
Data Watch

Small-Business Health Insurance: Only The Healthy Need Apply

by Wendy K. Zellers, Catherine G. McLaughlin, and Kevin D. Frick

Several private and public programs and countless proposals have targeted the estimated twenty-two million full-time workers and their dependents who lack health insurance.¹ Most of these programs rely on financial incentives designed to encourage employers to provide health benefits to their employees. Unfortunately, because of existing insurance company underwriting practices, incentive-based programs would miss a significant proportion of uninsured workers. This is particularly true for employees of small businesses, which are more susceptible to these practices.²

To date, reports of the barriers faced by small businesses have been based largely on anecdotal information about the underwriting practices of health insurance companies. In our study of health insurance benefits in small businesses, undertaken as part of our evaluation of The Robert Wood Johnson Foundation's (RWJF's) Health Care for the Uninsured Program, we surveyed health insurance companies and agents. We found strong evidence to support the assertions made by several small-business interest groups that insurance companies routinely use a variety of underwriting techniques to control the amount of financial risk to which they may be exposed in the small-business market. One of the largest companies doing business in this market summarized its underwriting guidelines: "Insurability is determined by many factors, including the nature of the business . . . , and most importantly, the good health of all employees and dependents."

Redlining. Enrollment of high-risk firms is limited through a practice known as redlining, in which specific types of industries are considered ineligible for enrollment, at any premium. Redlined industries include those characterized by an older work force (over age fifty-five) or high employee turnover, those engaged in seasonal work or exposed to hazardous working conditions, those lacking an employer/employee rela-

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tionship, and those “known to present frequent claims submissions.” In some insurance companies, a plan is available to high-risk firms, but with substantial premium surcharges added or with various restrictions on enrollment or coverage imposed.

Preexisting conditions. Enrollment by high-risk individuals is curtailed through the imposition of preexisting condition exclusions. These generally apply when one or more individuals in a group have a chronic, potentially expensive condition at the time of application or have had an illness thought to predict future costly use of care. The insurer can refuse health insurance to the whole group, impose a substantial surcharge on the premiums of all members in the group, or refuse to write a policy for the high-risk individual(s). Many insurers restrict coverage by stipulating that benefits for conditions for which an individual required medical treatment within a specified time period prior to initial enrollment (usually six or twelve months) will not be payable until the individual has been enrolled for six to twelve months. Some of these rules can be applied whether the policy is a new contract or simply a renewal of an expiring prior agreement.

Redlining and preexisting condition exclusions constitute a major problem for many small firms; approximately 15 percent of small firms fall into industries that are routinely redlined.³ Preexisting condition exclusion—particularly excluding an entire firm because of one employee’s health status—is a practice reserved almost exclusively for small businesses (those with fewer than ten or fifteen workers).⁴

Study Methods

Using a semistructured telephone interview, we surveyed forty-five insurance companies and thirty-seven agents in July and August 1991. We surveyed ten of the largest national companies in the small-business health insurance market and a sample of health insurance companies and agents in four sites: Pima County, Arizona (Tucson); Hillsborough County, Florida (Tampa); Genesee County, Michigan (Flint); and Denver/Boulder, Colorado. These sites were four of the nine areas where a project sponsored by The Robert Wood Johnson Foundation marketed a health insurance plan designed specifically for small businesses. We had surveyed small businesses (that is, firms with two to twenty-five persons working at least seventeen hours per week) in these four locales the previous summer as part of a larger evaluation of the RWJF Health Care for the Uninsured Program.

The sampling frames for the insurance companies and agents were provided by several sources, including Chartered Life Underwriters, the Association of Health Insurance Agents, state insurance offices, local

Chambers of Commerce, and individuals familiar with the local small-business health insurance market. We also received a list of the ten insurance companies with the largest small-business market share nationwide. We contacted all of the health insurance companies and random samples of agents on the various lists we received.

Only nine of the fifty-four insurance companies we contacted refused to respond. Flint, Michigan, the smallest of the four sites, has few insurance companies selling small-business health plan policies. Four of the local companies represented Blue Cross and Blue Shield plans. Of the eleven companies responding to our survey in Tampa, five do not sell health insurance benefits to companies with fewer than twenty-five employees. Approximately half of the agents we contacted participated in the survey.

The interviews averaged twenty minutes and addressed such issues as (1) how long they had been writing health plan policies in general and for small businesses in particular; (2) the minimum and maximum size of businesses to which they sell policies; (3) the types of plans available to small businesses; (4) employee eligibility criteria; (5) compulsory employer contributions; (6) differences in the premiums charged for large and small businesses; and (7) whether the respondent believes small businesses have difficulty purchasing health insurance and why. These questions led to discussions about restrictive enrollment standards that could result in preexisting condition exclusions and redlining.

