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## ***Legal & Economic Analysis of Health Insurance Exchange Mechanisms*** **(Calif. CE Approved Course #204198)**

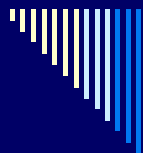
A Study Conducted by the Health Economic Consulting Group, LLC which was funded by the NAHU Education Foundation

-Presented by David L. Fear, Sr. RHU-

*Note: This CE Course Has Been Approved For Two (2)  
Credit Hours By The California Department of Insurance*

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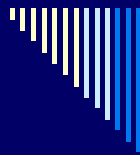
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## **What This Study Covers**

- Historical Perspective
- The Theory Behind Health Insurance Exchanges
- Legal Issues
- Other Issues
- Summary & Conclusion
- References

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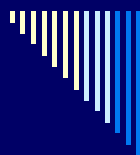


## Who Is The NAHU Education Foundation?

- The NAHU Education Foundation was founded by NAHU as a 501(c)3 non-profit entity that helps educate the public about health care and health insurance issues



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## Who Is The Health Economics Consulting Group, LLC?



The Health Economics Consulting Group is a group of academic health economists and health services researchers providing research consulting in areas related to healthcare and managed care in the United States. They recently completed a paper on "single payer" health systems for the California Association of Health Underwriters. They can be visited at [www.hecg-llc.com](http://www.hecg-llc.com)

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## Historical Perspective

- Health Insurance Exchanges aka:
  - Health Insurance **Connectors**
  - Health Insurance **Purchasing Cooperatives**
  - Health Insurance **Purchasing Pools**
- Purchasing Pool proposals have been resurrected:
  - Major part of the Clinton Proposal in 1993
  - Flurry of enactment in mid/late 1990's
  - Typically done by Government entities such as FEHBP, Cal-PERS or non-Profit Business Groups
  - Most Republican and Democratic presidential candidates are proposing something like this



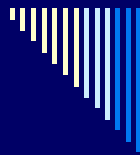
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## The Theory Behind Health Insurance Exchanges

- Designed to facilitate the availability, choice and adoption of private insurance plans to eligible individuals or businesses
- Created by government regulation but may be operated by non-profit entities or even private, for-profit firms
- Are usually part of a larger reform effort being considered

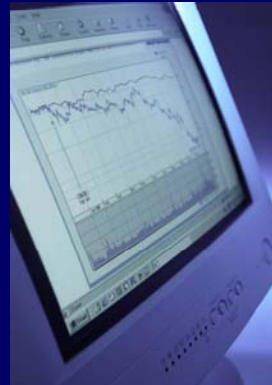


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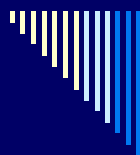


## What Are Health Insurance Exchanges?

- Typically they:
  - Determine eligibility to participate
  - Determine one or more benefit packages
  - Negotiate directly with insurers for the cost of those benefits
  - Market & Sell directly to individuals and/or businesses
  - Collects premium payments from participants
  - Remits premium payments to insurers
  - Features tax-deductible costs so individuals are afforded same breaks as employer groups



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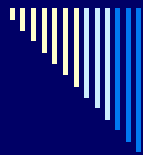


## Variations of Exchanges

- Proposed and enacted in various states:
  - Operating in MA as of 7/1/07
  - In 2007, they were proposed in: CA, CT, GA, KS, MD, MI, MN, MT, NJ, OK, OR, TX, VA, WA & WI
- Typical variations are:
  - Eligibility to participate
  - Scope of benefit packages
  - Degree of displacement in an existing market (i.e. individual)
  - Rating factors
  - Structure and Organization



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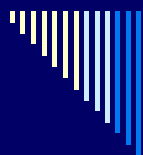


## Variations of Exchanges: Eligibility to Participate

- Individual Market Only
- Small Group Market Only
- Individual AND Small Group Markets
- The “Expanded” Small Group Market (to 100 lives)



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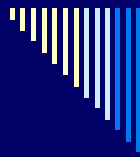


## Variations of Exchanges: Benefit Packages

- Seem to group into:
  - Basic or “Affordable” benefits
  - Standard or “Comprehensive” benefits
  - Health Savings Arrangements with “catastrophic” benefits
  - Additional issues considered:
    - Wellness, Prevention, Drugs, Emergency, Substance Abuse, Mental Health
    - Definition of “Medically Necessary”

