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A Practical Guide to Private Exchanges

By Karen Shelton and David Petta

Karen A. Shelton, FSA, MAAA, is an actuary at UnitedHealthcare in Richmond, Va. She can be reached at *karen_shelton@uhc.com*.

David T. Petta, FSA, MAAA, is an actuary at Aon Hewitt in Omaha, Neb. He can be reached at *david.petta@aonhewitt.com*.

With the implementation of the Affordable Care Act (ACA), public health insurance exchanges are providing Americans with another channel for purchasing health care. These exchanges provide plan offerings that comply with actuarial value thresholds and cover essential health benefits (EHBs). On the individual exchange, premium and cost-sharing subsidies may be provided to individuals meeting certain income requirements.

There are also private exchanges, which are separate from the public exchanges established under the ACA. These exchanges are operated by consultancies, health insurers and technology platforms that enable employers to offer more choice to employees for their health benefits through an online marketplace. Private exchanges have experienced rapid growth in the shadow of the ACA as employers look for creative ways to manage cost while providing competitive health benefits.

The chart below illustrates core attributes of the public and private exchanges.

The remainder of this article will focus on the private exchanges and their impact on employers who may be considering offering coverage to their employees through this channel.

Elements of a Private Exchange

Private exchanges are quickly evolving and can take many forms. The following are common attributes that are central to private exchanges:

Employee Choice—Private exchanges often offer more plan design options than traditional employer-sponsored plans. While not required, these plans will often be labeled in a consistent approach to the metallic levels used on the public exchange and target similar actuarial values. Depending on the private exchange, the available plan design options may be standardized.

Employer Subsidies—Employers will subsidize the cost of coverage, often through a defined-contribution approach where the employee can "buy-up" for lower-cost-sharing provisions or "buy-down" for lower premiums.

Ancillary Product Offerings—The private exchange will often offer ancillary products like dental and vision alongside the medical and pharmacy benefits via the exchange so that it's a complete "one-stop-shop" for health-related benefits.

Element	Public Exchange	Private Exchange
Who sponsors	Government	Employer
Who can enroll	Individuals and small groups	Employees and retirees of sponsoring employer
Types of coverage available	Medical and prescription drug	Medical, prescription drug, dental, vision and other voluntary benefits at the employer's discretion
Plan designs available	Plans must provide actuarial values of 90 percent, 80 percent, 70 percent or 60 percent as defined by the federal Actuarial Value Calculator. Individuals may be eligible for income-based reduced cost-sharing.	Exchange operator or employer defines the plan designs.
Who pays for coverage	Individuals and small employer groups pay the premiums for coverage. Individuals may be eligible for income-based government subsidies. Small employers may be eligible for small business tax credits.	Employers provide a subsidy toward the cost of coverage and covered members pay the balance.

Online Enrollment and Decision-Making Tools— Online tools are becoming more sophisticated and user-friendly, allowing for members to evaluate their health care needs, understand their employer's subsidy, and elect benefits that meet their needs.

Benefits Administration—Most private exchanges offer end-to-end benefits administration including enrollment, eligibility, customer service and billing.

Different Models and Approaches

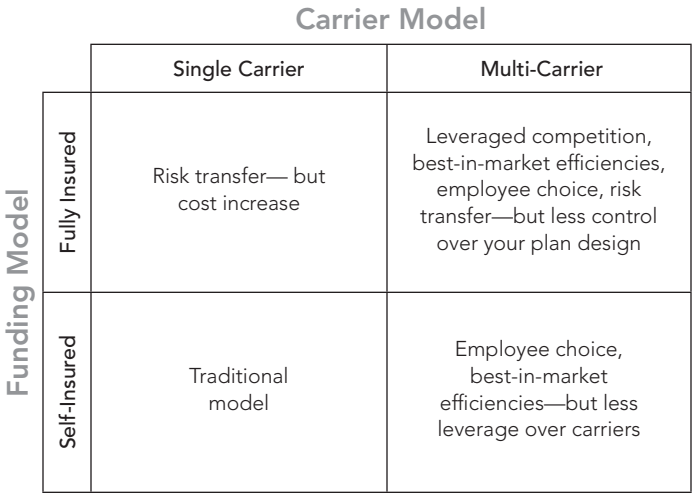
The two most distinct differences between private exchange models are carrier approach (single-carrier vs. multi-carrier) and funding methodology (self-funded vs fully insured). Single-carrier models typically offer a range of plan options and are offered primarily by the insurance carriers themselves. These models tend to offer more control over the plan, flexibility in funding mechanism, and in-depth carrier reporting that is consistent across the entire population.

