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House Committee on Small Business

"Making Health Care Reform Work for Small Business"

September 18, 2008

Thank you, Chairwoman Velazquez, for the opportunity to testify before the House Committee on Small Business to discuss policy solutions aimed at providing small businesses and their employees with access to affordable health care. I am appearing today as Executive Director of The Coca-Cola Bottlers' Association (CCBA), which represents 73 bottlers and 87,000 employees in all 50 states. I have also previously served as President of the Association Health Care Coalition (TAHC), a coalition of trade and professional associations that is committed to improving the health care options available to their small business members and testified in 2004 and 2005 on behalf of both CCBA and TAHC before both this Committee and the Senate Committee on Small Business & Entrepeneurship on various options for solving the health care challenges facing small businesses and their employees.

I thank you not only for the invitation, but more importantly for your leadership and support of innovative solutions to the small business health care crisis, including your sponsorship of HR 6582, The Small Business Health Care "CHOICE" Act of 2008. I also commend Congressman Pitts for his leadership in joining you as the lead cosponsor. For reasons which I will outline, I believe that the CHOICE Act will dramatically expand the affordable options available to small businesses and will make a sizable contribution toward solving America's health care challenges, probably to a degree that is far beyond the expectations of most, who may only see it as a first step toward health care reform. To a significant degree, and for the reasons that I will articulate below, I think it will eventually be viewed as the centerpiece of a marketplace-oriented, bipartisan solution to a problem that has plagued us for at least two decades—the challenges associated with providing affordable health care primarily through the workplace in an economy in which small businesses are the job creation and growth engine.

Before I specifically address this groundbreaking bill, I would like to provide you some background on CCBA's experience with health care insurance programs, its learning from participation in other insurance markets, and its efforts to develop new solutions for its members, many of which are prototypical small and mid-sized businesses, but some of which are very large businesses. That experience has taught us a lot about the very different challenges facing small businesses and larger businesses in providing health care to their employees and the forces that have driven increases in the ranks of the working uninsured, almost all of whom are employed by small businesses that would like to provide competitive health benefits. It also demonstrates the genius of a creative solution in the form of the CHOICE Act.

Coca-Cola Bottlers' Association Health Care Plans

For nearly 100 years, the CCBA has sponsored programs for our member bottlers. For most of that period, medical and other benefit programs have been one of our core offerings. We historically administered two separate health care plans: a fully-pooled program for small bottlers under 100 employees; and another individually experience rated program for those bottlers with over 100 employees. Both programs were fully insured, but involved various levels of risk retention by CCBA and its members.

Until 2000, CCBA's small member health care plan was able to significantly reduce the cost of insurance by combining over 60 small employers who participated in our fully pooled program with administrative costs of approximately 7%. This fully-pooled program for small employers (under 100 employees) was disbanded at the end of 2000 due to the overwhelming complexity of state small group reform laws and regulations. These well-meaning but complex and expensive laws caused virtually all insurance companies to cease participating in multi-state arrangements due to their reluctance to navigate the myriad individual state premium and coverage requirements for small employers.

Since then, health insurance premiums for our smaller member bottlers have increased from 20% to 25% annually. Further, their plan offerings have increasingly utilized higher copays, higher deductibles and higher annual out-of-pocket maximums. These changes have greatly reduced the employees' participation rates, effectively pricing 50% of the employees out of insurance and increasing the number of uninsured employees.

While CCBA was forced to disband our benefit plan for small employers, we have been able to continue operating the health plan for the benefit of our larger employer members (Coca-Cola bottlers with more than 100 employees). While our small employer members have incurred **20% to 25% annual** premium increases, our large employer members have been able to continue benefiting from the cost-saving efficiencies of participation in the CCBA plan, with average annual premium increases approximately equal to, or in some cases less than, the market average. Our large employer program also provides stability of plan design offerings and long term carrier contracting that enables access to a consistent provider panel enabling fewer provider **–** patient disruptions. We face vigorous competition in retaining those larger members, however, because they always have the option of switching to a self-insured/self-funded program and avoiding the additional costs associated with state regulations because of the applicable ERISA preemption for large employer self-funded programs. In other words, we often compete successfully for this business (particularly for members with 100 to 500 employees, which are not pursued as aggressively as larger members), but on an uneven playing field.

The Realities of the Small Group Health Insurance Market

This imbalance between the options available to our large and small members is reflective of the market imbalances facing large and small businesses. The implications of that imbalance become apparent upon examination of the basic economics of health insurance.

