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The Private Exchange Blog

Considering a Private Exchange? What You Need to Know Before You Decide to Switch

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As organizations continue to explore the possibility of offering their employees health care coverage through a private exchange, many are considering coupling this approach with a defined contribution (DC) strategy. Although a DC approach is not required under a private exchange, the level of choice available in these exchanges makes it attractive for some employers to switch to DC.

Under a DC/private exchange approach, the organization determines the amount of money to contribute on a per-employee basis. Employees can use that money to purchase a health care plan that meets their needs and fits their budget by selecting coverage from a menu of plans on their employer's private exchange. Many organizations believe a DC/private exchange will allow them to more accurately budget what they want to spend on health care and offer employees a wide choice of plans.

While this may sound attractive, it is important to understand the implications and how the move would affect the organization's employees and its budget. Employers should be aware of following issues:

- **Risk elimination is a myth.** Although many organizations think switching to a DC/private exchange will eliminate their claims fluctuation risk, those that self-insure will still be liable for the DC amount plus any claims that exceed their underwriting. For example, a self-insured organization that contributes $4,500 per year per employee to its 1,000 employees towards the cost of a $5,000 plan will still be liable for annual claims that exceed their expected total budget of $5 million. Employers are ultimately responsible for paying all claims up to any stop-loss insurance limit, regardless of whether the plan is trending well or is in a deficit. While being fully insured eliminates claims fluctuation risk, it also creates possible pitfalls, including additional taxes and risk premiums that are built into the rates. Furthermore, private exchanges are not insurance captives and do not pool risk across various employers, so each employer remains its own risk pool.

- **Geographical costs differ.** In a private exchange environment, plan premiums can vary from location to location. For example, a plan that costs $400 per month in one part of the country may cost $500 in another. Under a DC/private exchange, an organization's monthly contribution that might cover 100 percent of an employee's health care insurance costs in Montana might cover only 60 percent in New York. Rather than having one set of employee contributions for all employees, large organizations with employees in various parts of the country may want to consider adjusting their contribution depending on the cost of coverage where their employees live.
- **Some employees will be "financial losers."** Many organizations currently use their health care contribution strategy to incent individuals to enroll in a specific plan. Adopting a DC/private exchange may turn employees who were "financial winners" under the existing plan into "financial losers." Although employees' decisions about which plan to buy under a DC/private exchange will be based on the true cost and value of

the various plans, employees who now have a subsidized plan may feel cheated. In addition, many employees are not well equipped to evaluate competing plan values, network quality, access to specialists, drug formularies and many other important elements that should be part of the decision-making process. As a result, employers need to determine if their workforce is ready for such a transition and that the member support tools available through the exchange will be adequate to help employees make well-informed decisions.

- **Dependents/tiers do not have to be treated equally.** Organizations need to consider whether and how to cover dependents. While the Affordable Care Act mandates offering coverage for children 26 and under, there are no rules for covering an employee's spouse. For example, an organization that contributes $4,500 per employee to purchase health insurance does not have to contribute an additional amount if it decides to cover children and spouses. Although the overriding idea behind a DC/private exchange is to make "one contribution" for health benefits, the contribution often varies by coverage tier (single, dual, family) to limit the impact of the DC transition on those with family coverage. It is important to review the implications and the impact on the organization's budget when evaluating spouse and dependent contribution decisions.
- **Improved participation may increase costs.** Organizations that switch to an exchange environment may offer plans that are less expensive than their current offerings, which could create an offering that much more affordable under a DC structure in an exchange. The resulting "free"/low-cost plan could increase participation in the organization's group health plan. Organizations need to carefully consider what it would cost to create such an environment and the overall impact of the change. For example, a jump in participation from 60 percent to

75 percent could significantly increase the organization's health care budget if the current subsidy is not reduced.

Transitioning to a DC/private exchange can be complex, and it will affect the organization's employees and its budget. Organizations need to know that the change may not be as simple as it looks.

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