

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

Alan Cohen and Christopher Condeluci



Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

By: *Alan Cohen and Christopher Condeluci*

Private health insurance exchanges or “private exchanges” have been a hot topic of discussion over the past several months. Most private exchanges, however, have been in existence for a number of years, pre-dating the enactment of the Patient Protection and Affordable Care Act (hereinafter referred to as the “new health care reform law”). Private exchanges have varying business models. For example, some private exchanges service individuals purchasing insurance in the individual health insurance market. Other private exchanges service the “group” health insurance market – both the fully-insured and the self-insured markets – offering group health plans to large and small employers. Another private exchange model facilitates the purchase of an individual market plan by an employee whose employer is funding all or a portion of the employee’s health care coverage.

The next generation of benefits consulting – and the traditional agent and broker selling insurance – will be evaluating private exchanges and determining whether an individual and/or employer client should purchase health insurance coverage through a private exchange company. Private exchanges will not replace the role of benefit consultants and agents/brokers, rather, private exchanges will serve as a new product giving the consultant/agent/broker additional options for their clients. Private exchanges will also allow these businesses to serve more health care consumers which, upon the sale of insurance products through the private exchange company, will effectively increase their bottom line through a revenue sharing arrangement.

Health plans will also need to know how to identify the features that make a private exchange an attractive option for consumers. As the health care marketplace continues to evolve, carriers must adapt and find innovative ways to sell their insurance products to individual and employer customers. These carriers should look for creative delivery mechanisms that appeal to consumers who are actively looking for new alternatives to traditional health insurance. A private exchange is emerging as the innovative and creative marketplace that consumers are searching for.

What Is a Private Exchange?

At its core, a private exchange is a private business – typically operated by brokers or insurers – that sells insurance products to health care consumers through an on-line product. What makes private exchanges unique is their ability to enable the health care consumer to shop from among a wide-variety of major medical health plans and supplemental insurance products (e.g., hospitalization, disease, disability, or dental coverage) through the use of

What makes private exchanges unique is their ability to enable the health care consumer to shop from among a wide-variety of major medical health plans and supplemental insurance products (e.g., hospitalization, disease, disability, or dental coverage) through the use of creative, interactive technology.

* Alan Cohen is Chief Strategy Officer and Co-Founder of Liazon. He leads the development of Liazon’s award-winning Bright Choices® Exchange. Previously, Alan was the CEO and Co-Founder of Online Benefits, a benefits management and communication technology firm, and he also worked in the insurance industry for Prudential, Mass Mutual and CIGNA, and managed an insurance brokerage.

† Christopher Condeluci is Of Counsel at Venable LLP. Prior to joining Venable, Chris served as Tax and Benefits Counsel to the Senate Finance Committee from 2007 to 2010. As Tax Counsel to the Finance Committee, Chris actively participated in the health care reform debate and the development of the new health insurance Exchange.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

creative, interactive technology. Private exchanges also offer “decision support” or they employ “recommendation technology,” services that may not be offered in a traditional setting. Private exchanges provide end-to-end transactional services (e.g., collection of enrollment information on an electronic form and transmission of enrollment information to the insurance carrier electronically). They also offer benefits administration services to employers and support for individual health care consumers that may have questions about their coverage. These features – described more fully below – make a private exchange an attractive option for many individuals and businesses.

What Features Make a Private Exchange Successful?

1. Funding for Coverage

Under our current private health insurance system, there are two primary ways to fund the purchase of health care coverage. The first way is funding coverage on an after-tax basis. In other words, health care consumers pay for coverage with dollars out-of-their-own pocket, generally without any tax preferences for the purchase of the coverage. This practice is most common in the individual health insurance market where the purchase of private health insurance is generally not subsidized by an employer or the government.

The second way in which private health care coverage is purchased is through the employer-based system. Here, the employer typically pays for all or a portion of the employee’s health insurance coverage, which effectively reduces the cost of coverage to the employee. A second and sometimes over-looked feature is that although the employer’s subsidy is part of the employee’s compensation, amounts paid by the employer for health care coverage are not taxable to the employee for income and FICA tax purposes. And, if the employee is responsible for some portion of the cost of coverage, most employers establish a Section 125 plan which allows employees to pay amounts for such coverage before taxes are calculated on their pay. This favorable tax treatment is arguably the most significant benefit of employer-provided health insurance.