Attached to my testimony is an analysis prepared for CCBA by Mercer concerning the relative costs of the components of health insurance costs for small, medium and large employer groups. As it shows, non-actionable claim costs (the actual amounts necessarily received by providers of medical services) are roughly equal for small, medium and large groups. Other costs, such as administrative and risk underwriting expenses, are dramatically different depending on the size of the employer or group. "Actionable" claims (claims that can be managed in a way to achieve lower costs) and broker commissions are only modestly different.

Importantly, as the Mercer analysis shows, the amounts paid to providers for medical services are only slightly more than two-thirds of total costs in the small group market. In my view, any solution to the health care challenge facing small business and its employees (which is a large part of the overall health care challenge) must significantly shrink those hundreds of billions of dollars in non-provider costs, since they are not likely to be affordable to any of the players (the small business community, its employees, or the federal government and the federal taxpayer).

The two components that drive the greatest disparities and the greatest incremental costs for small business (administrative and underwriting risk expenses) must be the focus of any reform-based solution if that solution is to be effective. For a small group or small business, administrative costs are generally greater because the costs of setting up an insurance program, deciding on benefits, communicating benefit selections, enrolling employees, establishing a claims management process and processing rules that fit with the program benefits, etc., all tend to be fixed costs that drop on a per employee basis as those costs are spread across larger groups.

One solution to that administrative challenge, of course, is to pool smaller groups of individual employees into larger multiemployer groups under a common program to further spread those costs, such as through a pooled health care plan like CCBA's. Many such plans were built in the 80s and 90s, but virtually all multi-state plans, like CCBA's pooled small bottler plan, eventually forfeited the pooling administrative cost benefit because generally well-intentioned state regulations and coverage mandates forced the plan administrators to design distinct plans and distinct claims processing rules for every state (and in CCBA's case, nearly every different small bottler participant).

If state prerogatives are to be preserved, driving somewhat higher administrative costs for small businesses that band together to create scale in their own programs, how can Congress (or the marketplace) provide the solution that will deliver competitive total costs to small groups and small employees? One frequently discussed solution is to allow a government agency or other federally sponsored organization to negotiate on a national basis on behalf of small businesses with the major insurers to achieve the best possible rates for all eligible small businesses.

That approach (which essentially involves creation of pooled market power among buyers to counteract the perceived market power among sellers and thereby eliminate any excess profits collected by the sellers) has some promise to the degree that the source of the disparity in costs for large groups and small groups is the lack of bargaining power in the hands of the small group. To the extent that the disparity is driven by true cost differences in servicing large businesses and small businesses, and not differences in insurer profitability, however, even a massive coalition of small businesses is not going to achieve major savings.

My suspicion is that while some savings in administrative charges might be accomplished, national pooling will not close the majority of the approximately 13% gap in program administrative expenses for large and small groups, as reflected in the Mercer analysis. Some of those differences are reflective of real costs, largely driven by the costs of complying with state laws in dealing with multi-state groups of small businesses.

One very reasonable solution is to simply provide federal financial support to small business programs, given that a major source of their disadvantage is that federal law puts them at a disadvantage relative to large employees by exempting large single employer programs from state regulation while leaving small business subject to the same regulations even if they pool their coverage with other small businesses to create the same scale. While many in Congress are appropriately reluctant to use federal tax receipts to provide subsidies to particular categories of employers, I believe that the philosophical argument against those subsidies is not particularly strong when the subsidies are intended to counteract economic disadvantages resulting from state and federal regulations that have differential (and detrimental) economic impacts on the recipients of the subsidies.

I would also note that some form of financial support for the small business community is almost certainly necessary to create fundamental fairness in an environment in which many believe (and some states have required) that businesses provide mandated levels of coverage to their employees. The fair choice is to support small business financially if we believe that they should provide health care benefits to their employees, but face incremental costs in doing so because of an imbalanced regulatory environment.

Insurance Markets and Risk Shifting Costs

Moreover, an effective solution to the challenges facing small business and small groups also needs to address the second other major source of cost disadvantage, namely the much larger price that small businesses pay for risk retention services provided by insurance carriers. The reasons for that disparity are fairly obvious, since insurance carriers are in the business of understanding and pricing the risks that they take and fully realize that risks get smaller and smaller as they are spread across larger and larger pools of policyholders.

