Leveraging Private and Public Exchanges in an Employee Benefits Strategy

Health reform is helping to transform the health insurance marketplace and facilitate new opportunities to re-evaluate and restructure the underlying framework of employer-sponsored benefits. Central to these opportunities is the emergence of public health exchanges at the state and federal levels offering a coordinated platform of diverse designs and health plans available on a guaranteed issue basis and often with government-provided subsidies. Parallel and complementary to this trend is the emergence of private health exchanges that similarly offer a diversity of plans on a variety of bases. This article shows why, together, these offerings provide potential streamlined solutions for employers as they reevaluate how they facilitate and support access to affordable coverage for their employees (and retirees).

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Employers have many strategic considerations as they move forward under health care reform. Despite many unknowns—uncertainty in Washington and potential delays in both guidance and implementation—employers are now reevaluating and weighing their options. There is not one solution; each employer will have different considerations based on business objectives, competitive forces, employee demographics, culture, financial outlook and many other factors. The overriding challenge is to formulate a strategy that considers and takes advantage of the many moving pieces and protects against future unknowns.

This is not the first seismic transformation in employee benefits. Over the last two decades, there has been a dramatic shift in employer-sponsored retirement benefits from defined benefit plans to defined contribution plans. This change has been brought on by the cost of funding the benefit, changes in employment practices (e.g., the new generation of employees will change jobs and careers frequently), the economic burden of providing a defined benefit, and a shift in philosophy from a cradle-to-grave to a shared-responsibility model. While many of the same forces apply to medical coverage, the lack of a viable guaranteed issue health insurance market has made movement away from employer-based coverage impractical. The emergence of public and private exchanges under the Affordable Care Act (ACA) is changing that landscape.

Today, the opportunity to redefine our approach to health care benefits has never been greater. The overall insurance market reforms, together with the public health care exchanges and the associated government subsidies, have the potential to dramatically reconfigure employer-provided
health care. In addition, other ACA provisions are raising additional burdens and ongoing concerns with regard to sustaining our traditional approach. Many large employers are looking for new ways to limit their financial exposure and redefine their role as it relates to health care benefits. Fundamentally, it requires rethinking how health care benefits fit within our rewards strategies, what our role should be both financially and administratively, and whether there are advantages to giving up some level of control in stewardship of health care coverage for employees, retirees and their families (Figure 1).

**What Is a Health Care Exchange?**

An exchange in its simplest form is a place in which buyers and sellers come together to exchange goods and services. In the context of health care, individuals or groups would purchase health care coverage from one vendor or multiple vendors through a health care exchange, which can be either public, private or some combination thereof. The intent of an exchange is to provide easy access, choice and managed competition. Although private and public exchanges may serve different demographics, there are some common objectives, including providing access to a choice of plans at varying price points and more competitive pricing.

**Public Exchanges**

ACA mandates that all states set up health care exchanges by January 1, 2014 and that employers notify their employees of the exchanges (deferred until fall 2013). If the states are unable to meet ACA requirements, the federal government is required to step in and implement the exchange with or without state input. Many stakeholders consider the public exchange as the fuel that will transform the health care delivery system. It is the component of the legislation that is designed to have the greatest impact on reducing the number of uninsured in this country. Individuals and small businesses will be able to purchase insurance coverage with guaranteed issue starting in January 2014. No one will be turned down for coverage because of preexisting conditions. In 2017, large employers likely will have access to the public exchanges, although this will be at each state’s discretion.
Private Exchanges

Unlike public exchanges, private exchanges are not legislated by the federal government. They are a more recent initiative for active employees that is still in its nascent stage of development. Will they be a viable approach for active populations? Private exchanges, as they are evolving, can potentially provide employers an ability to limit their financial exposure as well as shed many of the administrative responsibilities related to health care benefits. In addition, they likely will provide access to a greater range of benefit options, including varying cost-sharing features and networks of different sizes and quality. Employee benefit managers will no longer have to make benefit design decisions for employees who are at different points in the life cycle, of varying health status, financial means, etc. Individuals will be able to select a plan that meets their individual and family needs.

Future Pillars of Health Care Benefits Strategy

In evaluating future directions for health care benefits strategy, there are three core options that can serve as the pillars moving forward (Figure 2).