A successful private exchange offers a seamless way for the health care consumer to purchase health care coverage, regardless of whether the coverage is subsidized by an employer or paid for entirely by an individual purchasing an individual market health insurance plan. For example, in the case of a consumer purchasing an individual market plan with after-tax dollars, a simple on-line payment system may be employed where an employee may use a credit or debit card to pay for such coverage. Alternatively, the individual may be permitted to arrange auto-payment from a bank account that transfers payment directly to the insurance carrier providing the coverage. These common payment mechanisms can be established at the same time coverage is selected, and integrated with other features that may be available through the private exchange.

In the case of an employer funding all or a portion of an employee’s coverage, utilizing a “defined contribution” payment system is an option that works particularly well in an exchange setting. This defined contribution approach is similar to a 401(k) retirement plan where employers contribute set amounts of money toward employees’ health insurance

In the case of an employer funding all or a portion of an employee’s coverage, utilizing a “defined contribution” payment system is an option that works particularly well in an exchange setting.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

coverage. Here, employers decide how much they want to spend on health insurance each year, and they set aside these amounts in a health reimbursement arrangement (“HRA”) or some other funding mechanism (e.g., a notional bookkeeping account).

A private exchange will facilitate the defined contribution payment system where the only role of the employer is contributing funds toward the purchase of health insurance coverage. In this case, the exchange may outsource payroll reduction functions to a company that specializes in providing payroll services. Alternatively, the exchange may choose to provide those services in-house. Either way, the exchange creates a system where the funds for health care coverage are seamlessly transferred from the employee and/or the employer to the insurance carrier providing the health insurance coverage.

2. Inventory of Major Medical Health Plans

Another feature that makes a private exchange successful is enabling a health care consumer to shop from among a wide-variety of major medical health insurance products with varying plan designs. For example, an exchange may offer up to 10 to 20 different major medical health plans, ranging from high-cost sharing plans down to low- or no-cost-sharing plans. In this case, the difference in cost between the plan designs may be as great as 60%. Offering this “inventory” promotes choice and consumerism, which has been proven to reduce health care spending, thereby saving money for both the individual health care consumer (in the case of an individual market plan) and the employee and employer (in the case of employer-provided coverage).

It is important to point out that private exchanges in the individual health insurance market typically permit multiple carriers to offer a wide variety of major medical health plans. Because health plans in today’s market are generally underwritten on an individual basis, carriers can often manage the risk of the consumers that the carrier insures. As a result, there typically is no problem of adverse selection in a multiple carrier private exchange in the individual market, which allows for a wide variety of inventory to be offered. However, once the health reforms enacted under the new law become effective (e.g., the prohibition against carriers underwriting based on health status), additional consideration would need to be given to risk adjustment.

The need for risk adjustment can already be seen when looking at private exchanges in the group health insurance market. Specifically, where multiple carriers offer major medical health plans to employees of employers in a group market private exchange, this multi-carrier exchange may produce adverse selection. Adverse selection may occur if “healthy risks” enroll in plans underwritten by a particular carrier participating in the private exchange, and “less healthy risks” enroll in plans offered by another participating carrier. In other words, one carrier may get the “good” health risks, while the other carrier attracts the “bad” health risks. Here, the carrier that attracts the bad risks will pay out more dollars in claims compared to the premiums collected (often times producing a significant loss for the year), while the carrier that gets the good risks will likely see a windfall.

An exchange may offer up to 10 to 20 different major medical health plans, ranging from high-cost sharing plans down to low- or no-cost-sharing plans... Offering this “inventory” promotes choice and consumerism, which has been proven to reduce health care spending.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

One way to mitigate adverse selection in a multi-carrier private exchange in the group market is through a robust risk adjustment or risk-sharing mechanism. Calibrating a risk adjustment or risk-sharing model that participating carriers may agree to, however, is extremely challenging. As a result, the threat of adverse selection and the difficulty of getting buy-in on risk adjustment/risk-sharing often discourages multiple carriers from participating in a group market private exchange.

