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Title: Insurance Standards Bulletin Series--INFORMATION

Subject: Guaranteed Availability Under Title XXVII of the Public Health Service Act – Applicability of Group Participation Rules

Market: Small Group

I. Purpose

The purpose of this Bulletin is to convey the position of the Health Care Financing Administration (HCFA) on the interaction of subsections 2711(a)(1) and 2711(e) of the Public Health Service (PHS) Act[1] and the regulations at 45 CFR § 146.150. Section 2711(a)(1) of the PHS Act requires guaranteed availability of health insurance coverage for small employers. Section 2711(e) of the PHS Act generally authorizes insurance issuers to use group participation rules to determine whether a particular small employer qualifies for coverage. This Bulletin clarifies that there are, however, some circumstances under which a given group participation rule is not permissible. Specifically, an issuer's group participation rule violates section 2711(a)(1) of the PHS Act, if it makes it impossible for a small employer to obtain coverage, even when every person who qualifies as an "eligible individual" under the employer's group health plan wishes to enroll in the plan. The Bulletin also clarifies how these provisions of the PHS Act affect State laws that deal with group participation rules.

II. Background

Statutory and Regulatory Requirements

Guaranteed Availability - General

Section 2711(a)(1)(A) of the PHS Act, generally requires every issuer that offers health insurance coverage in the small group market to accept every small employer that applies for coverage[2]. A "small

[1] Title XXVII of the PHS Act was added by Title I of the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

[2] "Small group market" is defined in section 2791(e)(5) of the PHS Act, 42 U.S.C. § 300gg-91(e)(5), as "the health insurance market under which individuals obtain health insurance coverage (directly or through any arrangement) on behalf of themselves (and their dependants) through a group health plan maintained by a small employer."

employer" is defined in terms of an employer who employs between 2 and 50 "employees,"[3] and the term "employee" has the meaning given such term under section 3(6) of Title I of the Employee Retirement Income Security Act of 1974 (ERISA)[4]. That section of ERISA states that the term "employee" means "any individual employed by an employer" (emphasis added). This includes any individuals who meet the common law master/servant test for determining who is an employee, such as based on the degree of employer control over the individual. See National Mutual Insurance Company v. Darden, 503 U.S. 318 (1992). (See HCFA's bulletin "Issue Related to Eligible Individual Status Under Section 2741(b) of the Public Health Service Act," Program Memorandum/Insurance Commissioners/Insurance Issuers, Transmittal No. 00-02, June 2000.) It therefore includes part-time employees.

Eligible Individuals

Under section 2711(a)(1)(B) of the PHS Act, issuers must accept every "eligible individual" who applies for enrollment under the terms of a small employer's group health plan, without regard to health status, as long as the person applies when he or she first becomes eligible, or during a special enrollment period. In other words, issuers are not required to accept applicants for coverage under the plan who do not meet the definition of an eligible individual, as determined under rules of the plan, the issuer, and State law[5]. Eligible individuals can include employees, dependents, retirees, and anyone else who meets the applicable criteria. An employer can also be an eligible individual if he/she is included under the terms of the plan.

Group Participation Rules

An issuer uses participation rules to achieve an important business goal: spreading insurance risk across a broad and diverse pool of individuals. The issuer maintains diversity of the entire pool by applying participation rules to each employer group that comprises the pool. Presumably, when an issuer refuses to sell or renew coverage to a group that fails to meet participation rules, the refusal is premised on the issuer's goal to spread its insurance risk. For example, an insurance product will not be viable if it does not have an adequate pool of healthy people paying into the system. If individuals are permitted to sign up for health coverage (and pay into the system) only when they are sick, and then drop the coverage when they are well, this goal is undermined. Requiring a group to maintain its participation above a specified percentage level serves to minimize this possibility.

Section 2711(e)(1) of the PHS Act specifies that the guaranteed availability requirement under section 2711(a) of the PHS Act "shall not be construed to preclude a health insurance issuer from establishing . .