Option 1: Staying the Course—Sponsoring a Single Employer Plan

Staying the course for most employers means continuing to provide a few limited plan options through one or two vendors, either through a self-funded or insured arrangement. The basic value propositions for this option include:

- Full control of plan design(s) consistent with human resource (HR) strategy and population-specific cost drivers
- Potential to save with self-insurance
- Potential to customize plan and avoid state benefit mandates
- Ability to integrate with health and productivity initiatives
- Cost-reduction efforts directly affect own experience under the plan.

However, many employers are frustrated with the status quo and are challenging themselves with key strategic questions:

- How important are employer-sponsored health care benefits to our retention, recruitment and productivity strategies?
- Can we maintain our current level of contributions and compete in a global economy?
- Can we rapidly innovate and adopt market changes as
a single employer sponsor (e.g., changes in the delivery system, such as through accountable care organizations)?

- What are ongoing and indirect burdens for maintaining our own plan? Will they grow with ACA?
- How will our competition likely act in light of ACA?
- How can we, as a business, be responsible for controlling health care costs?

**Option 2: Joining and Contributing Toward a Private Exchange**

The first private exchanges for active employees were scheduled to be in operation in January 2013. Several of the national brokerage firms have announced their entrance into the marketplace. Similar to the emergence of consumer-driven plans, the first entrants are their employees and select companies that are willing to be early adopters. One exchange is offering early entrants (all with over 5,000 employees) a group model experience-rated plan, a choice of nine carriers and multiple plan options that mirror the legislated “metal” plans (i.e., bronze, silver, gold, platinum). The basic value proposition for this option is:

- Ability to outsource for suite of products, plans, networks and vendors
- Potential to leverage and adapt to market changes more quickly
- Independent administration and stewardship of plans and related costs
- Option to have fully insured, fixed rates enabling true defined contribution.

However, there are differences in how a private exchange is potentially structured.

A group insurance-based private exchange can be structured on a basis that customizes the options available to those most aligned with the employer marketplace. Similarly, to the extent insured, rating strategies for group-based private exchanges can reflect some potential composite rating that can simplify transition from current employer contribution strategies. The extent to which those rates (or subsequent renewals) reflect an employer-specific experience can also vary. They may also be available on a self-insured basis.

An individual insurance-based private exchange also offers a suite of products and networks, but those products and networks are more “market based.” Often, that will mean much more focus on plans with higher cost-sharing and value-based designs (e.g., limited networks). Premiums will be based on community experience (not reflecting the employer’s specific experience) and also are likely to vary by geography and demographics consistent within the rating constraints of ACA. A potential advantage to this approach is that it enables the employer to move toward more market-based plans and true defined contribution, based on fixed community-based rates. However, the individual exchange approach now appears to be less viable for active employees (see tax considerations below).

Strategic considerations in implementing a defined contribution approach with a private exchange include:

- What benefits does the private exchange potentially bring to the company and its employees? What services will the exchange provide?
- Will increased competition result in lower costs? If costs continue to outpace inflation, will my employees be able to afford it?
- What options are out in the marketplace? How much choice are employees looking for? Should we limit or guide?
- In establishing an employer subsidy, how will we handle equity if prices vary by age, area or family status?
- Would the exchange be a good approach for a subset of my population?
- What are the associated risks of being an early adopter? What are the implications if I decide to revert to a single employer plan? Do the rewards outweigh the risks?
- Should I pursue a group or an individual model? Are there potential rating or regulatory advantages to moving one way versus the other?

**Option 3: Deferring to the Public Exchanges**

Individuals and small employers will be eligible to participate in the public exchanges starting in 2014. In addition, individuals and families with household incomes up
to 400% of the poverty level will be eligible for subsidies in exchanges if they do not receive “affordable coverage” through their employers. While larger employers are not currently eligible to participate in public exchanges directly, they may elect not to offer coverage or affordable coverage to some populations and “defer” to the public exchanges to provide coverage for some or all of their employees. The basic value proposition for this option includes:

- Ability to disassociate rewards strategy from health care coverage
- Potential to leverage market reforms, including government subsidies
- Eliminate health care coverage as barrier to global competitiveness
- Substitute controllable compensation for uncontrollable health care costs.