It is important to note that this road-block to a multi-carrier exchange does not necessarily have a negative impact on the amount of inventory that a private exchange in the group market may offer. For example, although these private exchanges may be contracting with only one or two carriers, the major medical plans that are offered on the single or dual carrier exchange are purposefully designed to range from high-cost sharing plans all the way down to low- or no-cost sharing plans. This wide range in plan design offers choice and promotes consumerism to the same (or even a more significant) degree than a multiple carrier exchange.

3. Supplemental Insurance Products

Private exchanges can be distinguished from the traditional distribution model in a number of ways. One way is through the private exchange company's ability to offer a wide menu of supplemental insurance products along with the inventory of major medical health plans in one convenient setting (i.e., a one-stop shop). These supplemental insurance products often range from stand-alone dental and vision plans and hospital indemnity to specified disease coverage, disability insurance, and wellness programs.

Offering supplemental products alongside major medical plans affords a consumer the opportunity (1) to purchase a low-cost health plan and (2) to add specified coverage to insure against, for example, catastrophic health events. This aggregation of insurance products typically may cost less than a major medical plan that provides "rich" benefits. In this case, the consumer may be paying less for an insurance package that provides a specified level of comprehensive coverage as opposed to purchasing a more expensive plan that may offer benefits and services the consumer does not want or need. In addition, a consumer purchasing this type of insurance package may not feel exposed to the threat of incurring significant out-of-pocket expenses by supplementing a less expensive high-cost sharing plan with a low-cost policy providing specified catastrophic coverage. In the end, the consumer has obtained comprehensive coverage at a lower cost instead of being under-insured or over-insured.

4. Decision Support

A key ingredient to a successful private exchange is providing decision support to help the consumer determine what major medical health plan or health insurance package (e.g., a major medical plan, coupled with a supplemental policy or policies) is best for them to purchase. Decision support may come in different forms. For example, one of the simpler forms of decision support is where a consumer is given the tools to isolate two or three major

Offering supplemental products alongside major medical plans affords a consumer the opportunity (1) to purchase a low-cost health plan and (2) to add specified coverage to insure against, for example, catastrophic health events. This aggregation of insurance products typically may cost less than a major medical plan that provides "rich" benefits.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

medical plans and compare the multiple plans by viewing a line-by-line description of the benefits or services covered under the respective plans.

Other decision support systems are more sophisticated. For example, some private exchanges offer “recommendation technology.” Here, the health care consumer is asked a series of questions relating to, among other things, the consumer’s expectations of care utilization (such as pregnancy or prescription drug use), along with the consumer’s risk tolerance, financial position, and the amount of an employer subsidy (if any). The technology synthesizes the answers to these questions – along with any claims data (if available) – with the major medical and supplemental insurance products offered through the exchange, and then the technology recommends a plan or an insurance package that may best fit the consumer’s needs.

5. Comprehensive Support Services

Lastly, a successful private exchange will provide customer services that seamlessly facilitate the purchase of health insurance, and customer support from the time the consumer enters the private exchange, all the way through to the actual purchase of a health plan and/or supplemental insurance product(s). In other words, the exchange provides services at the front-end of the purchasing process, and the necessary services to ensure the consumer gets health care coverage on the back-end. As discussed, such end-to-end transactional services begin with the web-site where the consumer can view the inventory of plans and shop for their coverage. Once the consumer decides on a particular plan or insurance package (usually with the assistance of decision support or recommendation technology), the exchange will collect the consumer’s enrollment information electronically. The exchange will then transmit this information to the insurance carrier providing the coverage in electronic form. And finally, the exchange will facilitate the funding of the health care coverage.

In addition to these services, a private exchange company will often serve as a benefits administrator or as a resource to health care consumers with questions about the inventory of health plans offered, or questions about the health coverage they have elected through the private exchange. Here, the relationship between the private exchange and the consumer continues on an ongoing basis, where the consumer may tap the resources of the private exchange for as long as the consumer is enrolled in a plan(s) or insurance product(s) offered through the exchange. In some cases, the private exchange has a client services team to support employers, and a call center to support consumers and their families, throughout the entire year. These services value-add to the customer services already provided by the private exchange, essentially making the exchange a full-service operation when it comes to purchasing health insurance coverage.

What Private Exchange Models Are Out There?

In general, there are three private exchange models in the current marketplace:

- Group Market Private Exchange – A private exchange that sells “group” health insurance to employees of employers.