CCBA has extensive experience in dealing with pricing and pooling of insurance risks, both in its dealings with health insurance carriers, but more importantly in its even more extensive experience in dealing with property and casualty insurance, since CCBA has been operating in that liability insurance arena throughout its nearly 100-year history. In our experience, the key to achieving savings on risk underwriting costs is to pool and retain those risks to the maximum extent possible, rather than relying on market and pricing mechanisms to mitigate those costs.

Although carriers create pools for small plans, these pools have typically been ineffective in keeping costs down and do not necessarily reflect the size of the pool; they also tend to have a disproportionate amount of bad risk in the pools and that also varies by carrier and by state. These pools tend to have much higher annual increases than experience rates plans that are not placed in pools. Typically, the actual experience of a business is going to be better than the carrier's pooled or manual rate (which is what the small business rates typically are).

The simple truth is that insurance carriers are in the business of pricing risks to generate profits for their shareholders. That is entirely natural and is simply reflective of the appropriate behavior of any participant in capitalistic markets. To some extent, carriers are able to price those risks efficiently and still generate profits because of their ability to spread the uncertainty associated with underwriting projections over such large groups of policy holders that the uncertainty risk becomes minimal.

For the business that seeks to obtain health coverage for its employees, the profit generated by the carrier in assuming part of the risk associated with writing health insurance policies is simply an additional cost. Its objective is to help its employees by relieving them of a part of the burden of unanticipated health care costs that they cannot afford, while reducing the risk that they are taking as employers and businessmen or women to a level that their business can potentially afford.

The solution for large businesses, in both the health care arena and in many other forms of risk management traditionally managed by individual and small businesses through insurance markets is through self-insurance and risk retention. Captives are often an effective vehicle for isolating and managing those retained risks and often provide some financial reporting and tax benefits by allowing those costs to be spread over the long time periods when they are likely to be recognized, rather than allowing financial results to swing significantly based on the timing when those unpredictable risks are actually realized. In either event, the large business avoids paying the profit that the carrier understandably must make if it is to take on that risk.

Our experience is that the same solution works equally well for small businesses. By combining with other businesses that face similar risks (or in some case totally unrelated businesses), to form cooperatives or multi-parent captives, and then retaining as much of the risk as is reasonably possible, small businesses can reduce insurance costs by minimizing the amount of actual risk that they attempt to shift to carriers, thus reducing the profit premium that they must pay to shift that risk.

Outside the health insurance arena, CCBA has implemented that strategy by forming its own liability insurance captive and retaining as much risk as possible within that captive. Nearly 30 years ago, CCBA began retaining some of the liability insurance risk that it had purchased from commercial insurers on behalf of its members within that captive, sharing the insurance premiums with the carriers and investing the premiums to generate further capital within its captive.

Over time, CCBA has built up the reserves contained in that captive through premiums received by its members and has taken on more and more of the insurance risk traditionally assumed by commercial insurers. As those reserves have grown, CCBA has been able to return much of the premium to its members in the form of renewal credits, while still pricing the coverage at highly competitive levels. In effect, CCBA has collected enough in premiums to cover both claims and the profits that a commercial carrier would expect to retain and distribute to its shareholders. Instead of retaining those profits, CCBA has instead returned them to the participants in its programs, reducing program costs. In 2007, CCBA was able to provide renewal credits amounting to over 25% of the normal premiums charged for its liability insurance programs.

The same solution can and will work within the health insurance arena, not only for CCBA and its members, but for other groups of small businesses. If, as the Mercer analysis indicates, that risk shifting cost is nearly 10% of the total cost of health insurance, CCBA or other organizations pooling groups of small businesses can reduce that cost to a very small number (or zero) over time, by simply pooling and retaining the risk. In order to do so, however, significant pools must be created (since short term fluctuations associated with risk retention for small groups would present too much risk) and other forms of cost disadvantages must be neutralized. Elimination of other cost disadvantages is critical because the only responsible way to manage pooled risks within a captive is to charge a market price for the risk at the inception and return the profits over time, because the captive must be capitalized at a level that can absorb unexpectedly adverse results in the early years; it is very unlikely that potential participants will be willing to be patient about receiving those risk retention benefits if they are paying higher costs for other components of the insurance "package" while they are waiting for risk retention benefits.

<u>The HR 6582 Solution</u>

Against this background, the CHOICE Act works almost perfectly against the major drivers of costs and cost disparities. It is faithful to core federalism principles and requires that covered programs be fully insured and also comply with all applicable state laws concerning mandated coverage and other state insurance regulations. While that recognition of the prerogatives of the states will leave in place the administrative cost disadvantages that make pooling of coverage for multiemployer groups small businesses so difficult, the CHOICE Act proceeds to solve that disadvantage by providing an offsetting federal tax credit for the small business employer, provided that certain reasonable requirement are met (employer subsidies of a reasonable portion of the cost and inclusion of a wellness program).

