Great Expectations

An Analysis of Health Insurance Exchanges Under Health Reform

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WILLIAM LINDSAY, III
President, Lockton Benefit Group, Denver
303.414.6131
blindsay@lockton.com

Background

The Patient Protection and Affordable Care Act (PPACA) of 2010—the federal health reform law— included a provision requiring each state to establish a Health Insurance Exchange by 2014.

States have the option of creating their own Exchange or deferring to the federal government, which will provide one for them.

The Department of Health and Human Services (HHS) has the responsibility of forming a basic framework within which state Exchanges will operate. However, those states that elect to create their own Exchange have a significant amount of latitude in the rules for their Exchange.

Health reform has raised expectations regarding increasing access to, while reducing the cost of, insurance, while simultaneously improving healthcare quality and simplifying the number and types of options available to purchasers, post reform. Unfortunately, the reforms do little to change either the principles underlying the operation of insurance or reduce the cost of healthcare. Therefore, I believe the reforms related to the establishment of Exchanges will have little effect on the overall cost of insurance or the availability of options. Exchanges will bring innovation and change to the market, and many of these changes—as described below—will be positive, but cost reduction and quality improvement will not be part of this change.

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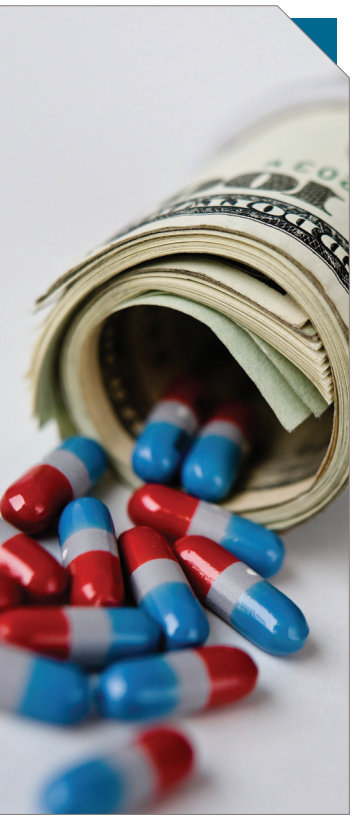
What is an Exchange?

Although the concept of an "Exchange" was first piloted in Massachusetts under that state's 2006 reform effort, the new PPACA Exchanges are not the same as what was developed in Massachusetts.

Massachusetts created a vehicle called a "Connector." The Connector was intended as a means to connect individuals seeking insurance with available options provided by the state or private insurers. The Connector is similar in concept to the PPACA Exchanges, but it is largely focused on the individual market.



Utah has also been down the exchange road. Realizing that the small employer market in many states has been challenging for small businesses seeking insurance, Utah created its Small Employer Health Insurance Options Program (SHOP) to help small businesses. Again, although similar, the Utah model is also not the same as the new PPACA Exchanges. Utah's model focuses primarily on small businesses, but endeavors to connect individuals with private health insurers via links to external websites. Thus, its reach is not as broad as that for the PPACA Exchanges.

The primary value to be provided by an Exchange under the PPACA is to identify individuals who are eligible for a federal premium subsidy, and then to provide a means to distribute that subsidy. Over the years, as health policy experts struggled with how low income individuals would be able to pay for mandated health insurance, the stumbling block was how to distribute a voucher or a premium subsidy to them; should these be sent to the person's home, or to their employer? Each of the options was fraught with challenges related to logistics, the risk of fraud, or theft, and delays due to administration.

Under the Exchange approach, individuals seeking insurance can be evaluated electronically to determine if they are eligible for public programs like Medicaid or eligible for a federal subsidy as provided for under the federal law. The Exchanges also can serve as a way to educate consumers on their available options, the price for each, the plan features, and potentially other comparators such as plan quality or performance.

There are to be two types of Exchanges that will be created in each state. The first is the Exchange geared for the individual health insurance market, like Massachusetts' Connector. The other is a small business exchange (SHOP), like that piloted in Utah in 2009.

> "The Exchanges also can serve as a way to educate consumers."