We also received marketing materials and underwriting guidelines for thirty-two companies. For thirteen companies, this material included information on industry redlining and restrictions. Two of these companies did not list firms or businesses that would be ineligible but rather provided a list of businesses they call "restricted." For several types of businesses, a precise definition of the restrictions was not included. One company specified a list of businesses to which premium surcharges apply. In addition to giving general preexisting condition rules, which were explained in all cases, four of the company's pamphlets included lists of specific preexisting conditions.

Results

Redlining. Barriers for small businesses in the health insurance market are quite pervasive. The overwhelming majority of company representatives (91 percent) and agents (73 percent) that we interviewed indicated that small businesses face problems when trying to purchase a health benefit plan. Approximately two-thirds of the company representatives and virtually all of the agents said that their company excluded certain industry types. Several respondents gave general catego-

ries of excluded industries, most frequently “high-risk,” and “hazardous,” but over two dozen specific industries were named by fifty-seven of the respondents as examples of industries excluded by their company or plan for small-business health insurance.⁶ The two most frequently mentioned were lawyers (too litigious) and physicians (high utilization) (Exhibit 1).

In addition to examples provided in the interview, thirteen of the plan descriptions that we received included specific types of businesses considered either ineligible or restricted. The types of businesses most frequently excluded illustrate the underwriting practices of most insurers. For example, hair salons were described to us as representing a “triple threat”—high employee turnover with little interest in long-term employment, a high proportion of women of child-bearing age, and a high proportion of homosexual men. Bars, taverns, and liquor stores, considered ineligible by ten of the plans, are perceived as bad risks because of high employee turnover and hazardous or unhealthy working conditions. In some cases, the risk being avoided is quite obvious. For example, one company writes health insurance policies for bakeries and confectioners but considers them ineligible for dental coverage.

Exhibit 1
Health Insurance Industry Redlining Practices

Industry	Number of plans listing industry as		Number of respondents listing industry as ineligible
	Ineligible	Restricted	
Bars and taverns	10	3	12
Entertainment businesses	9	4	7
Mining and quarrying	9	3	7
Bus, limousine, and taxi services	8	3	0
Hair salons	7	3	16
Fishing industries	7	0	0
Logging and sawmills	7	3	0
Barber shops	6	4	3
Detectives, security guards, and collection agencies	6	3	0
Explosives manufacturing and distributing	6	2	2
Hospitals	6	5	2
Liquor stores	6	2	2
Government agencies and municipalities	5	5	0
Junkyards and salvage firms	5	4	1
Law firms	5	2	19
Nursing homes	5	1	0
Trucking firms			5
Restaurants	:	3	14
Physician groups	2	6	19

Source: Survey of insurance companies and agents, 1991.

Even when considered eligible for coverage by some plans, this kind of industry is often labeled as “restricted.” These restrictions normally include a sizable surcharge and sometimes include limits on coverage (for example, only a high copayment option) or employee eligibility (for example, coverage may be available on a “management only” or “office/clerical only” basis). In certain instances, the difference between ineligible and restricted was not clear (one insurer considers hair salons an ineligible industry and barber shops a restricted industry, with a note to “contact your Customer Service Representative for details”).

Small businesses’ access to health insurance is compromised not only by explicit underwriting guidelines but also by implicit reluctance on the part of insurers and agents to market plans to certain small businesses. Several respondents made the distinction between offering a plan and marketing a plan. In addition, agents pointed out that quoting an exorbitantly high premium was one way to eliminate undesirable applicants without having to deny coverage.

Included in virtually every pamphlet’s discussion of eligibility was the caveat that these lists are not inclusive and that the insurance company reserves the right of refusal to any application not meeting underwriting criteria. In some cases, firms are denied coverage because one or more employees or their dependents have a preexisting condition. When asked why small businesses have difficulty obtaining health insurance, 80 percent of agents and 67 percent of company representatives cited preexisting conditions or “health problems.”

Preexisting condition exclusions. All of the twenty-two plans for which we received application information required every employee to fill out a detailed personal and family medical history and, in some cases, to submit to a physical examination. Company policies regarding preexisting condition exclusions were summarized in the literature we received from some respondents. All of these respondents mentioned several conditions that could result in denial of the application of an individual or firm: acquired immunodeficiency syndrome (AIDS) and AIDS-related conditions, cancers (blood, lymph, bone, soft tissue, and organ malignancies), heart disease (including aneurysm, myocardial infarction, and bypass surgery), and degenerative nerve disorders (multiple sclerosis and muscular dystrophy). All of the plans had provisions for preexisting condition rules, with the standard time window of twelve months before enrollment for defining a preexisting condition and twelve months after enrollment for establishing coverage eligibility. Some policies, however, specified certain conditions that would never be covered; one plan labeled these “unacceptable medical conditions,” for which no coverage can be provided. This plan mentioned twenty-one conditions but specified that this list was not all-inclusive.

