

December 9, 2011

Hon. Kamala D. Harris  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Dawn McFarland  
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 11-0060) to impose primarily consumer protection-related requirements on health insurers, as defined broadly by the measure.

## BACKGROUND

**Health Insurance.** Broadly speaking, health insurance can be defined as a system for the advance financing of medical expenses—incurred mainly by enrollees of Health Management Organizations (HMOs), Preferred Provider Organizations (PPOs), and indemnity health insurance arrangements—through payments made by persons, businesses, or other entities into a common fund used to pay for an agreed upon set of health services, goods, and medical supplies. Health insurance may apply to a broad or limited array of medical services and may provide for full or partial payment of their costs.

Health insurance comes in many forms. Two of the most common types of health insurance arrangements in California are as follows:

- **Health Maintenance Organization.** An HMO, referred to as a health plan, is responsible for providing medical services to enrollees who prepay a fixed amount usually on a monthly or yearly basis. The HMOs often contract with risk bearing organizations (RBOs), such as physician groups, to provide health services to enrollees for a fixed monthly payment. Through these contractual arrangements, the RBO assumes a portion of the risk for enrollee health care service costs.
- **Preferred Provider Organization.** A PPO, sometimes referred to as a health plan, is a type of indemnity insurance where the insurer usually agrees to pay medical providers, such as physicians and hospitals, for a portion of the health services related to an enrollee's illness or injury. Payments to medical providers are based on the number and type of services provided to the enrollee. A PPO differs from

other indemnity health insurance policies because it typically contracts with medical providers to provide health care services at reduced rates to the insurer and its enrollees.

There are other indemnity health insurance arrangements offered by insurers, such as catastrophic health insurance, that, although less common than HMOs and PPOs, are available in California.

***Existing Health Insurance Regulatory Structure.*** Two departments are responsible for regulating most health insurance: the Department of Managed Health Care (DMHC) and the California Department of Insurance (CDI). The DMHC regulates HMOs and some PPOs, while the CDI regulates indemnity insurers, including most PPOs. Existing state law imposes a variety of requirements on health plans and insurers in California.

While health plans and insurers are subject to different regulatory requirements, both DMHC and CDI are generally responsible for oversight and enforcement of existing state law and regulations related to health insurance. Some of the regulatory activities performed by both departments include licensing and policy review, monitoring financial stability, ensuring timely and accurate payments to health care providers, responding to consumer complaints, and determining whether decisions of health plans or insurers to deny or limit medical services are adequately justified. Neither DMHC nor CDI has the authority to stop health plans and insurers from increasing the rates they charge to their enrollees. However, both DMHC and CDI review rate information and are charged with identifying “unreasonable” rate increases and making the public aware of them. The departments’ regulatory activities are funded primarily through fees or assessments on the regulated health plans and insurers.

***Consumer Protections.*** Under current law, a number of protections are afforded to consumers both in laws that specifically apply to health plans and insurers and in laws that broadly apply to business practices, contracts, and other areas. For example, business and professions law protects against unfair or fraudulent business practices and deceptive or misleading advertising. Consumer protection laws are mostly enforced by state regulatory agencies and the state Attorney General.

***Taxation of Health Plans and Insurers in California.*** California levies a gross premiums tax on insurers. California levies a corporate income tax on certain health plans based on their net income. Revenues from both taxes are deposited into the state General Fund.

***Health Insurance Purchased by State and Local Governments.*** State and local governments are major purchasers of health insurance in California. For example, through the California Public Employees’ Retirement System (CalPERS), state and local governments pay most of the health insurance premiums for approximately 1.3 million government employees, retirees, and their families. The majority of CalPERS enrollees receive coverage through health plans regulated by the DMHC.

The state and county governments also operate programs that provide health care to qualifying low-income individuals. For example, the 2011-12 state budget provides approximately \$15 billion from the General Fund to provide health care to approximately 7.5 million low-income Californians enrolled in the state's Medicaid program, also known as Medi-Cal. The state contracts with health plans to provide coverage for most of the Medi-Cal enrollees. (The remainder of the enrollees are in fee-for-service Medi-Cal where the state directly pays providers for their services. Fee-for-service Medi-Cal is not regulated by either DMHC or CDI.)

**California Judicial Branch.** The California Constitution vests the state's judicial power in the Supreme Court, the Courts of Appeal, and the trial courts. Trial courts have jurisdiction over all civil cases including family law, probate, juvenile, and general civil matters. Appeals of decisions made in the trial courts may be heard in the Courts of Appeal. Subsequent appeals may be heard by the Supreme Court. The 2011-12 budget provides about \$4 billion for support of the judicial branch, including \$1.7 billion from the General Fund.

## PROPOSAL

Generally, the measure adds some health insurance-related consumer rights, imposes new regulatory requirements on health plans and insurers, and restates some consumer rights already found in current law. For example, under existing law, HMO enrollees have many rights including the right to see their own medical records and ask for an independent medical review of a decision their health plan makes about their care. Under the measure enrollees would own their medical records and their right to independent review would continue. The requirements of the measure apply to: (1) any contract or agreement in which a party promises to pay for, or become liable to pay for, any health care-related services or expense, and (2) any party who, for compensation, assumes any of another person's financial risk for the cost of any health care-related services.