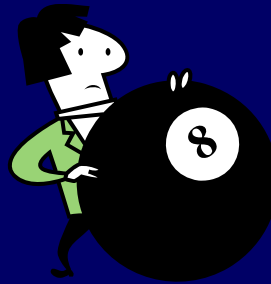


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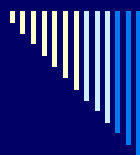


## Variations of Exchanges: Displacement

- How much will an exchange displace the current market?
  - MA initially folded individual market into the exchange and may include small group in near future
  - MO will completely replace the individual and small group markets (also proposed in GA too)
  - Others would have exchange as an alternative to existing market, not replacement
  - Some proposals require exclusive use of a purchasing pool for those receiving subsidies



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## Variations of Exchanges: Rating Factors

- Some exchanges will not change existing market factors:
  - MA individual & small group markets were guaranteed-issue with modified community rating before and after their connector program went into effect
- Others will modify the entire market when exchange is implemented:
  - MD proposes to allow for adjustments in age and geography
  - Others will permit age-banding as well as a wider degree of Risk Adjustment within the rate band structure



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## Variations of Exchanges: Structure & Organization

- Created by statute
  - Quasi-public entity
  - Non-Profit entity
  - Private, For-Profit entity who contracts with various participating insurers
- Governed by a board
  - Appointed by elected officials
  - State non-profit or public entity rules will probably apply
  - Other State/Local rules may apply
- Some private sector initiatives
  - In California:
    - Health Insurance Plan of California moved to Pacific Health Advantage
    - Private Purchasing Pools were created



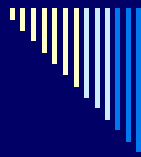
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## Key questions that need to be answered about Exchanges:

- *Will Exchanges improve access?*
- *Are the programs fair to all concerned in terms of tax treatment?*
- *Is the program cost efficient?*
- *Does the program feature quality service? Can it adapt quickly to needed changes?*
- *Will an Exchange lower the cost of health insurance?*



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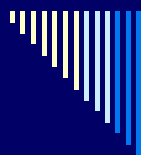


## Legal Issues

- Five issues of potential relevance:
  - ERISA pre-emption
  - Implications of IRS Code Section 125
  - Conflicts with HIPAA and COBRA
  - List Billing
  - Guaranteed Issue



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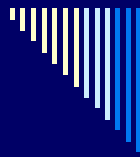


## Legal Issues: ERISA Pre-Emption

- ERISA does not permit States to regulate employer benefit plans
  - Some of the Exchange proposals will overstep ERISA and may require an Amendment at the Federal level:
    - Hawaii received an ERISA amendment for employer mandate in 1975
    - COBRA amended ERISA in 1986
    - HIPAA amended ERISA in 1996
- Historically, ERISA has pre-empted State attempts to tax employer benefit plans as well as laws that might put an administrative burden on employers



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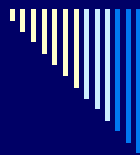


## Legal Issues: ERISA Pre-Emption

- In general ERISA pre-emption has been upheld:
  - For self insured health plans
  - Laws aimed directly at private-sector, employer-sponsored plans
  - Laws requiring that employers offer health plans
    - MA is requiring that employers with 10+ fulltime employees pay 33% of employee coverage OR pay an "in-lieu of" fee of \$295/employee/year: Will this be pre-empted by ERISA?
  - Laws imposing taxes on employer sponsored plans
  - Laws requiring plan information reports from employer sponsored plans
  - Laws requiring employers to participate in purchasing pools or coordinate with public health coverage



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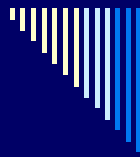


## Legal Issues: ERISA Pre-Emption

- Health Insurance Exchanges themselves may not violate ERISA if they are VOLUNTARY and not mandatory
  - The Wal-Mart suit in MD clarified ERISA pre-emption of mandatory programs
- Additional court challenges are expected in various states and while it is unclear how the courts will rule, the fact that ERISA was amended for Hawaii, COBRA and HIPAA means there is a possibility for changes!



