose to convert to an individual policy at any time during the continuation period, or after the exhaustion of continuation coverage, except if they become Medicare eligible.

# People Leaving Employer Health Plan Coverage

- People who leave group health insurance coverage also have portability rights under HIPAA.
- HIPAA mandated that every state develop at least one option for people who are transitioning group coverage and meet certain criteria, so that they can purchase an individual health insurance policy on a guarantee-issue basis.
- The people who are eligible to purchase these health insurance policies are known as having group-to-individual portability rights under HIPAA and are often called HIPAA-eligibles.
- The various states have developed a wide range of mechanisms to provide guaranteed issue coverage to their HIPAA-eligible populations, the most common of which is allowing them to purchase coverage thorough a state individual market high-risk health insurance pool.

# HIPAA-Eligible Individuals in Illinois

- In Illinois, the Comprehensive Health Insurance Plan (CHIP), the state high-risk health insurance pool, has been designated as the guaranteed issue option for individuals exercising their HIPAA portability rights.
- Federally eligible individuals under Section 15 of the Comprehensive Health Insurance Plan Act (Public Act 91-654), after first exhausting their continuation rights, may “port” into the HIPAA-CHIP program without preexisting condition limitations.

# Individual Health Insurance Coverage

- Approximately 5 percent of Americans do not get their health insurance coverage through an employer or through a government program.
- Instead they purchase private coverage on an individual basis.
- Individual health insurance coverage is regulated by the states' departments of insurance.

# Individual Health Insurance Coverage

- Individual health insurance is very different than group insurance in a number of ways.
- Individual market carriers are much more limited in their ability to spread risk.
- Benefit packages are generally less extensive than what is available to most groups.
- Deductibles and cost-sharing are generally higher, due to cost considerations of the individual purchasers.

# Individual Health Insurance Coverage

- Individual health insurance is also regulated differently than group policies in most states.
- A key reason why individual policies need to be regulated differently, is that in most cases, individuals do not purchase them unless they in some way anticipate that they will use their benefits.
- This is particularly true in states where individual market premium rates are very high.
- This occurrence is known as “adverse selection.”

# Individual Health Insurance Coverage

- To help prevent against adverse selection, 43 states, including Illinois, allow for medical underwriting in the individual market.
- The vast majority of these states, Illinois included, allow for unrestricted medical underwriting without rating bands, which are common in the small group market.
- Most federal HIPAA provisions do not apply to the individual market, and in the majority of states (including Illinois) traditional individual health insurance is not required to be issued on a guaranteed issue basis, so people may be turned down for coverage because of a preexisting medical condition.

# Individual Health Insurance Coverage

- In many states, individual market carriers can also issue elimination riders.
- Elimination riders allow for carriers to offer an individual with a preexisting condition coverage, but exclude coverage of that condition.
  - Example: An individual has severe season allergies, but can control them with medication. A carrier may offer a policy at a more expensive rate with full allergy coverage or offer a cheaper policy that excludes allergy coverage. The individual may find that it is more affordable to take the cheaper policy and pay for his/her allergy medication out-of-pocket.

# Individual Health Insurance Coverage

- Individual policies are also generally different than group policies concerning the amount of time prior to the application for coverage the carrier can look back for preexisting conditions, and also how long carriers are permitted to exclude coverage for those preexisting conditions.
- On the group level, according to HIPAA look-back and exclusionary periods are limited to no more than 6 months and 12 months. There are no such federal restrictions on traditional individual policies.
- Also, in the individual market there is no federal requirement that carriers give credit for prior coverage against preexisting condition waiting periods.

# Illinois individual market regulations (@ March, 2007)

- Medical underwriting is allowed without restriction.
- There are no rate caps in the individual market in Illinois.
- Coverage is not required to be guarantee issue in the Illinois traditional individual health insurance market. Elimination riders are also allowed in the individual health insurance market in Illinois.
- For individual health insurance policies, there is a 12-month look back period during first two years of coverage. If the condition is determined to be preexisting a 24-month exclusionary period is allowed.
- For individual health insurance policies, credit for prior coverage is not required.

# Medically Uninsurable Coverage

- Since in most states, individual health insurance is not offered on a guaranteed issue basis, people may be turned down for coverage if they have a very serious medical condition (i.e., HIV, cancer, diabetes, etc.).
- States are not required to have an alternative option for medically uninsurable individuals, but most states do.
- 33 states provide coverage to medically uninsurables through state high-risk health insurance pools.
- 12 states use other means of providing uninsurable people with access to individual market coverage, and 5 states have no such means (i.e., guarantee issue, carrier of last resort).
- In Illinois, the state high-risk health insurance pool, the Comprehensive Health Insurance Plan (CHIP), is the means of providing medically uninsurable people with access to the individual market.

# High-Risk Health Insurance Pools

- Risk-pool consumers are often self-employed individuals, early retirees or employees of small businesses that do not offer benefits.
- The average amount of time an individual spends in a risk-pool is 30 months.
- Consumers that need to purchase coverage in the high-risk-pool have access to comprehensive private-market coverage options that might not otherwise be available to them.
- These individuals pay higher rates than other individual market consumers, but these rates are capped, generally at about 125-200 percent of the average individual market rate.
- Consumers are provided with a very important safety net, and insurers are provided with a predictable means of accounting for uninsurable risks.

# We are here to help...

- The Illinois State Association of Health Underwriters, with support from the professional staff of NAHU, are happy to provide Illinois legislators and regulators or their staffs with additional information or assistance with health insurance at any time. Examples of types of information we may be able to provide include:
  - Examples of true health insurance rates.
  - More detailed information about health insurance markets, and how health insurance placements actually work in Illinois.
  - The perspectives of our clients, who purchase employment-based group health insurance in our state.
  - Information about health insurance markets, laws relative to health insurance, and pricing data from other states.
  - Updates on federal activity concerning the private health insurance market.

# For More Information

- You may reach ISAHU by contacting our representative in Springfield, Phil Lackman - (217) 321-3005; [plackman@pii.ai.org](mailto:plackman@pii.ai.org).
- For a listing of the contact information for ISAHU's board, go to [http://www.isahu.com/ISAHU\\_Board.htm](http://www.isahu.com/ISAHU_Board.htm).