A private exchange company will often serve as a benefits administrator or as a resource to health care consumers with questions about the inventory of health plans offered, or questions about the health coverage they have elected through the private exchange.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

- “Individual in Group Clothing” Private Exchange – A private exchange that sells individual market health plans to employees of employers through an HRA.
- Individual Market Private Exchange – A private exchange that sells health insurance to individuals and families in the individual health insurance market.

1. Group Market Private Exchange

Currently, there are private exchanges that service the “group” health insurance market. These private exchanges typically sell fully-insured group health plans to employers with as few as 2 employees to employers with 3,500 employees. These private exchanges may also offer plans to employers that self-insure their employees’ health risks, although this is not their primary market. Successful group market private exchanges offer employees the opportunity to choose from an inventory of varying major medical plan designs (e.g., 10 to 20 plans with a cost differential of upwards to 60%). This is a significant departure from the way small and mid-sized employers typically offer health care coverage to their employees – where they only offer 1 or 2 plan options. A successful group market private exchange will also offer a menu of supplemental insurance products that a consumer may purchase to complement their major medical coverage. Offering supplemental products (e.g., hospital indemnity, stand-alone dental and vision, and specified disease coverage) to employees is similarly not typical among most small to mid-sized companies.

Importantly, the most innovative private exchanges in the group market offer the option of a defined contribution payment system. As discussed above, under this approach, employers working with the private exchange decide how much money they want to spend on their employees’ health care coverage and they set aside these amounts in a notional bookkeeping account or an HRA. The employees then access the private exchange, equipped with the dollars the employer has provided them to shop for coverage.

When the employees access these private exchanges, they are plugged into the “recommendation technology” employed by the private exchange company. As described above, the employees are asked a series of questions and the technology essentially develops a “profile” of the consumer. The technology then matches up the consumer’s profile with various major medical health plans that are offered to them, along with specified supplemental coverage, and the technology recommends a plan or insurance package that is best for that consumer. The employee is then given an opportunity to understand why the particular plan or insurance package was recommended by reviewing informational material or watching an educational video explaining the benefits and services offered under a particular recommended product. If the employee is not satisfied with the recommended health plan/insurance package, the employee can choose their own plan/insurance package in an “a la carte”-type fashion.

Finally, successful group market private exchange companies offer end-to-end transactional services, making the buying experience a seamless process from beginning to end. These private exchanges also offer human resource-related services to the employer, effectively allowing the employer to streamline benefits administration.

When the employees access these private exchanges, they are plugged into the “recommendation technology” employed by the private exchange company.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

2. “Individual In Group Clothing” Private Exchange

Another private exchange model that offers insurance to employees enables the employer to allow its employees to purchase plans in the individual health insurance market (as opposed to the “group” market). Under this model, the employer funds an HRA that an employee may use to purchase an individual market plan. In this case, although the employee is purchasing an individual plan, the employee uses tax-preferred dollars instead of after-tax dollars.

“Individual in group clothing” private exchanges generally employ the same features as group market private exchanges. For example, these private exchanges offer the defined contribution payment system, “recommendation technology,” and end-to-end transactional services. The main difference between these private exchanges and the group market private exchanges is the type of State-regulated health insurance products they offer (e.g., individual market plans vs. group market plans).

It is important to note that currently, “individual in group clothing” private exchanges only operate in a limited number of States. This is because although an employee is purchasing an individual market plan, Federal regulatory guidance – and even some State insurance laws – indicate that where an employer funds its employees’ purchase of individually underwritten policies through an HRA, the HRA would be considered a group health plan, and therefore, subject to the HIPAA nondiscrimination rules. Under HIPAA, the premiums paid for a group health plan cannot vary based on the health status of the insured, which occurs by definition when a plan is underwritten in the individual health insurance market.

In 2014, however, the new health care reform law prohibits insurance carriers from underwriting individual market plans based on health status. This change in the law should open up more markets for this model because presumably, employers may allow their employees to purchase plans in the individual market through an HRA without any concern of violating HIPAA. But, because insurers are no longer permitted to underwrite an individual market plan based on health status, coupled with the new adjusted community premium rating rules that insurers must abide by beginning in 2014, the premium rates in the individual market could be higher than the rates in the group market. This may be especially true for younger, healthier workers and for workers in States where the individual and small (and large) group markets remain segregated.

