ACA Phase 2:
Strategic Considerations for Employers

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1. Main ACA Provisions on Employers' Radar

Employer provisions:

- Employer mandate (effective next year)
- SHOP exchanges (implemented, with problems)
- Small Business Health Care Tax Credit

Objectives for today:

1. how do these provisions work
2. how do they affect/create decisions for employers
3. economic case for exchanges
4. how are the exchanges doing

Employer Mandate

- Only applies to employers with 50+ FTEs
- Goes into effect Jan 1, 2015 (postponed)
- Employer must offer “affordable” coverage meeting minimal coverage standards
- Otherwise, penalty is assessed *if* any employee of firm receives premium tax credit (the individual subsidy) for coverage purchased on HIX (the individual exchange)
- Maximum penalty = $2000*(FTEs-30)

The SHOP Exchanges

- For employers with <50 FTEs, no employer mandate
- Instead of contracting for health coverage, employers can offer coverage through SHOP exchanges
  - SHOP=Small Business Health Options Program
  - SHOP exchanges mimic function of HIX in the individual market (clearinghouse of private insurance options)
  - Employers contribute fixed amount towards premiums; employees pay difference based on their choice of plan
- Extends to employers with <100 FTEs in 2016
- Utilization of SHOP very low in yr1
  - factors: online enrollment not available in 32 states relying on HealthCare.gov; early renewals

Employer Subsidies

- Employers with <25 FTEs and average annual wages <$50k are eligible for the Small Business Health Care Tax Credit provided…
  - employer uses SHOP to offer coverage, and
  - contributes at least 50% towards costs of employee-only (not family or dependent) coverage
- Size of subsidies:
  - 50% maximum credit for employer premium costs for employers with <10 FTEs and avg wages <$20k
  - % value of credit declines as FTEs/avg wage increases

2. Employer Strategic Considerations

- The major ACA provisions apply differently to different-sized employers…
- Will take each in turn:
    - Large Employers (50+ FTEs)
    - Medium-sized Employers (25-50 FTEs)
    - Small Employers (<25 FTEs)
- Central economic insights:
    - “health benefits” are part of total compensation package
    - employer health costs offset wages
    - employers/employees jointly benefit from arrangements that maximize value-for-premiums

Large Employers (50+)

- Main ACA-related decision: continue (or start) offering insurance, or forego offering and potentially incur penalty
  - important → penalty only applies if employees receive subsidized coverage through the HIX
  - may not apply if employees are "high wage" (>400% FPL), or if "special deals" can be made with select employees
- Some opponents have argued that the ACA will cause some employers to discontinue coverage because penalties are less than employers cost of providing coverage
  - unlikely
  - if it is in employers' interest to offer coverage when NO penalty exists, why would they discontinue coverage when they're penalized for noncoverage?

Medium-Sized Employers (25-50)

- Face two levels of strategic decisions:
  - Offer coverage or not
  - If offers, utilize SHOP or contract in open market
- Employer considerations:
  - What share of employees would be eligible for subsidies on the HIX, and what is quality/premiums of plans on HIX?
    - reduces the benefit (low-income) employees derive from employer group coverage
  - Diversity of employee preferences for different types of coverage
    - diverse preferences → greater value in using SHOP or leaving employees to nongroup market
  - What is quality/premiums of plans on SHOP?
    - dependent on insurer participation

Small Employers (<25)

- Face similar choices and strategic considerations as medium-sized employers with the following caveat
  - if avg wage < $50k, opportunity for employer subsidies increases incentive to offer coverage and utilize SHOP
  - employers should calculate the size of the discount potentially available to them
  - but availability of individual subsidies on the HIX also reduces value of employer group coverage for these employees

3. Why Exchanges?

- Most large employers self-insure, and evidence suggests they get reasonably good “value-for-premium”
  - low admin costs → more HC dollars end up financing health services instead of overhead

- Contrasts poorly with the small group and nongroup markets
  - see Table 5 from Litow (2006) report