The Rules

- By January 1, 2013, each Exchange must be certified by HHS. Certification requires the Exchange to demonstrate that it will be "fully operational" prior to open enrollment, which is scheduled to begin in the autumn of 2013. If a State does not establish an Exchange or meet requirements for certification, the federal government will create a federal program for them.
- Exchanges must be non-profit entities or governmental agencies.
- Exchanges must serve both the individual and small employer markets (a small employer for this purpose is defined as an employer of 100 or fewer employees, but states can elect to retain the current, federal definition (in HIPAA) of 50 or fewer, until 2016; by 2017 states must open their Exchanges to large employers as well).
- States can elect to combine their individual and small group markets together, or keep them separate.
- Exchanges must meet minimum federal standards, but states can then create their own rules on top of these minimum standards.

Advantages

The potential advantages provided by the Exchange are numerous:

- An efficient way to provide information in a uniform manner to purchasers.
- An effective way to distribute subsidies to low income individuals.
- An effective way to identify if small businesses applying for coverage are eligible for a federal tax credit.
- A means to help purchasers understand their options.
- A modern means of enrollment using the Internet.
- An efficient way to tie federal tax records with state programs such as Medicaid.
- An efficient way to determine if consumers are eligible for government programs such as Child Health Plan or Medicaid.
- A way to introduce new purchasing and communication modalities to the market, which may improve efficiency and consumer satisfaction.

Opportunities

- The Exchange concept swaps a variable expense in the insurance premium (agent commissions) for a fixed expense (bricks, mortar, and salaries). The fixed expense then has to be amortized over the life of the Exchange and paid for in some manner.
- Exchanges are a core underpinning of the health reform plan, but they are unproven. For Exchanges to operate as envisioned, they will need to be created, tested, and modified.
- Once established through the assistance of federal subsidies, each state Exchange will need to identify ways to pay for itself. Numerous options exist but each of these has significant policy implications (e.g., an assessment on those who use the Exchange, a charge spread over the entire market (those in and outside the Exchange), a surcharge or tax on all employers, etc.).
- To the degree that Exchanges vary widely from state to state, it may make it difficult for small businesses that are multi-state.
- Since the federal rules are designed to allow state experimentation and structures unique to each state, many options exist. However, most of these choices have their own public policy implications, and the impact of each needs to be carefully considered.

Options

States that elect to create their own Exchange have numerous options to consider. A few of these include:

COLLABORATION OPTION

- Whether to collaborate with other states in the creation and operation of the entity. The advantage of collaboration is that less populated states can spread the cost over a broad base. The negative is the loss of a given state's exclusive control of the entity.

> "There is risk the Exchange will experience higher than expected losses, forcing its rates to be uncompetitive."

STAND-ALONE OPTION

- Whether to house the Exchange in state government or have it stand-alone. The advantage of a separate, non-profit is the avoidance of the Exchange being a government program. The negative is the need to establish governance, funding, and accountability oversight for the entity.

FACILITATOR OPTION

- Whether to structure the Exchange as a "purchaser" or a "facilitator." By being a purchaser, the Exchange can bid the opportunity to offer insurance products. A purchaser can thus seek lower than market rates, and can set rules that encourage consumers to obtain insurance through it.
  - The purchaser model has immediate appeal because of the potential to bring leverage to the market, and lower prices. The challenge is the risk to the rest of the market, outside the Exchange, when the purchaser is a government entity that will decide which plans can have access to individuals and small businesses. It also poses the real risk of forcing insurers to subsidize the rates within the Exchange by shifting more cost to those outside of the Exchange, thus eventually destroying the non-Exchange commercial market. Finally, there is also the risk that the Exchange will experience higher than expected losses, forcing their rates to be uncompetitive.

- The "facilitator" approach recognizes that post-implementation, the current insurance market will continue to exist. As a facilitator, the Exchange can offer an option for consumers but without a competitive price advantage. Consumers can thus select the Exchange for its benefits, other than price. This approach avoids the risk that the Exchange gets less advantageous risks, and thus fails.