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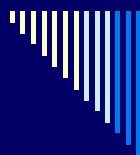


## Legal Issues: Section 125

- The MA program requires employers with 10+ employees to adopt a Section 125 plan, and file a copy of the plan with the Connector Authority:
  - Failure to comply may subject employer to the “free-rider” surcharge (*retro-active billing of medical expenses above certain levels*)
  - A potential problem in MA was just resolved when IRS clarified that individual policies can be run through Cafeteria arrangements (previously only group coverage was allowed to be run through a Section 125 plan).



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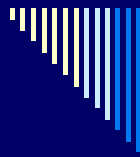


## Legal Issues: HIPAA & COBRA

- Some fundamental questions about COBRA eligibility need to be addressed:
  - Will employees of a small employer be considered COBRA eligible when they are obtaining coverage via an Exchange?
  - Some exchanges feature individual policies only – will COBRA or State-Cobra rules apply to these entities?



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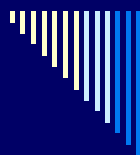


## Legal Issues: HIPAA & COBRA

- HIPAA issues are also unclear at this time and focus on two major points:
  - HIPAA's non-discrimination provision is an issue related to Group, Individual and List Billing arrangements
  - HIPAA's portability provision is an even larger issue to be resolved (group to individual, individual to individual)



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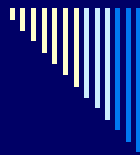


## Legal Issues: HIPAA & COBRA

- Thus, will Exchange policies be subject to HIPAA regulations since they are considered individual and not group coverage?
- It is expected that challenges will be raised about how Exchanges comply with HIPAA and COBRA laws.
  - List Billing practices (permitted in some states) will have to be reviewed



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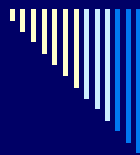


## Legal Issues: List Billing

- In spite of recent IRS ruling about permissibility of individual plans being run through a Section 125 plan, the DOL has indicated that a **Section 125 plan is an employer sponsored plan** as well as those individual plans that have any employer contribution:
  - ERISA comes into play
  - Effectively means list billing becomes subject to COBRA and HIPAA related rules



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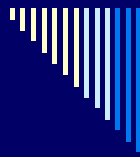


## Legal Issues: Guaranteed Issue

- Currently six states require GI for all individual products (ME, MA, NJ, NY, VT and WA).
- Several other states require GI for some individual products, typically based on an individual's HIPAA eligibility.
- All states now have GI for small groups per HIPAA, so what's the problem?
  - Individual GI has led to erosion of markets in those states due mainly to adverse selection and community rating requirements
  - Most Exchange proposals assume GI of individual policies in that market – which leads to community rating or variations of such



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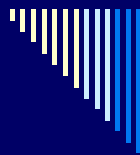


## Legal Issues: Guaranteed Issue

- Solution to market erosion due to GI requirements?
  - Passage of an individual mandate to purchase coverage
- Other issues related to GI of individual products:
  - Adverse selection against the Exchange due to GI or community rating structure vs. non-Exchange coverage
- If the Exchange is selected against, then costs will increase and eventually be priced out of the market
  - Voluntary pools have found this has happened

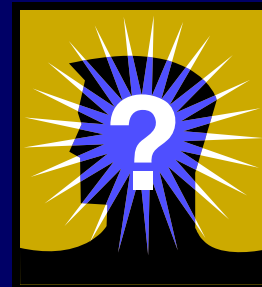


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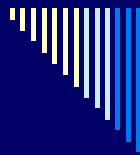


## Other Issues: Access

- Will Exchanges increase access to coverage for the uninsured population?
  - Evidence indicates that voluntary pools have failed to increase access
    - They lack “group stability”
    - They have not been able to offer a lower priced product than can be found outside of the Exchange itself
  - Voluntary pools are susceptible to adverse selection
    - Individuals who would otherwise pay higher prices outside of the pool enroll in the pool
    - This drives up premium rates in the pool, making them uncompetitive with non-Pooled coverage
  - Many voluntary pools don't use agents and that reduces enrollment in the pool



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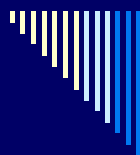