Table 5
Private Industry Assumed Expense Summary by Market and Function

Administrative Costs by Market	Individual	Small Group	Large Group	Total as a % of Earned Premium
Overhead, Miscellaneous	2.0%	2.0%	1.0%	1.3%
Issue Underwriting	3.0%	1.5%	1.0%	1.3%
Actuarial	1.0%	1.0%	0.5%	0.7%
Record Keeping, Policy Service, Compliance	1.5%	1.5%	1.0%	1.2%
Claims	3.0%	3.0%	3.5%	3.3%
Development, Eligibility, and Enrollment Subtotal	**10.5%**	**9.0%**	**7.0%**	**7.8%**
Commission	12.5%	8.5%	1.0%	4.0%
Marketing (non-commission)	2.0%	1.5%	1.0%	1.2%
Profit	3.0%	2.0%	2.5%	2.5%
Selling & Cost of Capital Subtotal	**17.5%**	**12.0%**	**4.5%**	**7.6%**
Total (excluding taxes)	**28.0%**	**21.0%**	**11.5%**	**15.4%**
Premium and Other Tax	2.0%	2.0%	1.0%	1.3%
Total (as a % of earned premium)	**30.0%**	**23.0%**	**12.5%**	**16.7%**
Total Without Commission, Premium Tax & Profit	**12.5%**	**10.5%**	**8.0%**	**8.9%**

http://www.cahi.org/cahi_contents/resources/pdf/CAHIMedicareTechnicalPaper.pdf

Note: reflects 2003 data.

Key Points

- Share of premiums absorbed as "overhead" is dramatically higher in small group/nongroup markets
  - Large (12.5%), Small (23.0%), Nongroup (30.0%)
- Almost <u>none</u> of the difference is due to *differential profit margins*
  - Large (2.5%), Small (2.0%), Nongroup (3.0%)
- Most of the difference is due to differential costs of *marketing* (esp. broker commissions)
  - Large (2.0%), Small (10.0%), Nongroup (14.5%)

- *So what could explain this?*

Search Frictions (*AER* 2012)

- In some markets, consumers have difficulty comparing all their options, which undermines optimal choice
  - hard for employers/individuals to evaluate value-for-premium, can at best evaluate a subset of their options
- Implications
  - "law of one price" fails for identical insurance products
    - instead insurers profitably pursue a range of premium-setting strategies (high margin/low volume vs. low margin/high volume)
  - insurers compete more so over "marketing" activities, less so over actual value-for-premium
  - equilibrium premiums are higher (on avg), but don't necessarily lead to higher profit margins
    - excessive premiums end up financing excessive marketing expenses ("marketing arms race")

Why Exchanges?

- The economic case for "exchanges" is that they make the marketplace easier to navigate, thus reducing the negative effects of search frictions
  - lower premiums
  - less (unexplained) premium variation
  - less insurance turnover
  - lower marketing costs
- Sometimes these exchanges arise naturally ("from the market")
  - i.e. when both sellers and buyers benefit from reduced frictions (think stock exchanges)
- Other times, they have been created publicly
  - i.e. when consumes benefit but sellers may not (think Medicare Part D)

