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Perspectives

Thinking of Joining a Private Health Insurance Exchange? Look Before You Leap

By Nancy Duta and Christopher Calvert

Employers that have not yet done so will soon have to start making decisions about whether to take advantage of the health insurance Exchanges[1] that are being developed under the Affordable Care Act.[2] Although the public Exchanges that are being created by the government have received most of the attention so far, private Exchanges have also been set up as alternatives to both public Exchanges and current forms of employer-sponsored health coverage. Many private Exchanges are aggressively marketing their services as they compete for business. Before employers sign on, however, they need to do their homework and learn about the various options.

This article focuses on what employers must know in order to make informed decisions about private Exchanges, how they differ from public Exchanges and how to determine if a private Exchange is the right fit for their employees.

What Is the Difference between Public and Private Exchanges?

Public and private Exchanges share several common features. Any health insurance Exchange is an online marketplace through which employees and retirees can purchase health insurance and evaluate the differences among plan designs and/or carriers. An Exchange is generally a web-based portal, similar to a retail website, except that it sells health insurance coverage instead of consumer goods. It also includes member support tools to help users understand how the Exchange operates and make informed decisions.

The private Exchange model typically uses a defined contribution (DC) approach to health care. Employers provide a set dollar amount toward health coverage, and the employees use that money toward the purchase of health insurance from the insurance carriers on the Exchange their employer has selected. Private Exchanges are operated by private-sector companies or non-profit organizations, and are not subject to the Affordable Care Act. Private Exchanges are typically fully insured with fixed premium payments paid on a per-employee basis. Private Exchanges negotiate premium rates with participating insurers and employers select Exchange

[1] The Department of Health and Human Services has announced it will use “health insurance marketplaces” instead of “health insurance Exchanges.”

[2] The Affordable Care Act is the shorthand name for the Patient Protection and Affordable Care Act (PPACA), Public Law No. 111-48, as modified by the subsequently enacted Health Care and Education Reconciliation Act (HCERA), Public Law No. 111-152.

options based on the needs of their employees. Generally, there are two types of private Exchanges:

- ***Single-carrier Exchanges*** are typically run by insurers and offer only the sponsoring insurer's plans. Employers are generally involved in selecting the various plan design options that will be offered to their employees, but there is no variety among insurers offered.

- ***Multi-carrier Exchanges*** are typically run by third parties and include numerous plan design options from multiple insurers. The insurers compete for enrollment by offering different pricing structures, health care networks and levels of performance and customer support.

A few private Exchanges have been in existence for a number of years, focusing mostly on the retiree/Medicare market where individual plans are the dominant mode of coverage and thus more easily adaptable to Exchange-based models. Although most were started by technology-oriented startup companies, a number of these Exchanges have since been sold to brokerages, benefits outsourcing operations and other organizations that want to enter to this potentially lucrative market. They are generally considered group purchasers of health coverage and operate in the large group market.

In contrast, the Affordable Care Act created a set of highly regulated public health insurance Exchanges, which must be operational as of January 2014 with an open enrollment period beginning in late 2013. There are two types of public Exchanges — individual Exchanges and Small Business Health Options Program (SHOP) Exchanges. Participants purchasing coverage through individual public Exchanges will be eligible for a federal premium assistance tax credit (a "subsidy") toward coverage if their household income is less than four times the federal poverty level (FPL)[3] and they do not have affordable coverage available to them (*e.g.*, through their employer, Medicaid or Medicare). Unlike the individual Exchanges, the federal subsidy is not available in the SHOP Exchanges, but employers can use cafeteria plans to allow employees to pay their portion of the premium on a pre-tax basis.

Private Exchanges cannot take advantage of the federal subsidies. Consequently, employees purchasing coverage on a private Exchange will *not* receive the premium assistance subsidies for low-income employees. This difference between the private and public Exchanges can be extremely significant for individuals in lower-paid jobs. Similar to the SHOP Exchange, employers using a private Exchange can take advantage of cafeteria plan rules and allow employees to pay for their share of the premium on a pre-tax basis.

Advocates of private Exchanges believe they contain certain advantages:

- Less risk for the employer as trend (future increases in health care costs) is transferred to the carrier, if an employer moves from a self-insured to a fully insured arrangement,

- Simplified employer administration,

- More choice for employees, and

- Improved cost awareness for employees.

[3] In 2013, the FPL (except in Alaska and Hawaii) is $11,490 for a single individual and $23,550 for a family of four.

Sibson Consulting believes that to realize any of these advantages, plan sponsors must fully understand the details of the Exchange design. They need to consider a number of factors before pursuing this path or choosing a partner.

Is a Private Exchange Right for You?

Each private Exchange is different. Consequently, employers must ask questions about features and be skeptical about promises. Joining a private Exchange is bound to change both a company's relationship with its employees and how it administers health care benefits. To determine the potential effect on the enterprise, employers should answer the following questions:

- ***What role does the employer want to play in health care delivery?*** Employers need to consider whether they will be offering health care coverage, in light of the Affordable Care Act provisions. The driver of this decision tends to be financial, partly because employers must look closely at the implications of the Affordable Care Act's employer shared responsibility penalty[4] and excise tax.[5]

- ***What is the employer's long-term strategy and its Employment Value Proposition (EVP)?***[6] It is important to know if health care benefits play a major role in employee attraction, retention and engagement. Many employers compete for the best employees by focusing on benefits. If an organization joins a private Exchange, each employee would pay a different premium, partly because each employee would choose a plan that best fits his or her needs. How employers address this issue would depend on their EVP and the extent to which they want to make their employees financially "whole" by increasing their compensation and/or benefits. Employers also need to consider whether joining a private Exchange may damage employee perceptions that their health care coverage is employer-sponsored. Moreover, it may be difficult to gauge how employees feel about the new arrangement.

