

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

EFFECT OF ERISA ON STATE
INSURANCE LAWS:

A MANAGEMENT ADVISORY REPORT



Richard P. Kusserow
INSPECTOR GENERAL

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EXECUTIVE SUMMARY

PURPOSE

This Management Advisory Report (MAR) describes the effect of the Employee Retirement Income Security Act (ERISA) on State laws prohibiting discrimination in insurance plan coverage on the basis of place of residence.

BACKGROUND

In 1990, the Office of Inspector General (OIG) released the report, "Coordination of Third Party Liability Information between Child Support Enforcement and Medicaid." As part of this study, the OIG conducted interviews with CSE agency staff to document the problems they face in identifying and pursuing medical support. One problem identified is that some private insurers limit coverage of a policyholder's dependents to those currently residing in the policyholder's residence. This has the effect of denying medical support for AFDC children who no longer live with their absent parent. We recommended that the Family Support Administration (now the Administration for Children and Families (ACF)) and the Health Care Financing Administration (HCFA) require States to implement legislation to prohibit discrimination in insurance plans on the basis of place of residence. This legislative proposal is currently being drafted.

A potential loophole to such a strategy was brought to our attention in interviews with State CSE directors during a subsequent study. Some directors indicated that insurance plans covered under the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. § 1001 *et seq.*) are exempt from state regulation of insurance. This MAR presents the results of our research into this issue.

FINDINGS

ERISA prevents States from assuring that AFDC dependent children are covered under their absent parents' group health insurance plans. The Office of General Counsel has informed us that State laws regulating insurance will not apply to employee benefit plans which are self-insured.

The pool of self-insurers have grown considerably since passage of ERISA, increasing the significance of this gap in coverage.

RECOMMENDATION

The HCFA and ACF should address ERISA preemption problems when drafting a legislative proposal to require States to prohibit discrimination in insurance plans on the basis of place of residence.

INTRODUCTION

PURPOSE

This Management Advisory Report (MAR) describes the effect of the Employee Retirement Income Security Act (ERISA) on State laws prohibiting discrimination in insurance plan coverage on the basis of place of residence.

BACKGROUND

In 1990, the Office of Inspector General (OIG) released the report, "Coordination of Third Party Liability Information between Child Support Enforcement and Medicaid."¹ This study assessed whether child support enforcement (CSE) agencies were identifying absent parents with children on Aid to Families with Dependent Children (AFDC) who had group health insurance available to them, whether their AFDC-supported children were enrolled in the plan, and whether this information was transmitted to Medicaid in order to avoid payment for claims that should have been covered by private insurance. The OIG report documents that the Medicaid program would save \$32 million annually if CSE agencies adequately detect and pursue available group health insurance.

As part of this study, the OIG conducted interviews with CSE agency staff to document the problems they face in identifying and pursuing medical support. One problem identified by a number of these respondents concerned limitations in private insurance coverage. Some private insurers limit coverage of a policyholder's dependents to those currently residing in the policyholder's residence. This has the effect of denying medical support for AFDC children who no longer live with their absent parent. This limitation in coverage costs the Federal government at least \$1 million annually. We recommended that the Family Support Administration (now the Administration for Children and Families (ACF)) and the Health Care Financing Administration (HCFA) pursue a legislative remedy to require States, as a condition of receiving matching funds under title IV, to implement legislation to prohibit discrimination in insurance plans on the basis of place of residence. This legislative proposal is currently being drafted.

A potential loophole to such a legislative strategy was subsequently brought to our attention through interviews with State CSE directors during our study, "State Child Support Enforcement Criteria for Targeting Medical Support," which was released in

¹Office of Inspector General, "Coordination of Third Party Liability Information between Child Support Enforcement and Medicaid," OEI-07-88-00860, January 1990.

draft to HCFA and ACF on May 20, 1991.² Some directors indicated that insurance plans covered under the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. § 1001 et seq.) are exempt from state regulation of insurance, and could therefore continue to discriminate against dependents on the basis of place of residence despite state legislation generally prohibiting this practice. This MAR presents the results of our research into this issue.

²Office of Inspector General, "State Child Support Enforcement Criteria for Targeting Medical Support," (draft), OEI-07-90-00120, May 1991.

FINDINGS

ERISA prevents States from assuring that AFDC dependent children are covered under their absent parents' group health insurance plans.

- ▶ ERISA establishes Federal requirements for employee benefit plans, including health insurance plans.

ERISA is a comprehensive Federal law which sets uniform standards for employee benefit plans. Employee benefit plans are pension plans and welfare plans, including health insurance plans. Businesses which provide health insurance to their employees are subject to ERISA requirements, regardless of whether they contract with a second party to provide the coverage and assume the risk or whether they self-insure and assume the risk themselves.