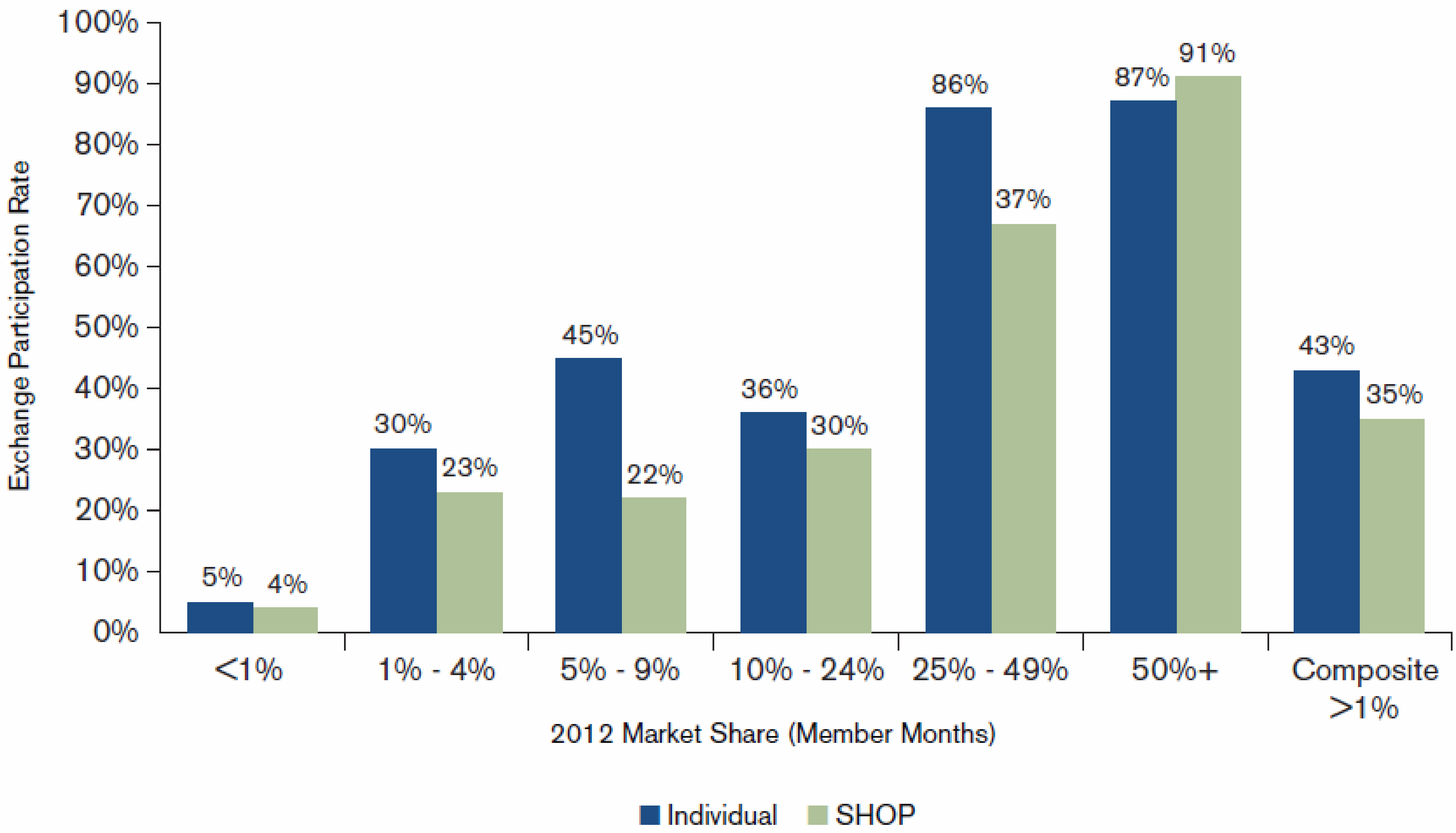
4. How are HIX and SHOP doing?

- Considerations of medium/small employers largely hinge on how well the HIX and SHOP exchanges operate
  - Do they provide good value-for-premium?
  - Do they offer the types of coverage *my* employees would find attractive?
  - Do they offer a diversity of coverage types to appeal to the diverse preferences of *my* employees?
  - And are the two exchanges different along these dimensions?
- And these things largely depend on insurers' participation
- *What do we know so far?*

Insurer Participation

- In first year, participation rates were modest, but appear to be increasing this year
  - large-market share insurers more likely to participate in yr1
  - participation rates were higher in HIX than SHOP
- Noticeable increase in entry of new insurers
  - 22% in HIX; 14% in SHOP
  - mostly offering “value” options
- Number of competing insurers varies widely by market size
  - not uncommon for small markets to have only 1-2 insurers competing on HIX/SHOP exchanges

Insurer Participation Rates by 2012 Market Share



Plan Options

- Average number of plans offered in each market (yr1)
  - on HIX: 48
  - on SHOP: 24
  - again, highly dependent on market size, # participating insurers
- Premiums on HIX were surprisingly low compared with typical employer group plans
  - but haven't seen convincing apples-to-apples comparisons
- High propensity of "narrow network" plans, and plans at the silver/bronze levels
  - suggests insurers expected particularly price-conscious consumers in these markets

Plan Options

"Across the markets we analyzed, there is a greater breadth of network options available on the individual exchanges compared to the 2013 individual market, with nearly every rating area offering consumers products with networks spanning from very narrow to broad. This trend is consistent with what we see in most well-functioning consumer markets ranging from cell phone plans to automobiles – a variety of choices comprising different value propositions at different price points."
(McKinsey Center for U.S. HC Reform, 2013)

- This specifically relates to the HIX
- In the near term, SHOP exchanges still face concerns in terms of low insurer participation, and low *employer* participation could undermine *insurer* participation

Thank you!

- Looking forward to your questions…