After putting the small business cooperative program on a reasonable competitive footing from a cost perspective, the CHOICE Act proceeds to call for a quid pro quo which actually works as a second benefit, by both requiring and enabling formation of a cooperative and captive to reinsure substantial individual claims. One obvious rationale of that feature is to assure that catastrophic claims by individuals insured within the program remain covered and are not excluded because the carrier is unwilling to cover or provide affordable pricing for employers and their employees that present obvious and known risks (the "lazering" process that CCBA and its members have sometimes faced). At least as importantly, however, the cooperative requirements provide incentives and opportunities for small businesses and their trade associations or other partners to not only cover catastrophic claims, but to retain most of the risk associated with health insurance programs, by retaining all individual risks exceeding $10,000 annually.

The incentives provided by the CHOICE Act will also work to reduce many of the other costs disadvantages facing small businesses, by allowing formation of relatively large pools of lives relatively quickly. In CCBA's case, we believe that it would allow us to re-form our small bottler program within a very short period of time and to restore the competitive benefits that we were once able to provide to those bottlers, perhaps on even more favorable terms. We also anticipate that we can successfully extend the program into similar businesses within minimal additional work. Indeed, we believe that, over time, we will be able to make that program extremely attractive for even bottlers and other businesses that are not eligible for the tax credit because they have more than 100 employees (our captive-insured liability programs work very successfully for somewhat larger business). In those cases, we believe that we be able to provide more affordable insurance coverage and reduce the ranks of the uninsured without any expenditure of federal tax dollars to support the particular medium sized businesses that might participate.

Collateral Benefits Derived from Promoting a Role for Associations in Health Care Benefits

Bona fide trade and professional associations are established and run by their employer members and exist for the sole purpose of serving the needs of their members and members' employees. Bona fide associations, including national, regional and state-based associations, have been a vital source of health coverage for millions of American workers employed in small businesses for decades. They must be part of any health care solution for it to be effective, because they provide the expertise, support and infrastructure needed by the small business community to effectively tap the opportunities that will flow from any form of meaningful health care reform.

Associations are uniquely structured to be part of our healthcare delivery system. Because they are established to represent their members in other areas, they possess the infrastructure, administrative mechanisms, and experience needed to unify employers and employees into effective consumers of health services. By serving this need for small employers, associations add value to our health care system as a whole, as well as to their members.

In our own case, we go considerably beyond simply building a program that our members can use. With the help of our consultants and insurance partners, we work closely with our members to develop and implement wellness programs for their employees. We also provide a critical role in providing support from a trusted and familiar source to our members and their employees in making the right choices that will help them manage costs and avoid behaviors that tend to drive up those costs, through smoking cessation, weight management and other similar programs.