- ***Is the private Exchange considered individual or group market coverage?*** Federal rules govern the tax status of employer-sponsored insurance coverage. If private Exchanges are considered group health coverage, then employers will likely be able to continue to use Health Reimbursement Accounts (HRAs) as a purchasing vehicle for the coverage. However, if private Exchanges are using the individual market, HRAs cannot be used to purchase the coverage on a tax-preferred basis.[7]

[4] The employer shared responsibility penalty of Section 4980H of the Internal Revenue Code (IRC) will be imposed on "large" employers with at least 50 full-time equivalent employees under certain conditions. The amount of the employer penalty will be based on whether the employer offers health coverage to employees. A large employer will be treated as having offered coverage to its full-time employees and their dependents for a calendar month if, for that month, it offers coverage to 95 percent of its full-time employees (as long as dependent coverage was also offered). Failure to offer coverage to 95 percent of all full-time employees will result in the 4980H(a) penalty being imposed. There are two branches of the employer shared responsibility penalty known as the "4980H(a)" and "4980H(b)" penalties. For more information, see Sibson Consulting's *Capital Checkup,* "IRS Proposes Rule on Employer Penalty Under the Affordable Care Act" (www.sibson.com/publications-and-resources/capital-checkup/archives/?id=2298).

[5] Starting in 2018, employers that continue to offer health coverage will be charged a 40 percent excise tax on the value of group health plans in excess of certain thresholds, now set at $10,200 for employee-only coverage and $27,500 for family coverage, with extra thresholds for certain high-risk professions and retirees.

[6] The Employment Value Proposition includes what an organization offers its employees in terms of benefits, experience and opportunity in Exchange for an employee's effort and commitment. Sibson's model consists of five components: affiliation, work content, career, compensation and benefits.

[7] See *FAQs about Affordable Care Act Implementation Part XI* (http://www.dol.gov/ebsa/faqs/faq-aca11.html), January 24, 2013.

- ***What is the competition doing?*** Employers should try to discover whether their peers are continuing the *status quo,* terminating group health plan coverage or joining an Exchange. Ideally, they should find out what type of coverage the competition is offering.

- ***What role does the employer want to play in improving the health and wellness of its employees?*** According to Sibson's healthy enterprise research,[8] employers that focus on optimizing the health and positive behavior of their employees can experience benefits that go beyond reducing their health insurance costs. For example, employers could move from paying for treatment-focused services to investing in keeping employees healthy. Employers should not lose sight of their wellness philosophy and initiatives. It is important to continue to maximize workforce productivity and employee health, even if the organization's mode of providing health coverage is through an Exchange.

- ***What is the Exchange's underwriting model and does adverse selection[9] play a role within the Exchange model?*** A private Exchange that has three or four large employer members today and doubles in size next year may change its rates if the new members change its demographics. Depending on the underwriting model of the Exchange, costs could swing wildly from year to year. In addition, because health insurers can offer the same group plans both inside and outside of the Exchange, older/less healthy employees may purchase their insurance through the Exchange if that is the more affordable option. This could result in adverse selection, eventually leading to higher premiums.

- ***How involved would the employer be in vendor administration?*** Although joining an Exchange may reduce vendor administration, it will not eliminate it. A key question is: how much consistency and uniformity do employers want for their workforce? The way employers communicate with their insurance carriers may also change. Employers need to think about whether they would be working directly with the Exchange or vendor platform and if daily communication would be with the Exchange or the insurance carriers. Employers should also review how much, if any, interaction there would be with an account service team. In addition, they need to consider whether they want to be involved with selecting insurance carriers and plan design, or leave all selection up to the employees.

- ***Will joining a private Exchange improve the employer's access to high-quality health plans?*** With a private Exchange, employers can choose from a menu of insurance carriers, which will help employers that are geographically diverse. Employers should compare their current plan offerings with those in the Exchange to determine if the benefits they currently offer are similar to those being offered through the Exchange and whether the networks are similar or different. They should also look at the premium rates and investigate whether the quality of care would be reduced within an Exchange. The Exchange model may give employees more freedom and choice of coverage options, but employees could enroll in a less rich plan and be subject to more out-of-pocket costs than intended in time of illness. The immediate next step would be to carefully evaluate the Exchange options to make an informed decision.

- ***Has the employer assessed its internal capabilities?*** Joining an Exchange will generate administrative and technological challenges. Employers need to research how they would be affected by the Exchange's billing and payroll systems. They also should look at the quality of the Exchange's call center and web capabilities for employees and employers, the Exchange's staff and the reporting tools available to employers.

[8] For more information, see "Is Your Organization a Healthy Enterprise?" (http://www.sibson.com/publications/perspectives/volume_17_issue_2/healthy.html) in the July 2009 Issue of *Perspectives* (updated in January 2011).

[9] Adverse selection is the disproportionate purchase of health insurance by the least healthy individuals.

- ***Who owns the private Exchange?*** Companies that used to be advisors on health care issues are now becoming issuers in the Exchange market. Employers need to consider the source of any advice they receive.

- ***How would the employer's human resources (HR) function change?*** Many employees need assistance when choosing a health care plan and look to HR for help. Because most employees will probably continue to do so, employers need to determine how HR will communicate and deal with the carriers, how claim disputes and other issues will be handled and who owns the relationship.

Conclusion

For decades, employers primarily collaborated with insurance carriers to provide health benefits to their employees. Public and private health insurance Exchanges will soon provide a new avenue for health coverage that employers may want to explore.

It is important to understand that not all private Exchanges are the same, and they are different from the public Exchanges. In order to make informed decisions, employers need to fully understand what private Exchanges are and how they operate, all while continuing to set annual health care budgets.

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