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[3] The exact language of section 2791(e)(4) of the PHS Act, 42 U.S.C. § 300gg-91(e)(4), defines "small employer" as follows: ". . . in connection with a group health plan with respect to a calendar year and a plan year, an employer who employed an average of at least 2 but not more than 50 employees on business days during the preceding calendar year and who employs at least 2 employees on the first day of the plan year." Also see 45 CFR § 144.103.

[4] See section 2791(d)(5) (42 U.S.C. § 300gg-91(d)(5)), and the regulation at 45 CFR § 144.103.

[5] Section 2711(a)(2) of the PHS Act states that " . . . the term 'eligible individual' means, with respect to a health insurance issuer that offers health insurance coverage to a small employer in connection with a group health plan in the small group market, such an individual in relation to the employer as shall be determined--(A) in accordance with the terms of such plan, (B) as provided by the issuer under rules of the issuer which are uniformly applicable in a State to small employers in the small group market, and (C) in accordance with all applicable State laws governing such issuer and such market."

. group participation rules for the offering of health insurance coverage in connection with a group health plan in the small group market, as allowed under applicable State law." The statute defines a group participation rules as "a requirement relating to the minimum number of participants or beneficiaries that must be enrolled in relation to a specified percentage or number of eligible individuals or employees of an employer."

III. Discussion

Definition of "Small Employer"

As discussed in section III of HCFA's bulletin "Group Size Issues Under Title XXVII of the Public Health Service Act," Program Memorandum/Insurance Commissioners/Insurance Issuers, Transmittal No. 99-03, September 1999, a problem arises if a State law specifies that only "eligible employees" are to be counted in determining whether an employer meets the definition of a "small employer" and is, therefore, entitled to guaranteed availability. This will be a problem for very small employers if the State's definition of an "eligible employee" is more restrictive than the PHS Act/ERISA definition of an "employee." For example, because the PHS Act definition includes part-time employees, if a State law defines an "eligible employee" as a full-time employee, some employers who would meet the definition of a small employer under the PHS Act (e.g., an employer with two part-time employees) will be excluded from the small group guaranteed availability protection by that State's definition of an "eligible employee". In other words, a State law cannot have the effect of instituting a more restrictive definition of "small employer" than that set forth in, and required by, the PHS Act.

Use of the Term "Eligible Employee"

A question has been raised about the use of the term "eligible employee" in State laws or by issuers. It is essential to determine, first, how this term is being used. It is not acceptable to incorporate the term into the definition of a "small employer," to the extent some employers and individuals who should receive the PHS Act protections fail to receive them. However, we believe it is acceptable to use the term in the context of a group participation requirement. The statute defines a group participation rule as "a requirement relating to the minimum number of participants or beneficiaries that must be enrolled in relation to a specified percentage or number of eligible individuals or employees of an employer." We believe that the term "eligible individuals or employees of an employer" is flexible enough to include a group defined as "eligible employees." This is because, as long as a group participation requirement does not violate the "impossibility" principle described above, a rule can be structured in any number of ways to reach a particular mathematical result, regardless of how the numerator and denominator of the proportion are characterized (where the numerator is the number of participants or beneficiaries who must enroll in order for a group to qualify for coverage, and the denominator is the total universe of people who have to be counted).

How the PHS Act Limits an Issuer's Use of Participation Requirements

The heading for subsection 2711(e) of the PHS Act, which deals with group participation rules, identifies it as an "exception" to the guaranteed availability requirement. As noted previously, the statutory text states that the small group guaranteed availability requirement of section 2711(a) of the PHS Act does

not preclude participation rules. The statute thus makes clear that the guaranteed availability requirement takes precedence, even though it does not eliminate the possibility of using participation rules. Accordingly, the exception cannot "swallow the rule," and the statute does not permit an issuer to use participation rules that would make the guaranteed availability requirement meaningless. The statute requires that every small employer; i.e., those with between 2 and 50 employees, be guaranteed the chance to obtain health insurance coverage for any individuals that meet the statutory definition of an "eligible individual." Thus, while the statute generally permits the use of participation requirements, if an issuer's participation rule makes it impossible for any particular small employer to qualify for a policy, even if every "eligible individual" under the employer's plan seeks to participate, then the participation rule violates section 2711(a) of the PHS Act.