ERISA establishes requirements for the disclosure of certain information and the operation and management of such plans. ERISA concerns itself solely with administrative matters; it does not prescribe the content of plans and the nature of benefits that must be provided.

- ▶ Certain ERISA plans are exempt from state laws regulating insurance.

Generally, the provisions of ERISA supercede state law. However, ERISA provides that it should not be construed to exempt anyone "from any law of any State which regulates insurance. . ." while at the same time stating that no employee benefit plan should be considered an insurance company for the purposes of any State law which regulates insurance companies or insurance contracts. As a result of this rather confusing language, which appears to give with one hand what it takes away with another, much litigation has taken place over the breadth of ERISA's preemptive power.

In response to our inquiry about the effect of ERISA on State laws such as those supported by the OIG in our 1990 report, the Office of General Counsel (OGC) has informed us that State laws regulating insurance will not apply to employee benefit plans which are self-insured. However, since such laws apply to insurance companies, these laws will effectively apply to ERISA plans which purchase outside insurance policies to provide benefits to the plan participants.

As a result, State laws which prohibit insurers from limiting dependent coverage on the basis of place of residence would have no force for employers who self-insure. For those businesses, coverage may be legally limited to dependents living with the covered employee, and State law generally prohibiting this practice would have no effect.

The pool of self-insurers have grown considerably since passage of ERISA, increasing the significance of this gap in coverage.

Self-insurers constitute a large and growing segment of the business community. The large majority of Fortune 500 companies are self-insured. In 1985, almost half of firms with 100 employees or more were self-insured, doubling the figure from four years earlier. Since, as discussed above, State law prohibiting discrimination in coverage on the basis of place of residence would not reach ERISA plans which are self-insured, a large part of the coverage problem identified in the 1990 OIG report unresolved.

The problems posed by ERISA for the Federal and State governments are serious and deserve further consideration.

A recent report by the U.S. General Accounting Office found that "States' limited authority over ERISA plans does not allow them to prohibit these plans from certain actions to avoid payments for [Medicaid] recipients' covered costs."³ ERISA poses serious problems for States trying to mandate employer benefits or undertake other initiatives to improve health care access:

...ERISA preempts state attempts to apply minimum benefit laws to self-insured plans. Self-insured plans may thus offer less comprehensive, and less expensive, health benefit plans. ERISA also relieves self-insured plans of the financial burden of contributing to state risk pools along with other insurers, and from the regulatory burden of other state insurance requirements. Finally, self-insured companies are not subject to state insurance premium taxes....

Indirect state regulation cannot be effective in this mixed market. Benefit mandates are realistically limited: the greater the state mandates, the greater the incentive for employers to self-insure. Attempts to raise funds for access initiatives from the health insurance market are also frustrated. ERISA preempts state attempts to directly tax employee benefit plans. The statute has prevented attempts to broaden the funding of state high-risk pools--self-insured employers have remained free of liability for loss assessment. Similarly, proposals to provide risk pools for small employers at the state level have been hampered by the inability of states to spread potential losses from such

³U.S. General Accounting Office, "Medicaid: Legislation Needed to Improve Collections from Private Insurers," GAO/HRD-91-25, November, 1990.

programs across the entire insurance market, including self-insured employers.⁴

Staff of HCFA and ACF have previously indicated that they are aware of the problems posed by ERISA and Federal preemption of State laws mandating health care coverage for children supported by absent parents. As more and more businesses self-insure, in part to insulate themselves from state laws regulating insurance, the exposure for the Medicaid program in financing health care for employees and their children grows. This topic has also been explored in various forums addressing obstacles to medical support for children of absent parents.

⁴Mary Anne Bobinski, "Unhealthy Federalism: Barriers to Increasing Health Care Access for the Uninsured," U.C. Davis Law Review (Volume 24, Number 2, Winter 1990).

RECOMMENDATIONS

The HCFA and ACF should address ERISA preemption problems when drafting a legislative proposal to require States to prohibit discrimination in insurance plans on the basis of place of residence.

In 1986, Congress amended ERISA to provide that certain State laws regulating insurance are not preempted by ERISA. These State laws prohibit employee benefit plans from including any provision which limits coverage for an individual who would otherwise be covered by the plan, simply because that individual is eligible for Medicaid. Such State laws ensure that Medicaid is the payor of last resort. Thus, precedent exists for a legislative remedy to avoid ERISA preemption problems. The HCFA and ACF may wish to consider this approach as they draft proposed legislative language.