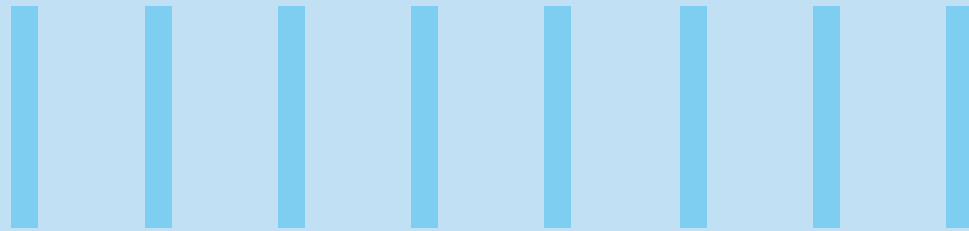




## THE PROMISE OF NEW MARKETS: DO YOU HAVE A GAME PLAN FOR EXCHANGES?



### **Abstract**

Healthplans recognize the importance of onboarding onto public exchanges to capture new members from uninsured and small business segments. However, the movement towards defined contribution plans represents an existential threat and opportunity. Healthplans need a strategy and roadmap for private exchanges to retain existing (or capture new) large employers that embrace this shift. Those that don't, risk losing share in their core group market.

# The Right Exchange: Public or Private?

Anyone who thought the Patient Protection and Affordable Care Act (PPACA) would only impact the uninsured and underinsured is missing the big picture. Major legislation like the PPACA always has important collateral effects. Earlier reform efforts, while unsuccessful in terms of legislation, started the important process of organizing healthcare providers into coherent delivery systems – such as group practices, independent practice associations, and physician-hospital associations.

The PPACA has set in motion a similar flurry of activity for both payers and providers, as can be seen in the proliferation of private exchanges.

For now, a public exchange is designed as a vehicle to provide affordable insurance to the uninsured and small employers.

Tax credits and subsidies are made available to individuals below 400 percent of the Federal Poverty Level (FPL) and to employers with 25 or fewer employees on lower income, but only on public exchanges. Private exchanges are, in part, a competitive response to public exchanges. However, their structure and target market are typically quite different. Private exchanges provide an alternative to public exchanges for better-heeled, self-pay

individuals, and small employers. Private exchanges appeal to employers of any size, as evidenced by the announcement that Sears and Darden Restaurants plan to participate in Aon's multi-carrier exchange.

The defining characteristic of the new generation of private exchanges is the shift in benefit financing from a 'defined benefit' to a 'defined contribution model', led by the transition from fixed benefit pensions to 401K retirement plans. In the traditional defined benefit health insurance model, an employer typically contributes a fixed percentage of the premium, say 80%, and the employee contributes the remaining 20%. Employers in a defined contribution plan pay a set dollar amount towards the premium and the employee applies that amount towards one of the plans offered by the exchange.

Any difference between the cost of the plan and the employer contribution is the responsibility of the employee. The defined contribution model fixes the benefit expense for the employer and typically provides the employee with a broader choice of benefit plans than usual.

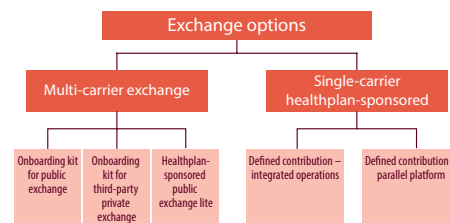
Private exchanges represent one facet of the trend toward consumer engagement in the healthcare marketplace. Placing more responsibility on the consumer to make

smart choices is a good idea. However, the sponsors of private exchanges and the plans that participate also have a responsibility to provide consumers the information they need to make informed decisions. Who are the sponsors of private exchanges? It could be anyone, although the most likely sponsors are those organizations responsible for brokering or providing health benefits – brokers / consultants and healthplans. Various models are operational in the marketplace, with many more likely to come.

The most common types of private exchanges include:

- Multi-carrier small group
- Single-carrier healthplan-sponsored
- Multi-carrier large and midsize group

The differences between these models are more than cosmetic, so it is worth taking a closer look.



