



# BENEFITS PERSPECTIVES

Current Issues in Employee Benefits

## Private exchanges: The future for large plan sponsors or a passing fad?

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Given this year's introduction of public health insurance exchanges at the state and local levels, there has been significant interest in and some movement toward private health insurance exchanges. Several high-profile large plan sponsors have made the transition, and the "exchange" concept continues to gain traction. However, several years may pass before anyone knows if private exchanges will become prevalent among large plan sponsors or be remembered only as a passing fad in an attempt by employers to control employee healthcare expenses.

This article examines key issues for large plan sponsors that are evaluating a private exchange for their active employees.

### Balancing choice with plan cost efficiency

Private exchanges are generally sponsored by private-sector healthcare consulting firms or other entities and combine technology with employee outreach and subsidies. They provide a means for employers to subsidize healthcare coverage while giving employees greater choice of health plans than traditional employer-sponsored benefit arrangements. Further, these exchanges are for-profit endeavors and do not allow their participants to receive federal premium subsidies to be used in purchasing health coverage. For the purpose of this article, private exchanges exclude individual Medicare-eligible retirees.

In general, plan sponsors that use private exchanges want to continue to offer employer-sponsored health benefits, but also want to manage costs through a defined contribution approach. They also believe employees may prefer the private exchanges to a standard group health plan because the exchanges typically offer a range of benefit "richness" (similar to the metal levels—bronze, silver, gold,

and platinum—found in public exchanges), provider choice (narrow to broad network options), and insurance carriers (some with at least three different carriers). Yet while the standard group health plan might not offer the same degree of consumer choice as found in a private exchange, it may maintain certain advantages from a plan risk selection, quality, and cost perspective.

### Risk selection

A private exchange may offer employees an enhanced ability to choose a health plan that will minimize their out-of-pocket healthcare expenses (i.e., premium and cost sharing). For example, an employee who expects to incur several thousand dollars of healthcare expenses during the upcoming benefit year may elect to purchase a very-low-deductible plan. Conversely, an employee who believes he is unlikely to incur any healthcare expenses other than for preventive care may elect a very-high-deductible plan. While a standard group health plan offering multiple choices may face similar selection dynamics, adverse selection may be enhanced in a private exchange offering a wider range of plan choice. This adverse selection is a result of employees having insight into their own healthcare needs and the ability to choose an option that most benefits them financially.

When considering private exchange options, plan sponsors should evaluate how the private exchanges are balancing greater employee choice with limits on the potential for adverse selection. For example, are employees permitted to change from a lower-cost to higher-cost benefit option in a single year, or is plan selection movement restricted in some manner? Unmanaged risk selection may result in unsustainable employee healthcare cost increases, which may unravel an employer's defined contribution strategy or result in benefits that are perceived by employees as below average relative to industry norms.

## Quality

With the introduction of guaranteed issue coverage to the individual market through the Patient Protection and Affordable Care Act (ACA), some employers believe they have a diminished incentive to offer healthcare coverage to employees. However, in addition to avoiding penalties for not offering coverage, employers have strategic reasons to offer healthcare benefits to employees. Specifically, healthy employees generally translate into minimized absenteeism, as well as greater productivity. Health coverage has also been a critical benefit in terms of attracting and retaining the best employees. Therefore, quality healthcare is an important part of the value proposition offered by employers. For large plan sponsors that currently maintain value-based benefit designs providing incentives for employees to participate in wellness programs or utilize other value-added plan features, the current benefit offerings likely reflect careful planning by the human resources department. While the actual plan offerings may be limited, the options may be well received by employees.