This approach is more market-based because the rules for insurance company rate setting, renewals, etc., are the same inside the Exchange and out. The result is a level playing field and less risk of adverse selection either to the Exchange or the rest of the market.

SHOP EXCHANGE OPTION

- Initially, SHOP Exchanges' eligibility can increase to employers with up to 100 employees, or employers that remain at 50 or fewer employees until 2016.

The advantages of going larger (to 100) initially are:

- The ability to gain more market share right away and thus make it easier to gain market acceptance while also spreading the cost of operation over a larger base.
- The opportunity to help more small businesses who are struggling to offer health insurance.
- The ability to meet the federal rules, which move the definition of "small employer" to 100 employees beginning in 2016.

The disadvantages of going to 100 initially are the following:

- Currently, many state laws provide that employers with more than 50 employees have rates based to some degree on their own demographics and experience. Consequently, many small employers have established wellness plans, smoking cessation policies, etc., as a way to control their healthcare costs. Under the new federal rules, the rates for these larger small businesses would now be community- based. Rate bands will be compressed and the claims experience of a specific employer will not be considered. The result will be a rate decrease for some, but an increase for many. These rules will thus impact those who elect to use the Exchanges as well as those who continue to purchase coverage on their own, outside the Exchange.
- Another disadvantage of enlarging the Exchange definition of "small businesses" before the law requires it is that employers at the upper end of these criteria (those with 75 employees, etc.) now have the option to partially self-insure their health benefits. Making these employers eligible for the Exchange creates a circumstance where the more healthy groups stay out of the Exchange, and continue to self- insure, while those with greater losses move to the Exchange. The result of this adverse selection will drive the Exchange rates up.

SELF-REGULATION OPTION

- States can permit Exchanges to regulate themselves, thus creating their own rules for rating, renewals, market conduct, etc., or continue to have state insurance rules apply uniformly to insurers inside and outside the Exchange.
  - The advantage of Exchange autonomy is that the Exchange can determine that it wants to regulate insurers more aggressively, and thus better meet the needs of its customers.
  - The disadvantage of this approach is the segregation of the markets, which may cause adverse selection. This approach may also discourage some insurers from deciding to participate in the Exchange.

Conclusion

The formation of Exchanges provides states with the opportunity to determine how best to fit the federal reform to their unique circumstances. This opportunity also enables state policy makers to experiment with approaches and concepts that resonate with them and their citizens.

In considering these options, it will be important for states to understand the fluid nature of the insurance market and thus consider the risk of unintended consequences as this new market is created. Unfortunately, Exchanges will not address the true cost of insurance nor improve the quality of the healthcare to be delivered. These issues will survive to be addressed in other venues, at a different time.

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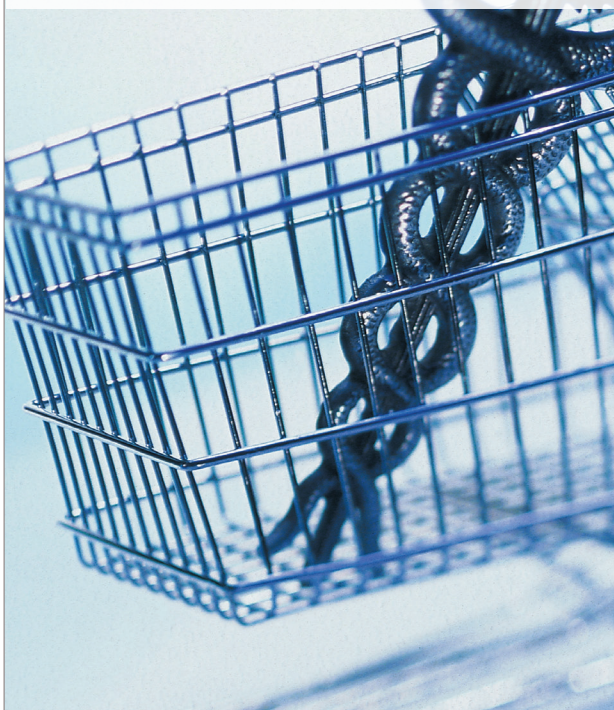

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