This is particularly relevant for employers that have lower paid workers who would otherwise be eligible for subsidies through the public exchanges. Retirees younger than age 65 also may be better served by the public exchanges due to favorable ACA provisions related to guaranteed issue, community rating with limited rate banding based on age, and the potential government subsidies. Dependents are another constituent that might be considered separately. In all such instances, employers will need to be aware of and perform detailed pay-or-play analyses to understand the full financial impact on them.

Strategic considerations in deferring to the public exchanges include:

- What is the impact on employee attraction and retention? What will our competitors do?
- Is paying the penalty under ACA a more attractive financial option if employees would benefit more from obtaining subsidized coverage through the public exchange?
- Will employees or retirees need to be compensated as an offset for any benefits withdrawn? Will they need to be grossed up (since medical benefits are currently not taxable to them)?
- Is there a concern that rates for similar coverage will vary among employees?

**Other Considerations**

Beyond these specific areas, the following are other considerations as employers reevaluate their strategic directions.

**Subpopulations**

It is important to consider the potential use of private exchanges separately for different subsegments. This starts with active employees, versus early retirees and Medicare-eligible retirees. The maturity and value proposition of the exchange market vary considerably across each segment. An employer
may also decide that maintaining some control over benefits is an important recruiting and retention tool for its salaried active employees but not for its hourly employees. This may be particularly true for its lowest paid employees, who will be eligible for subsidized premiums and lower cost sharing.

**Tax Status**

Generally, employer-provided health coverage is highly tax-favored. The cost of health coverage provided to employees is excluded from their income and is fully tax-deductible to the employer. This can be a major incentive to continue to provide tax-favored benefits rather than taxable income to employees. Consequently, it is an important factor to structure a defined contribution approach to health benefits in a manner that preserves similar tax-favored status. For example, recent guidance clarified that a health reimbursement account (HRA) may not be used on a standalone basis for active employees to fund individual policies (e.g., in an individual exchange) as a tax-advantaged funding vehicle for employees to participate in an individual exchange.

**Optimizing Penalties and Accessing Subsidies**

Most employers will continue to provide affordable minimum coverage for their full-time employees and consequently avoid pay-or-play subsidies. However, many others will need to consider strategies that straddle both paying and playing. The key is to optimize those strategies to mitigate overall costs (penalties, cost of coverage and other indirect costs) as well as employee impact. For example, one strategy is to provide coverage to all full-time employees but to allow it to be “unaffordable” to some employees. In this instance, it will be important to integrate access to subsidies through either private or public exchanges.

**Impact on Health Care Cost Curve**

No matter what strategic approach is taken, there will be a continuing concern about its sustainability if health care costs are not better controlled. Many employers believe their efforts at wellness and consumerism are already paying dividends to mitigate future growth in costs. Others, however, believe that we continue to fight a losing battle as long as people continue to be sheltered from most health care costs and providers continue to be reimbursed for delivering more care instead of based on their value in managing population health. Still others argue that health care exchanges could play a role to accelerate some of these changes including allowing more rapid adoption of delivery-based strategies and incentivizing consumers to move toward more value-based plans and providers. Time will tell.

**Our Path Forward**

Some employers are making significant changes to their benefit plans as a result of ACA, while others will be tempted to stay the course since there is nothing from ACA forcing radical change upon them. However, for all employers, the time is now to revisit health care strategy from the ground up, challenge the status quo, evaluate the options, make a strategic choice and execute against that plan. In many instances, the path forward will be incremental and transitional (e.g., changing retiree strategy first while positioning toward significant changes for actives in the future). However, this new opportunity and potential window to consider raising the strategic levers of change should not be missed.

**Endnotes**

1. Affordable coverage is based on whether the employee has access to single coverage where the employee contributions are no more than 9.5% of income.
2. ACA does not currently permit larger employers to participate in public exchange but by 2017, states may, at their discretion, allow larger employers to participate. Since the exchanges may operate differently by state, they are likely to remain a difficult option for employers to participate with (particularly after 2017).
3. ACA limits rating by age to be no greater than a 3:1 ratio of highest cost to lowest cost age groups.