## Other Issues: Access

- Will **mandatory** pools be more successful than previous voluntary models?
  - The demographics and general conditions of uninsured persons tend to indicate that they have options but do not exercise them except under adverse situations (i.e. sick people buy COBRA, poor people take Medicaid, etc..)
  - If they sell a Cadillac policy to individuals they will find no more buyers than the current market has experienced – people don't want to buy “expensive” coverage
  - Exchanges will tend to be operated on the basis that benefits are the foremost issue – **they aren't expected to offer low-cost plans**
  - State benefit mandates will hinder Exchanges just as they have done with non-Exchange products at both the group and individual levels



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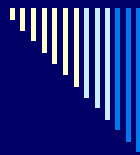


## Other Issues: Fairness

- A major concern is **forcing** individuals who qualify for a **premium payment subsidy** to only buy coverage from a State sponsored Health Insurance Exchange rather than a free-market choice:
  - This penalizes the low-income insured who are employed and have private insurance – they are spending a high percentage of their wages on insurance – is that fair not to give them a subsidy?
- Is the “**food stamp**” approach a better way to get **premium payment subsidies distributed**:
  - You can buy your groceries at any market you like – not just from a government run store
  - Should the purchase of health insurance be the same way?



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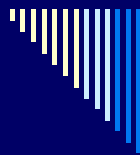


## Other Issues: Mandated Benefit Exemption

- Some proposals have Exchanges being granted an exemption from having to provide policies which contain various state benefit mandates
  - Thus, Exchanges would have a competitive price advantage over non-Exchange policies issued directly by insurers who must still comply with state benefit mandates
  - If lawmakers want insurance to be less expensive then they should consider allowing the sale of “mandate free” coverage both in and out of an Exchange



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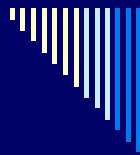


## Other Issues: Risk Pools & Adverse Selection

- **Voluntary pools have been adversely selected against, became uncompetitive and not survived**
  - When a pool plays by a different rule than the market, it may be “gamed”
- **In a mandatory pool situation:**
  - Employers may find coverage too expensive on the street, drop coverage and move employees into the pool – what kind of risks do you think the pool is getting in that case?
  - Proposed “in-lieu” taxes may be a bargain for sicker employer groups and neutral for healthier groups – thus who decides to get coverage from the pool?
  - If those “in-lieu” taxes never rise to keep up with inflation of health care, then it becomes even more attractive as time goes on (go to the pool and lower costs)

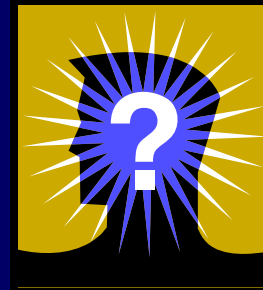


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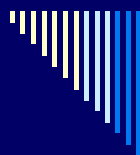


## Other Issues: Risk Pools & Adverse Selection

- One other serious issue is the potential for adverse selection within the pool from among the participating carriers:
  - An Exchange would have to create a “level playing field” in terms of benefits and financing so as to assure participating insurers that they are not being selected against by individuals
  - In California, this very issue caused the voluntary purchasing pool to begin to lose participating carriers after less than 3 years of operation
    - That eventually led to the pool’s closing on 12/31/2007 (after 14 years of operation) when it failed to retain more than one participating health insurer



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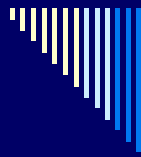


## Other Issues: Employer As Advocate

- **Current Exchange proposals assume that the employers role in the provision of health insurance is at best value-neutral:**
  - The current employer-based system would demonstrate otherwise:
    - Many are willing and enthusiastic in securing cost-efficient coverage
    - Most demand quality and value for the dollars being spent
    - They reduce administrative costs by aggregating larger numbers of persons under a single policy or administrative scheme (compared to individual coverage and the cost to administer such)
    - Keep carriers honest in disputes about claims, premium and services

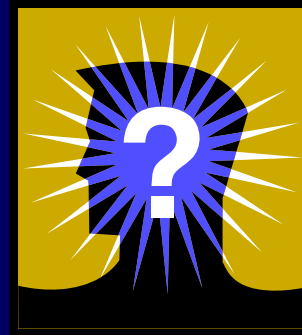


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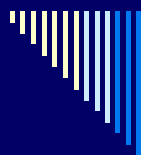