When evaluating the quality and services of a private exchange, plan sponsors should consider:

- Insurer participation  How does the private exchange determine which insurers participate? Is it simply any insurer that wants to participate (or pays the exchange the most), or does the exchange have an evaluation criteria? Are there minimum quality criteria that an insurer has to meet for exchange participation.
- Wellness  Does the private exchange offer employee wellness or care management benefits that are equal to or better than the employer's current options? Does the private exchange's wellness vendor offer any performance guarantees? If the private exchange does not offer wellness services, can it coordinate with a plan sponsor's external vendor? It is important to remember that private exchanges (or insurance carriers within private exchanges) will still experience rate or medically underwrite an employee population or offer a self-funded option. Therefore, to the extent that a group's claims experience deteriorates, employee or plan sponsor healthcare expenses will increase as they would under a standard group health plan.
- Ancillary benefits  Does the private exchange offer ancillary benefits, such as dental, vision, and disability benefits, typically offered by large group plan sponsors? If yes, are the plan choices comparable to the employer's current offerings and are they priced more effectively?
- Employee experience  Are employees able to easily access and understand the exchange? Do they understand how their benefits are funded? Do all employees have access to quality plans across multiple employer locations?

## Cost considerations relative to self-funded plans

Historically, a majority of large plan sponsors have self-funded their employees' health coverage, with insurance carriers providing administrative services and network access. As the health insurance landscape changes, these employers may have to evaluate the impact of purchasing insurance if the private exchange offers plans only on a fully insured basis. (Exchange sponsors take advantage of the commissions included in fully insured products to fund the cost of administration in a way that may not be transparent to the employer.)

Plan sponsors should also remember some of the advantages available to self-funded plans (whether inside or outside of private exchanges), including, for example:

- Eliminating or substantially limiting insurer profit margins;
- Lowering administrative costs, in general;
- Avoiding state premium taxes and certain ACA provisions, such as the health insurer tax;
- Providing benefit flexibility by avoiding state benefit mandates and allowing for other options better suited to a specific workforce when designing benefit plans; and
- Allowing more control over benefit management.

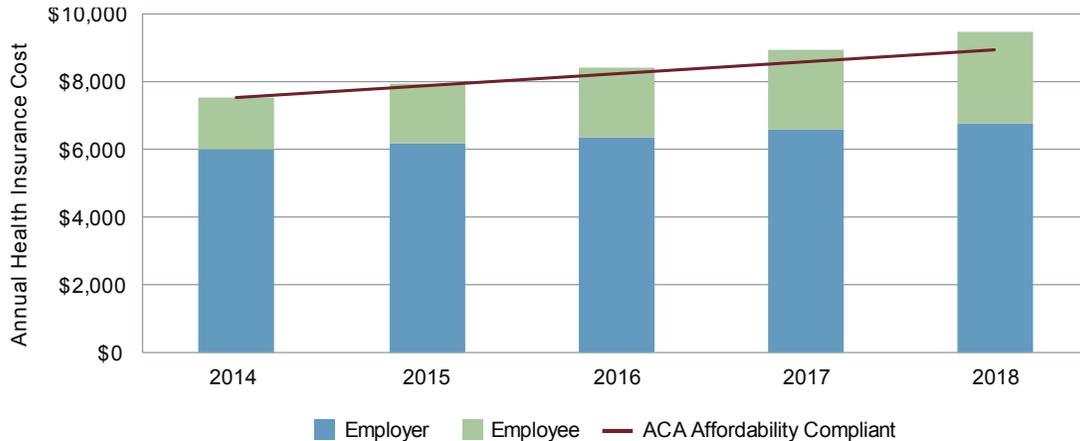
As the health insurance environment continues to evolve, insurers' profit margins may get thinner and the difference between the insured and self-insured environments may be reduced. Additionally, insurers may offer fully insured products with lower price points by altering provider network configurations (e.g., accountable care organizations, narrow networks paying less than traditional commercial rates) relative to those offered in the self-funded market. Finally, as private exchanges evolve, insurers may offer discounted products to attract new and retain existing plan sponsors, resulting in larger or smaller differences between fully insured and self-funded rates.