Example 1: An issuer claims it has a "group participation rule" that requires at least 10 employees to participate in the plan in order for the employer to obtain or maintain the group coverage. Such a rule would make it impossible for employers with fewer than 10 employees to purchase a policy under any circumstances. This is not a valid participation rule.

Example 2: An issuer's "group participation rule" requires at least three employees to participate in a plan, irrespective of an employer's actual size. This rule obstructs the ability of employers with two employees ever to purchase coverage from this issuer. It, too, is not a valid participation rule.

Example 3: An issuer requires the participation of at least 75 percent of an employer's eligible employees. An employer with only two employees can meet this requirement if both employees enroll. The employer can be denied coverage if only one employee enrolls, but it is not impossible for the employer to obtain coverage from the issuer if all the employees enroll. This is a valid participation rule.

Calculation of the Denominator

The size of the denominator can be determined in different ways. For example, in a particular plan "eligible individuals or employees" may include all eligible individuals, regardless of whether they already have other health coverage. In another plan, the universe of eligible individuals may first be reduced by excluding from the calculation eligible individuals who have voluntarily declined coverage under the plan because they have other health coverage. A third possibility would be to define "eligible individuals" so that anyone who already has health care coverage (e.g., coverage under a spouse's or parent's group health plan) is not even eligible to join the plan. Regardless of how it is accomplished, when there are fewer people included in the denominator, it takes fewer people in the numerator to meet a specified participation level.

The statute specifies that in order for the group participation rule to be valid, the minimum number of participants must be "in relation to a specified percentage or number of eligible individuals or employees of an employer." However, the statute does not require that all eligible individuals or employees of an employer be counted in the denominator. In some cases, State law will require issuers to exclude people from the denominator when they have other coverage. This is consistent with the goal discussed above, of strengthening the viability of insurance products by encouraging people to stay in the pool of people who are paying into the system. If an employer seeking coverage has some

employees who have no health coverage, and some who already have health coverage from another source, this goal would be best served by excluding from the denominator those eligible individuals who have other coverage. If a participation rule does not count all the employees (both the insured and the uninsured) in the denominator of the group participation rule calculation, then a much smaller number of the uninsured group must participate in order to satisfy the participation rule. It is then less likely that people who want to pay into the system will be excluded[6].

The following examples illustrate the application of participation rules that distinguish among eligible employees and non-eligible employees for the purpose of calculating participation rates and/or exclude certain eligible individuals from the denominator:

Example 1: Company A has five employees. All five employees are eligible to participate in the plan, but three have declined to do so because they have other group health coverage. Under the issuer's group participation rule, 75 percent of eligible employees must participate in the plan. However, in this situation, the issuer's participation requirement provides that employees who are eligible to participate in the group health plan, but are enrolled in other group health coverage, are not considered as eligible employees for purposes of applying the 75 percent minimum participation rule. Therefore, the 75 percent rule is considered to have been met by the enrollment of only two employees, because there are only two employees in the denominator, and counting the two new enrollees in the numerator (creating a fraction of 2/2, also sometimes referred to as "2 of 2") results in 100 percent participation.

Example 2: Same facts as in Example 1, except all eligible employees are considered in determining whether the minimum group participation rule is met. In that event, the 75 percent minimum participation rule is not met by the enrollment of only two employees because there are still only two enrollees counted in the numerator, but the denominator is now five. (2 of 5 or 2/5.) Because the resulting participation level is only 40 percent, the issuer may decline to issue small group market coverage to the employer.

Example 3: Company B has 10 employees. Eight employees are eligible to participate in the plan (two are not because they are part-time). Two of the employees have declined to participate in the plan because they are covered under their spouse's health plan. Under the issuer's group participation rule, 75 percent of eligible employees must participate in the plan. The issuer's participation requirements provides that employees who are eligible to participate in the group health plan, but are coverage by a spouse's plan, are nonetheless considered eligible employees for purposes of applying the 75 percent minimum participation rule. Therefore the 75 percent rule is met by the enrollment of six employees (the six new enrollees in the numerator, and the eight eligible employees in the denominator, results in 6 of 8, or 6/8, or exactly 75 percent participation).