Multi-carrier exchanges offer a choice of plan options from several insurance carriers. Depending on the exchange, either the employer or the employees have the choice between multiple carriers. In a multi-carrier model, carriers may compete side by side, offering plans with various price points, provider networks and coverage levels.

A fully insured, multi-carrier model will also include a risk-adjustment mechanism to offset additional costs borne by carriers who attract members with greater health risks. The risk adjustment is a "net-zero-sum" where the amount of premium transferred to carriers with higher risks will equal the premium paid out by carriers with lower risks.

A private exchange model has many potential advantages and disadvantages that will need to be taken into account by an employer who is considering implementing a private exchange approach to benefits offering.

Advantages:
- Increased employee choice
- Cost-savings potential from increased competition across carriers and best-in-class carrier pricing in a multi-carrier model



- Increased consumerism from members buying-down benefits as a result of a transparent defined-contribution approach
- Robust online decision-support tools and customer service
- Benefits administration simplification
- Shift financial and regulatory risks (fully insured model)
- Cost predictability under a fully insured model
- Improved cost transparency

Disadvantages:
- Additional expenses for exchange operator financing and risk assumed by carriers in a fully insured model
- Less control/flexibility over plan design, clinical management, member outreach, etc.
- Need to increase defined-contribution amount over time, otherwise plan cost could become overly burdensome to beneficiaries
- Other member concerns such as loss of plan-sponsor support, less generous benefits and general fear of change

Cost Impacts via the Private Exchange

One of the major advantages often being cited for the implementation of a multi-carrier private exchange is the potential cost savings that comes from two primary areas: carrier best-in-class pricing and increased carrier competition.

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Carrier Best-in-Class Pricing

Provider and facility contracts can vary significantly across carriers and by region, resulting in a carrier who may be very competitive in one region and less competitive in another. Many employers do not have a "best-in-class" approach where the most competitive carrier by region is offered because of the resources required. Multi-carrier private exchanges can offer best-in-class pricing that's administratively simple, which may provide meaningful savings.

Illustrative Example I

Employer X currently has one insurance carrier providing health insurance to its employees in two regions with rates and subsidies as follows:

	Region A	Region B	
	Carrier 1	Carrier 2	Total
Annual Plan Cost	$4,500	$5,000	$470,000
Employer Defined Contribution	$3,400	$3,400	$340,000
Annual Employee Payroll Contribution	$1,100	$1,600	$130,000
Enrollment	60	40	100

Another insurance carrier may have a more efficient network in Region B and (all things equal) will have more competitive pricing in that region.

	Region A		Region B		
	Carrier 1	Carrier 2	Carrier 1	Carrier 2	Total
Annual Plan Cost	$4,500	$4,800	$5,000	$4,500	$461,500
Employer Defined Contribution	$3,400	$3,400	$3,400	$3,400	$340,000
Annual Employee Payroll Contribution	$1,100	$1,400	$1,600	$1,100	$121,500
Enrollment	55	5	20	20	100

In Region A, Carrier 2 has a higher cost but is still expected to attract a small portion of the membership in that region. In Region B, the cost for Carrier 2 is 10 percent lower than Carrier 1, resulting in 50 percent of the employees in this region choosing Carrier 2. The net impact on plan cost is a savings of ~1.8 percent.

Increased Carrier Competition

Within a fully insured, multi-carrier model, carriers compete for business directly from the employee through price, networks, and other items such as customer service or brand identity. Insured contracts align incentives between carriers and encourage carriers to choose more innovative approaches since they are marketing to the consumers at a retail level (not a benefits department who represents the employee population as a whole).

Items Increasing Costs

While we've discussed areas of potential savings from the private exchange, it's important to note that there are costs of moving from a self-funded to a fully insured model. These include items such as premium tax, insurer tax, state-mandated benefits and insurer risk charges. The exchange operator will also charge for resources needed to effectively run the exchange.

Member Buy-Downs

Early experience from the private exchanges indicates that members tend to enroll in options with higher cost share and lower premiums when compared to traditional employer-sponsored group insurance, with a majority choosing a high-deductible health plan (HDHP).