3. Individual Market Private Exchange

A private exchange in the individual market is arguably the most simplistic of all of the private exchange models. In general, these private exchanges offer inventory (i.e., a variety of plans underwritten by multiple carriers) and end-to-end transactional services, including customer support for consumers with questions about the products that are made available through the exchange. These private exchanges also employ electronic payment systems that facilitate seamless payment for coverage upon initial purchase. Private exchanges in the individual market, however, generally do not offer the same decision support as private exchanges in the group market (or in an “individual in group clothing” private exchange). And, currently, premium rates for older, sicker individuals are typically higher than premium rates for these

Private exchanges in the individual market, however, generally do not offer the same decision support as private exchanges in the group market.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

same individuals in the group market (although the premium rates for younger, healthier individuals are often times be less than group market rates).

After the enactment of the new health care reform law, it appeared that private exchanges in the individual market would be irreparably harmed by the new health insurance Exchanges created under the law (hereinafter referred to as “public Exchanges”). This was due to the fact that the rich subsidies for health insurance that are to be made available in 2014 could only be accessed if the consumer purchased insurance through the newly created public Exchanges. In other words, consumers purchasing an individual market plan through a private exchange could not access the subsidies.

However, the Department of Health and Human Services (“HHS”) clarified in final implementing regulations that agents and brokers that operate a “web-based entity” (otherwise known as a private exchange) can sell to individuals “qualified health plans” (“QHPs”) offered on the public Exchange and these individuals will be able to access the subsidies for health insurance (if eligible based on income and family size). It is important to point out that States have the flexibility to determine whether its public Exchange will work with “web-based” agent/broker entities (i.e., private exchanges) or not. In other words, the State will decide whether it wants to leverage private exchanges to serve as an extension of the public Exchange.

While there is limited guidance on web-based entities, one can speculate that these private exchanges will operate in a similar manner as described above, employing the various features that make a private exchange a successful one. However, because the HHS regulations require significant coordination between the private exchange and the public Exchange, and the new rules require the public Exchange to perform critical functions, such as transmitting enrollment information to insurance carriers, some of the core services that would otherwise be performed by the private exchange may be performed by the public Exchange, or not at all. As a result, a private exchange that wants to serve as a web-based entity may differ from the models in the current marketplace.

Please note that a web-based entity/private exchange may continue to offer health insurance sold outside of the public Exchange. In this case, the private exchange will likely employ the features discussed above, and will likely find success selling products to health care consumers in the individual market that may not be eligible for the subsidies for health insurance. It is also important to point out that premium rates for older, sicker individuals will likely be lower than current rates in the individual market due to the prohibition against underwriting based on health status and the new adjusted community rating rules that are applicable in the individual market beginning in 2014 (although these new rules will likely increase the premium rates that younger, healthier individuals currently enjoy in the individual market).

States have the flexibility to determine whether its public Exchange will work with “web-based” agent/broker entities (i.e., private exchanges) or not. In other words, the State will decide whether it wants to leverage private exchanges to serve as an extension of the public Exchange.

Private Health Insurance Exchanges: What Are They and What Makes Them Successful?

The Future?

Even if the new health care reform law is modified or halted by a Supreme Court decision or the 2012 elections, private exchanges will play a critical role in the future of health care. Why? Because private exchanges provide a consumer-friendly way to purchase health insurance, often times at lower costs. Private exchanges offer expanded choice of health plans and insurance packages, which most consumers today want, especially in the group health insurance market. Private exchanges also make it easy to choose a plan that best fits the consumer's needs. Importantly, private exchanges will not replace the role of benefit consultants or the traditional agent or broker. Instead, private exchanges are a product for the next generation, and consultants/agents/brokers working with a private exchange will likely profit from selling insurance products to a larger number of health care consumers. Health plans participating in a private exchange will also be able to reach a wide variety of customers, and consumers that are anxious to transition from a one-sized-fits-all model to customized health care solutions.

Private exchanges provide a consumer-friendly way to purchase health insurance, often times at lower costs. Private exchanges offer expanded choice of health plans and insurance packages, which most consumers today want, especially in the group health insurance market.