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[6] We would also note that in this situation, one way for the group to achieve the required participation level would be for people who are already insured to enroll in the employer plan, and maintain duplicate coverage. Since the two types of coverage would presumably coordinate with one another, with one policy paying out-of-pocket costs incurred under the other policy, for those people there would be no barrier to excess utilization, and it could drive up costs for both parties.

Example 4: Same facts as above in Example 3, except that employees who decline coverage because they have other coverage are not counted for purposes of applying the 75 percent minimum participation rule. Therefore, the participation rule could be met in this case by the enrollment of only five employees (the five enrollees in the numerator, and the six employees in the denominator, 5 of 6 or 5/6 results in over 80 percent participation). Therefore, the 75 percent participation rule is satisfied.

Preemption and Enforcement

Whether State law conflicts with the PHS Act will depend on how the State law is worded. Section 2723(a) of the PHS Act specifies that State law will generally be preempted only if it "prevents the application of" a provision of Title XXVII of the PHS Act. As explained in HCFA's bulletin "The Relationship of Certain Types of State Laws to the Application of the Guaranteed Availability Requirements of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) in the Small Group Market," Program Memorandum/Insurance Commissioners/Insurance Issuers, Transmittal No. 00-03, June 2000, State law "prevents the application" of a PHS Act provision if the State law makes it impossible for an issuer to comply with Title XXVII. If a State law simply permits but does not require an action that is prohibited under Title XXVII, the State law would not be applicable. The issuer simply could not take advantage of the State law provision.

We note, however, that States are given the authority to implement the provisions of Title XXVII, as long as they do not fail to substantially enforce those provisions. HCFA will consider all facts and circumstances in determining whether there is such a failure. If, for example, a State law uses the term "eligible employees" in a way that might be considered to be preempted by Title XXVII because it excluded some employers from the definition of a "small employer," but a permissible definition of "eligible individuals" under section 2711(a)(2) of the PHS Act, or a permissible participation rule could be applied to exclude the same employers, HCFA might be less likely to find that there was a failure to substantially enforce.

IV. State Laws Governing Group Participation Requirements

Group participation rules are permitted under many State insurance laws, either by explicit reference or implicitly through the absence of a prohibition. Most of the States have chosen to regulate participation requirements. Generally, a State that has a small group guaranteed availability requirement seeks to ensure that issuer participation requirements do not make it too difficult for employers to obtain coverage. For example, a State law may specify the maximum participation level that an issuer can require. It is common for State laws that address participation requirements to specify that an issuer's rule cannot require the participation of more than a specified percentage (frequently 75 percent) of "eligible employees." We believe that this is consistent with section 2711(e) of the PHS Act, which states that the guaranteed availability requirement of section 2711(a) of the PHS Act should not be construed to preclude an issuer from establishing group participation rules, "as allowed under applicable State law."

Examples of State Participation Requirements

Some States apply participation requirements that are based on the NAIC's Small Employer and Individual Health Insurance Availability Model Act. The Model states that an issuer may not require a minimum participation level greater than 100 percent of eligible employees working for groups of three or less and 75 percent of eligible employees working for groups of four or more; and the issuer is not permitted to include certain individuals, such as those with other health coverage, within the total number of eligible individuals used to calculate participation requirements.

Other States apply participation requirements that do not permit issuers to impose different participation rules on different size small employers; however, issuers are allowed to include individuals who have other coverage within the total number of eligible individuals. States that have adopted requirements that prohibit the counting of eligible individuals who have other coverage (whether or not based on the NAIC Model Act) obviously are more protective of small groups. We applaud States that have done this. However, we do not believe that the definition of a participation rule in section 2711(e) of the PHS Act precludes an issuer from including individuals with other coverage in the denominator of the minimum participation calculation. Thus, a State law which permits the inclusion of such individuals is not preempted.

Where to get more information:

The regulations cited in this Bulletin are found in Parts 144 and 146 of Title 45 of the Code of Federal Regulations (45 CFR § 144 and 146). Information about HIPAA is also available on HCFA's website at http://hipaa.hcfa.gov.

If you have any questions regarding this Bulletin, call the HIPAA Insurance Reform Help Line at (410) 786-1565.