The primary reasons a member would be more inclined to buy-down on the private exchange are twofold. First is the premise that there can be no cross-subsidization between gross premium rates as each plan is intended to stand on its own. This means that the full impact of member selection (net of risk adjustment, if applicable) must be included in the premium rates, as well as differences in actuarial values and expected utilization due to higher or lower member cost share (price elasticity). This could produce rates for the most generous plan (Platinum) that are considerably higher than the rates for the leanest plan (Bronze),[1] even after accounting for risk-adjustment transfers.

The more traditional approach to setting premium/

premium equivalent rates under group insurance has been to reflect only the actuarial value difference of the plan offerings and price elasticity. This is particularly the case for self-funded plans where determination of the premium equivalent rates is at the discretion of the employer.

The second reason employees tend to buy-down coverage on the private exchange is that employers are using a defined-contribution approach to determine employee payroll contributions, requiring the member to pay the full additional cost of the more generous plan design. Currently many employers pay a flat percentage of the plan cost, essentially providing a higher subsidy for more generous coverage.

Illustrative Example II

Employer X currently offers a 60 percent Bronze plan and a 90 percent Platinum plan. Under a traditional self-funded approach, the employer sets the premium equivalent rates to reflect the differences in actuarial values. The employer also currently subsidizes 63 percent of the premium rates.

If the employer were to move to the private exchange and offer similar plans, the premiums between the plans would be wider, in order to be self-supporting. Assuming this employer provides a $3,300 defined contribution for single coverage ($275 per month), the chart above shows how the single member's payroll contribution would be impacted.

In this example, the payroll contribution difference changes from $65 per month under the current approach to rate setting to $300 per month under the private exchange. Given these dramatic differences in price, it's likely that many members will now enroll in the less-costly Bronze plan.

Also under a defined-contribution approach, the employer may choose to express costs on an annual basis rather than per pay period or per month. Should the employer in the above example choose to illustrate costs on an annual basis, the member would see a $3,600 per year difference, which is likely to attract an even greater portion of members.

It is often part-science-part-art to determine the optimal defined-contribution amount. As with any

Illustrative Example 2

	Current		Private Exchange	
	Platinum 90% AV	Bronze 60%AV	Platinum 90% AV	Bronze 60%AV
Monthly Premium Rate for Single Coverage	$525	$350	$600	$300
Employer Subsidy				
%	**63%**	**63%**	46%	92%
$	$330	$220	**$275**	**$275**
Monthly Employee Payroll Contribution	$195	$130	$325	$25
Bronze-Platinum Contribution Difference	$65		$300	

contribution strategy, an employer will want to consider a number of items, including:

- Current funding approach—What is the employer's current philosophy around subsidies and how does it compare to a defined-contribution approach? If they are very different then the employer may need to ease into a defined-contribution approach over a few years, if allowed by the exchange operator.
- Variations by coverage tier—Does the employer want to subsidize dependents at a different level than the employee?
- Member impact—How does this impact the member payroll contributions and what sort of dissatisfaction could arise? Defined contribution may need to be phased in over a number of years, if allowed by the exchange operator.
- Financial goals—Does this change meet the employer's financial goals?
- Competitive pressures—How does the subsidy compare to the benefits provided by other organizations that compete for similar talent?

It's likely that all these considerations will need to be evaluated in order to determine the most appropriate level of subsidy which, in-turn, affects member buy-downs in the private exchange.

Additionally, many of the exchanges provide consumer-centric decision-making tools in an easy-to-navigate format, making it easier for employees to understand the differences in price and coverage,

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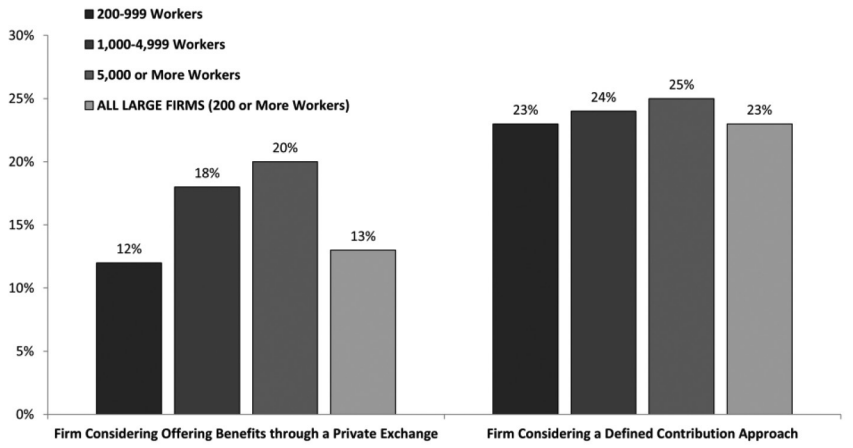
Exhibit 2