Our survey revealed some disparities in the underwriting practices between national company headquarters and local company offices. For example, several national companies stated that they did not exclude applicants because of type of business or preexisting health problems, yet the local offices gave us a list of exclusions. In several cases, the differences between national and local practices were the result of state-based variation in insurance laws. About half of the states have passed laws that prohibit insurance companies from enforcing preexisting condition rules on individuals who are renewing a current policy or transferring from one insurance company policy to another.

Policy Implications

Underwriting practices may discourage small employers from shopping for a better insurance value or employees from shopping for a better job. In addition, hiring practices of small employers may be influenced by whether or not the health status of a job applicant could threaten the premium rate for or the insurability of all the people in the firm, leaving some perceived “uninsurables” also unemployable.

Because of current underwriting practices, some small businesses would find it difficult to respond to any financial incentives or government mandates to provide health benefits to their employees. According to representatives interviewed, seven of the nation’s ten largest insurers in the small-business health insurance market routinely exclude certain types of small businesses, and all of them exclude, where state law permits, individuals or their firms because of preexisting conditions. Approximately 15 percent of small businesses fall into categories that are considered ineligible or restricted. No estimate is available of the number of businesses and individuals denied coverage because of the adverse health problems of an employee.

Although most health insurance companies reject the applications of specific types of firms and individuals, some do not. Also, not all companies identify the same high-risk firms or conditions. Therefore, even though a small business may face difficulties finding insurance, plans are almost always available to that business. However, for some high-risk businesses, the price they face as a result of premium loading represents an effective obstacle to the purchase of a health benefit plan.⁷

Top advisers in the Bush administration are proposing changes in the regulation of small-business insurance as part of their health reform strategy. Most of the reform proposals being discussed recommend eliminating preexisting condition exclusions. However, few recommend eliminating an insurer’s ability to consider a particular type of business ineligible based on perceived risk.⁸ Even if underwriting practices are

altered, the premium loading that is assessed most “high-risk” businesses represents a form of de facto exclusion. It is likely that substantial financial incentives for these businesses will have to accompany any legislation that mandates employer-based health insurance.

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NOTES

1. PF. Short, A.C. Monheit, and K. Beauregard, *A Profile of Uninsured Americans*, National Medical Expenditure Survey Research Findings 1, DHHS Pub. no. (PHS) 89-3443 (Rockville, Md.: U.S. Public Health Service, September 1989); and R.J. Blendon and J.N. Edwards, “Caring for the Uninsured: Choices for Reform,” *Journal of the American Medical Association* (15 May 1991): 2563–2565.
2. National Federation of Independent Business, “NFIB News: Small Businesses Will Choose Layoffs, Shutdowns if Forced to Offer Health Benefits, Survey Shows” (Washington, D.C.: NFIB, 19 July 1989); National Rural Electric Cooperative Association, *The NRECA Survey of Health Coverage in Smaller Firms: Evidence and Policy Implications* (Washington, D.C.: NRECA, June 1988); and “Mandated Health Benefits-Pro/Con Split along Familiar Lines,” *Federation of American Health Systems Review* (May/June 1989): 39–42.
3. Colorado Department of Regulatory Agencies, Division of Insurance, *Health Insurance Availability and Affordability in Colorado: A Report on Underwriting and Pricing Practices* (Denver: Division of Insurance, 1990). Estimates calculated from data available from *County Business Patterns* (U.S. Department of Commerce, Bureau of the Census, 1987).
4. D. Stone, “Preventing Chronic Disease: The Dark Side of a Bright Idea,” in *Chronic Disease and Disability: Beyond the Acute Medical Model* (Washington, D.C.: National Academy Press, 1990), 83–103.
5. A total of forty-five companies and thirty-seven agents completed interviews, as follows. Tucson: eight companies, ten agents; Tampa: eleven companies, eight agents; Flint, four companies, nine agents; Denver, twelve companies, ten agents; and ten national companies.
6. In spite of mandatory workers’ compensation laws in each state, a relatively high probability of work-related accidents or illnesses is a key reason that many industries are considered ineligible. Most insurers we interviewed do not think workers’ compensation plans adequately protect them from medical claims arising from work-related illness or injury.
7. C.G. McLaughlin, “The Dilemma of Affordability: Private Health Insurance for Small Businesses,” in *American Health Policy: Critical Issues for Reform*, ed. R. Helms (Washington, D.C.: American Enterprise Institute, 1992).
8. J. Hoadley and J.M. Jones, “Regulating Health Insurance in the Small-Group Market: Proposals to Increase Availability and Affordability,” National Health Policy Forum, Issue Brief no. 581 (Washington, D.C.: The George Washington University, 1991).