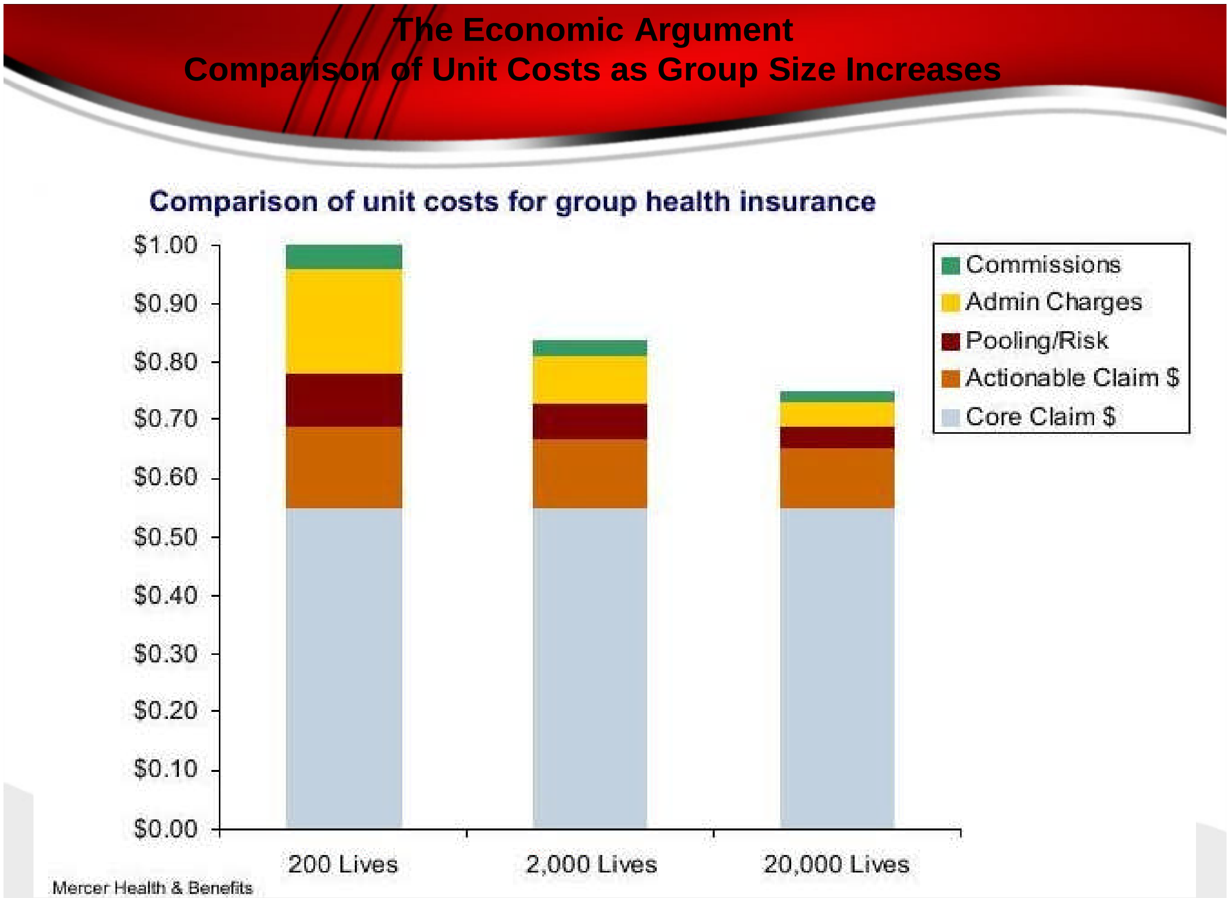
Conclusion

As a strong believer in the superiority of market-oriented, rather than public sector driven, solutions to policy challenges (all other things being equal), I would like to add a footnote to my comments that is directed at others that share that belief. The CHOICE Act does involve the investment of federal tax dollars (whether viewed as a tax credit or a subsidy) to the problem of declining access to affordable health benefits for our nation's small employers and their associates. That should not deter any fiscal conservative from providing their enthusiastic support to the Act, because it represents the type of investment that will deliver huge returns to the public because of the way in which it will affect the markets for the delivery of health care and health insurance. Beyond the direct role that it will play in promoting the formation of small business cooperatives, it will also open up the carrier market in that more carriers will be willing to quote on the business (because their own potential exposure will be mitigated by cooperative reinsurance), thus creating market competition that can further drive costs downward.

As noted above, the cooperatives that it will "seed" will take billions of dollars in costs out of the system that are not reaching the hands of providers of health care services. By restoring the current imbalance between small and large employers it will place those employers on more equal footing in recruiting new employees and in competing in the marketplace for the goods and services that they produce and sell. Small business has always been the engine of innovation and entrepeneurship in America (as well as job creation) and restoring competitive balance will generate long term returns in nearly every arena imaginable.

Moreover, the tax credits provided under the CHOICE Act are not, at their essence, incremental public expenditures. By significantly reducing the ranks of the uninsured, market-based reform (and federal spending) that empowers small business to provide quality health care benefits (including preventative care) will reduce the cost of uncompensated care by providers and will shrink total health care spending. Moreover, unlike many other type of public programs, which are unable to deliver a dollar in benefits to the intended targets because of the administrative costs associated with program administration, the CHOICE Act will require minimal administration and will drive market forces that will deliver tens or even hundreds of dollars in benefits to its targets for every dollar of tax revenues expended. In my view, it is a paradigm for the kind of federal spending that should be embraced, and not questioned, by fiscal conservatives.

Thank you again Madam Chairwoman for the opportunity to share my views and the experience of CCBA and other similar trade associations in supporting the small business community in providing quality health care benefits.


The Economic Argument
Comparison of Unit Costs as Group Size Increases
Comparison of unit costs for group health insurance
$1.00
$0.90
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Commissions
Admin Charges
Pooling/Risk
Actionable Claim $
Core Claim $
200 Lives
2,000 Lives
20,000 Lives
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