## Multi-Carrier Small Group

Companies such as Bloom Health and Connected Health represent the leading edge of the private exchange market. These companies were built from the ground up on the funding model based on defined contribution benefit. The target market is often smaller employers that are struggling to provide health benefits for their employees, and are seeking cost-effective alternatives. Rather than have their broker 'shop' their benefits to different carriers, they engage a small group private exchange, which serves as their broker to multiple insurance companies. In this arrangement, a 15-employee group is broken down into 15 individual contracts by the private exchange. Employees choose a carrier and are underwritten as if they were applying as individuals. Carriers

are able to perform medical underwriting and the employee pays the difference between the employer's contribution and the premium. The exchange gets paid a commission as a broker for the transaction.

The leading edge is not yet bleeding, but this model directly competes with public exchanges. Many small employers that offer health insurance will move to exchanges, so that their employees can take advantage of the subsidies offered by the PPACA.

For participating in public exchanges, employers may also be eligible for tax credits that will not be available in private exchanges.

Why would small employers choose a

private exchange over a public exchange? For starters, private exchanges offer more benefit flexibility. Public exchanges are limited to the 'metal' plans required by the PPACA, whereas private exchanges can provide consumers with a wider array of benefit plan options. These include ancillary benefits such as long-term disability (LTD) and supplementary life. Employees can purchase these options with their dollars under the defined contribution model. It remains to be seen whether these advantages will be enough to keep small employers from moving to public exchanges. The acquisition of Bloom Health by WellPoint, HCSC and BCBS of MI suggests that there may still be life in this model.<sup>1</sup>

# Single-Carrier Healthplan-Sponsored

BCBS of Kansas City embodies the healthplan-sponsored private exchange model<sup>2</sup>. Like the multi-carrier small group model, the target market here is the small employer who might otherwise migrate to public exchanges.

In this model, employers can choose their contribution level and employees can choose from a wide selection of plans. The variety of plan options is the primary attraction of this model, although the

healthplan is counting on the employer's interest in retaining more control over benefits than would be afforded through public exchanges.

In the public exchange model, employees have the option to sign up with plans from multiple carriers. Employers participating in the Small Business Health Options Programs (SHOP) component of public exchanges delegate virtually all responsibility for employee health benefits

to the exchange. Private exchanges offered by BCBS of Kansas City provide employers a defined contribution model, along with more benefit-design flexibility and control.

To date, the single-carrier model has represented a defensive strategy, enabling payers to consolidate their small group business in the face of competition from the SHOP component of public exchanges.

## Multi-Carrier Large and Midsize Group

Aon is the poster child for this segment of the private exchange market, and Towers with its acquisition of Extend Health is another player.<sup>3,4</sup>

Aon has established itself as a major private exchange player with the recent launch of its private exchange and the announcement of two major employer participants – Sears and Darden Restaurants. Unlike Bloom Health and other private exchange companies that

have thrived primarily in the small group space, Aon has moved large employers from a self-funded defined benefit plan administered by a single-carrier to a fully insured, defined contribution plan administered by Aon with multiple participating carriers.

A number of carriers have signed up to play in this scenario, including HCSC, Cigna and United Healthcare, but not without some trepidation.

Unlike the multi-carrier small group model, the usual individual rating rules don't apply. Medical underwriting is not an option, and it's unclear what selection bias will prevail for any particular healthplan. How do you design your plan and engage consumers to get a population with at least a balanced risk profile? This is a new territory for most healthplans. Those choosing to participate in this initial Aon experiment expect to learn and make adjustments based on experience.

## What Does This Mean to Payers?

The market has not yet shifted en masse to private exchanges and defined contribution models. Now that the PPACA is the law and the Presidential election has been decided, public exchanges will become a fact of life, which will move the concept of private exchanges into the mainstream. On one hand, public exchanges are a source of business for healthplans despite concerns about risk and pricing. On the other hand, third-party private exchanges like Aon represent

competition to a healthplan's existing market share. Third-party exchanges disintermediate the primary carrier, dividing the employee base among the carriers that participate in the exchange.

A growing percentage of employers will want to transition from 'defined benefit' to 'defined contribution' plans. If healthplans do not provide a platform for this transition, employer-customers are likely to move to another carrier or a third-party

sponsor who does. Every healthplan should build, acquire or contract an exchange platform for defined contribution to meet existing and future market demands. Healthplans must move fast to offer defined contribution options to all segments of their business, and not just the small employers. Self-funded employers will be moving steadily in this direction, prompted by the same benefit consultants that sponsor private exchanges.

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