**Measure Imposes Additional Requirements on Health Plans and Insurers.** Health plans sometimes require that a medical professional, such as a physician, obtain prior authorization before the plan will agree to pay for a medical procedure or treatment that the medical professional recommends for a patient. In some instances health plans deny authorization of a procedure or medical treatment thereby limiting medical services. The measure changes some of the procedures for and potential consequences of limiting a medical service. For example, under the measure, the decision to deny or limit a medical service would need to be made by a person with the education, training, and relevant expertise that is appropriate for evaluating the specific issue involved in the denial, thus requiring health plans and insurers to seek more input from specialists when making coverage decisions than would otherwise be required under current law.

Health plans and insurers would also be required to comply with various provisions of the measure aimed at increasing the ease with which consumers could understand the health insurance products marketed by health plans and insurers. For example, health plans and

insurers would be required to provide descriptions, in layman terms, of the products they market and disclose, in layman terms, any limitation in benefits.

***Some Medical Providers Potentially Subject to Additional Regulations.*** Under existing law, RBOs are subject to limited oversight by a health plan/insurance regulator. Under the measure, all statutes and regulations governing the business of insurance may be extended to RBOs, potentially resulting in additional compliance obligations for these entities.

***Expanded State Regulatory Responsibilities.*** The measure largely adds requirements to the Insurance Code, which is enforced by the CDI, but DMHC-regulated health plans are also subject to the provisions of the measure. Thus, health plans may be subject to dual regulatory oversight by both the DMHC and the CDI in enforcing the measure. Additional workload for state regulators that may result from this measure includes, but is not limited to, reviewing new policy forms, suspending licenses for plans or insurers that violate any provision of the measure, and expanding regulatory jurisdiction to include RBOs that are currently subject to limited oversight by a health plan/insurance regulator.

***Most Persons Given Legal Standing to Enforce the Measure Through the Courts.*** With limited exceptions, the measure gives legal standing to any person who seeks to enforce the requirements of the measure (including those that are declaratory of current law) through legal action, regardless of whether the person has been personally harmed by a violation of the measure. This is in addition to state agency regulatory enforcement.

## **FISCAL EFFECTS**

***Scope of the Measure's Application Is Uncertain.*** Depending on the interpretation of the measure, some of the additional consumer rights and health insurance regulatory requirements may apply to other insurance products that are not considered to be health insurance products, such as life insurance. Even if the measure did apply to these other products, it is not clear how its provisions would be applied to them. Furthermore, it is unclear whether the provisions of the measure would apply to health care services provided through fee-for-service Medi-Cal. For purposes of estimating the fiscal effects of this measure, we assume that it would only apply to health insurance regulated by DMHC or CDI. If, instead, the measure applies to other insurance products and state programs, the fiscal effects discussed below would be more pronounced.

***Likely Increased Costs for State and Local Governments Purchasing Health Insurance.*** The measure contains a number of provisions that would likely increase costs for health plans and insurers and therefore impact state and local governments as purchasers of health insurance. For example, some potential sources of increased costs for health plans and insurers include:

- Medical costs from paying for more costly medical services in response to some of the provisions in the measure, including provisions that increase the likelihood of legal challenges to practices of health plans and insurers related to the provision

of medical services. For example, by giving legal standing to persons who are not personally harmed by a violation of the measure, health plans and insurers would likely face a greater prospect of litigation. In response to this threat, plans and insurers may be less likely to deny or limit certain medical services. To the extent this results in plans and insurers covering more medical services, it would likely increase costs for health plans and insurers.

- Legal costs associated with lawsuits that could result from giving legal standing to enforce the measure to an extremely broad universe of persons, including those who are not personally harmed by a violation of the measure.
- Administrative costs from new requirements, such as requiring specialists to be consulted before services can be denied or limited.
- Increased fees resulting from additional DMHC and/or CDI regulatory enforcement costs, which are to be funded largely by fees and assessments on the health plans and insurers.

Some or all of any increased cost to health plans and insurers would likely be passed on to purchasers of health insurance, including state and local governments, in the form of higher health insurance premiums. To the extent this occurs, we estimate these state and county costs would be at least in the millions of dollars annually.

***Likely Minor Net Impact on State General Fund Revenues.*** The net impact of this measure on state General Fund revenues is unknown. On its own, an increase in health insurance premiums on policies issued by CDI-regulated insurers, resulting from potentially increased costs imposed on these insurers by this measure, would generate additional state gross premiums tax revenues. However, if fewer businesses and individuals chose to buy health insurance as a result of such premium increases, then the potentially increased revenues from premium increases would be at least partially offset by a reduction in revenues due to there being fewer enrollees. In contrast, on their own, potentially increased compliance costs resulting from this measure could reduce the taxable income of DMHC-regulated health plans and could therefore reduce state corporate tax revenues to some degree. The net impact of these various potential revenue effects would probably be minor.

***Potential Increase in State Court Costs.*** This measure could result in an increase in the number of civil cases filed in the courts, causing increased court costs to process and hear the additional cases. The magnitude of these state costs is unknown, but could be significant, depending on the number of cases filed and how they are adjudicated by the courts.

## **SUMMARY OF FISCAL EFFECTS**

If this measure is interpreted to apply only to health plans and insurers regulated by CDI and DMHC, it would have the following significant fiscal effects:

- Likely increase in costs to the state and local governments, at least in the millions of dollars annually, associated with increased premiums for government-purchased health insurance.
- Likely minor impact on state General Fund revenues from gross premiums and corporate income taxes.
- Potentially significant increase in state court costs depending on the number of cases filed and how they are adjudicated by the courts.

Sincerely,

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Mac Taylor  
Legislative Analyst

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Ana J. Matosantos  
Director of Finance