## Other Issues: Medical Costs

- While Exchanges are expected to be “tough negotiators” with health insurers who participate in the pool, they are not directly paying for services – the third party payer system is still in place.
  - What about “crowd out” from private to public programs?
- Will Exchanges have realistic expectations about costs when they are not involved in directly paying for services:
  - The initial bids in MA were nearly 100% higher than estimated
  - Caused the MA Connector Authority to revisit plan designs and benefit packages



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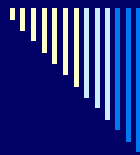


## Other Issues: Economic Impact

- The CA proposal is estimated to have a \$1.7 billion annual cost – this is a huge amount of money which will grow steadily based on medical inflation
- Net costs of implementing a state-run Exchange should include:
  - Elimination of costs related to employer-based model (i.e. agents)
  - Premium rate increases due to pool severity/adverse selection
  - Elimination of employer bargaining ability
  - Increased employer contributions (those who were not paying before)

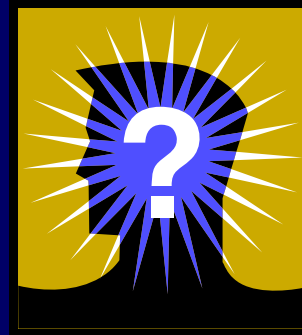


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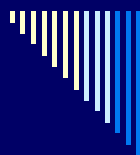


## Other Issues: Service Quality

- Exchange programs require choices on the part of employees and to a lesser degree, employers:
  - Currently licensed insurance professionals serve in this role
  - It is unclear who would provide advocacy in an Exchange program for both employees and employers
    - Direct interface with insurers is problematic and difficult for consumers
    - Customer service is a challenge for government agencies



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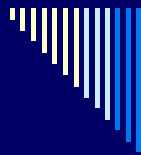


## Other Issues: Adaptation

- Public administration replaces private administration: What does public administration have to offer?
- To quote:
  - ***“Government administered health care: The efficiency of the post office and the compassion of the IRS, at pentagon prices”***
- While there are obvious challenges in “corporate” America, since the days of Teddy Roosevelt, we have learned that a mix of regulation and private sector competition tends to best serve the public
  - Will a governmental entity do a better job in representing consumer needs in the purchase and financing of health care services?



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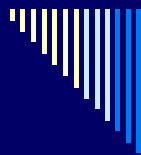


## Other Issues: Administrative Costs

- Exchange proponents argue the reduction of administrative savings in programs such as FEHBP and Cal-PERS
  - These are employer groups of a very large and homogenous population
  - They may have smaller administrative costs as a percentage of premium, they still are increasing rates due to the underlying cost of health care services
- Exchanges will have to serve the needs of diverse groups of individuals and small employers
  - In CA, after an initial period in which the HIPC did not use agents, they decided it was more cost effective to serve small employer groups by paying an agent (who competed for the business) a modest fee.
  - MA has apparently made this same decision with regard to **small groups** who buy coverage through the Connector – it is cost efficient to have agents assist, however agents are not compensated for individuals



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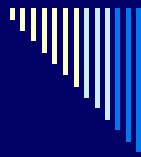


## Conclusion

- There are some tradeoffs with Health Insurance Exchanges:
  - They are far from a perfect means to improve overall health insurance access
- There are considerable legal obstacles to be resolved for the optimal functioning of Exchanges:
  - ERISA challenges
  - Portability and group vs. non-group distinctions (Section 125, HIPAA, COBRA and list billing)
  - Adverse selection & cost challenges due to guaranteed issue and community rating



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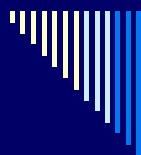


## Conclusion

- There are several economic issues inherent to mandates and government administered Exchanges
- Back to the beginning – will these key questions about Exchanges get answered:
  - **Will Exchanges improve access?**
  - **Are the programs fair to all concerned in terms of tax treatment?**
  - **Is the program cost efficient?**
  - **Does the program feature quality service? Can it adapt quickly to needed changes?**



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## References & Recommendation

- The study itself lists 72 references which were reviewed in putting together this NAHU Education Foundation sponsored work
- We advise insurance professionals to share this study and related information with public policy makers, elected officials, regulators and other participants in the health care reform debate.
  - *Obviously, much more study and consideration needs to take place prior to implementation of Health Insurance Exchanges as a part of any serious reform effort at either the national or state levels*



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