## Defined contribution budgeting for the long term

Plan sponsors may see private exchanges as a suitable approach to cap or limit their future healthcare costs at a time when budgets are tight. However, the defined contribution approach may not have long-term sustainability if healthcare costs continue to grow faster than an employer's contribution increases without adjustments for employee's out-of-pocket costs.

For example, Figure 1 illustrates an employer making a \$6,000 contribution per employee in 2014, with increasing contributions of 3% each year through 2018. Total healthcare expenses are \$7,500 in Year 1, with the employee responsible for \$1,500. However, if the healthcare cost trend is 6% annually, employees' expenses increase from \$1,500 in 2014 to over \$2,700 by 2018 (about 16% annual trend). While a defined contribution can create significant savings for plan sponsors, they also need to consider the impact on employee retention and morale if competing employers increase contributions for their employee healthcare plans to blunt the effects of healthcare inflation.

FIGURE 1: 3% EMPLOYER DEFINED CONTRIBUTION INCREASE, 6% ANNUAL TOTAL PREMIUM INFLATION



The ACA also introduces a measure of employee affordability for employer-sponsored coverage. This limits an employer's ability to shift health insurance costs to employees without incurring a financial penalty. Scheduled to begin in 2015, applicable large employers must offer employees single coverage costing less than 9.5% (subject to indexing) of an employee's household income. If employees are not offered coverage meeting this requirement, they potentially will be eligible for a federal premium subsidy in the ACA individual insurance marketplace and thus cause the plan sponsor to incur a nontax-deductible penalty. While private exchanges may be a vehicle to offer ACA-compliant low-cost plans to employees, if employees' contributions rise as illustrated in Figure 1, the ACA affordability issues and penalty may be encountered relatively quickly.

Employers contemplating a defined contribution approach should bear in mind that this method is not unique to a private exchange model. Plan sponsors may keep relatively consistent plan contributions each year, using reinsurance to limit unexpected high costs while maintaining self-funded coverage outside of a private exchange. Self-funded employers have been doing so for many years prior to the advent of private exchanges.

Plan sponsors contemplating a defined contribution approach whether in a private exchange or a standard group health plan should address these key questions:

- What is our budgeted annual health insurance contribution increase? Do we modify this amount if our plan experience is significantly higher than expected?
- Will our plan meet the ACA's affordability standards in both the short and long term? If not, what are the potential penalties?

- What is the impact to our corporate culture and employee retention if employee health insurance contributions must increase significantly from year to year?

### Multi-year commitment

Before making the investment to move from a self-funded to fully-insured arrangement (or vice versa), plan sponsors should ensure they understand the direct and indirect costs of moving between funding vehicles. To the extent a plan sponsor moves to a fully insured private exchange, it should commit to staying in such an arrangement for several years because of the administrative burdens (e.g., necessary staffing, communications, payroll-related adjustments) and disruptions to employees.

### 2018 excise or "Cadillac" tax:

#### Narrowing the range of plan offerings

The ACA's nondeductible excise tax—40% of the cost exceeding prescribed amounts on plan sponsors starting in 2018—applies regardless of the portion of the cost borne by the employer or the employee. Thus, a defined contribution approach that requires a significant employee contribution for a plan that has relatively low cost sharing may still generate an excise tax, which will increase employer or employee costs even more. This will likely lead to plan sponsors attempting to avoid the tax by offering plans with a lower actuarial value. Alternatively, plan sponsors may increase the premium charged to beneficiaries to shift the cost of the excise tax to the employee. In both of these situations, the availability of these richer plans in early years will likely not continue without at least shifting additional costs to employees.

## Conclusion

Plan sponsor circumstances will often dictate a preferred approach when private exchanges are contemplated. There is no one-size-fits-all solution. Whether a plan is insured or self-insured, employers should consider the key issues raised in this article, for there is a range of pros and cons about transitioning to a private exchange. Because many of the elements of private exchanges can be offered without moving to the exchange structure, employers should evaluate the move more as a purchasing decision and less as a strategic decision.



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