Among Large Firms (200 or More Employees) Offering Health Benefits, Percentage of Firms Considering Offering Health Benefits Through a Private Exchange, by Firm Size, 2014

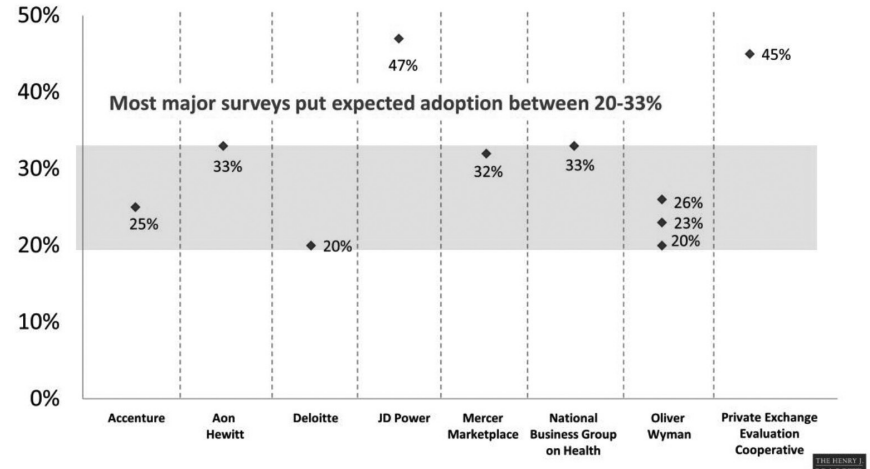


NOTES: A private exchange is one created by a consulting company, not by either a federal or state government. Private exchanges allow employees to choose from several health benefits options offered on the exchange.

SOURCE: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2014.

Exhibit 4

Employers adopting private exchanges within 5 years



SOURCE: Accenture (2013), Aon Hewitt (2014), Deloitte (2013), JD Power (2012), Mercer (2013), National Business Group on Health (2013), Oliver Wyman (2012), Private Exchange Evaluation Cooperative (2013)

and can encourage employees to fund an HSA with the difference in premiums.

The growth in enrollment in HDHPs is important as these plans increase consumerism, which will cause members to engage more with their providers on care and cost decisions, ultimately putting more pressure on providers and facilities to provide higher-quality care for a lower price.

Exchange Outlook[2]

According to the Kaiser Family Foundation, private exchanges include approximately 1.7 million group plan enrollees (2 percent of employers) and this is expected to grow into the future. The 2014 Kaiser HRET Employer Health Benefits Survey (EHBS) found that employers with 200 or more workers who currently do not offer benefits through a private exchange were considering this marketplace. Additionally, this survey also indicates that even more employers are considering a defined-contribution approach rather than moving to a private exchange. (See Exhibit 2.)

Though 2 percent of employers currently offer coverage through this marketplace, most major surveys expect this to grow to 20 to 33 percent by 2018. (See Exhibit 4.)

Whether or not the private exchanges grow to these anticipated levels, they are changing the way employers are looking to provide benefits and insurance carriers are looking to sell coverage to members.

For more information on the private exchanges please see the Kaiser Family Foundation Report, Examining Private Exchanges in the Employer-Sponsored Insurance Market, September 2014.

END NOTES

1 Platinum and Bronze plans in this article represent a private exchange offering that will have approximately a 60 percent actuarial value for Bronze and 90 percent actuarial value for Platinum; these are not meant to reference the metallic plans on the individual exchange required by the ACA.

2 Alex Alvarado, Matthew Rae, Gary Claxton, and Larry Levitt, Examining Private Exchanges in the Employer-Sponsored Insurance Market, The Henry J. Kaiser Family Foundation, September 2014. *http://files.kff.org/attachment/examining-private-exchanges-in-the-employer-sponsored-insurance-market-report*, accessed on March 10, 2015.