Improving Insurance Purchasing as Part of Health Reform

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Basic Challenge with Insurance Markets

- Making coverage affordable generally
  - Two solutions
    - Improved efficiency — yield lower price
    - Subsidies
- Making affordable for high-risk people
  - Could afford “average price” coverage but not premium sufficient to cover high risk
Improving Market Performance - State and/or Federal Options

- Insurance rate reform
  - Moving toward community rating
  - Guaranteed issue
- High-risk pools
- Publicly funded reinsurance
- Section 125 plans
- Insurance exchange/purchasing pool / Connector
Mandating Section 125 Plans

• Reduces cost of coverage because of federal tax subsidy even when employer coverage not offered
• Employee voluntarily reduces income to have employer pay premiums
• Salary reduction amount not taxed as income or FICA wages
  – FICA savings is 7.65%
  – Federal marginal rate 10% to 35%
  – State income tax rates 0% to 9%+

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Mandating Section 125 Plans

• States can apparently mandate without ERISA problems
• Costs state almost nothing
• Not onerous for employers
  – Few requirements
  – Need not pay any premium
  – Saves employer FICA tax on reduced amount
• But might induce some employers to drop coverage

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Insurance Exchange
Solving Problems for Small Groups and Individuals

• High administrative costs
• No single place to go to buy coverage or get objective information
• No standardization of products
• No bargaining power with insurers
Insurance Exchange Solution

• Efficient single source of coverage
  - Place to see and choose plan alternatives
  - Compare plan values (report cards)
  - Place to use subsidies to maximize impact
• Puts health plans in head-to-head competition
  - Examples: FEHBP and CalPERS
• Some administrative economies of scale
Lessons Learned About Exchanges

• Hard to attract customers
• Hard to attract and keep health plans
• Need to be big to achieve objectives
• Unlikely to lower price appreciably without complementary policies
• Can not separately pool risk unless captive audience (like FEHBP)
Exchange Design Issues

- Public or private or something in between
- Price taker or negotiator - Every willing health plan or selective contracting
- Degree of benefit standardization
- Required source for some populations?
A Federal Exchange

• Assume some substantial subsidies to purchase private coverage are part of federal reform
• But general subsidies alone not adequate for high-risk people – face high private premiums
• Individuals and small-groups need efficient source of coverage
• Levels the playing field for people in different states
• Strong source of leverage (as with Medicare)

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Federal Exchange – Problems

• Would have to provide guaranteed issue and some form of community rating to be politically acceptable

• But many states do not provide coverage on that basis (especially in individual market).

• Could cause adverse selection against federal exchange; could be very costly
Federal Exchange - Solutions

• “Eat” the cost of adverse selection
  - But create strong incentives for states to change rating rules away from community rating

• Require uniform rating rules in all states
  - But could create “sticker shock” for low-risk people
Complements to Exchange

• Most promise if combined with other reforms—subsidies, rate compression, standardized benefits, mandates

• Part of Massachusetts grand reform

• Key element in proposed California reform

• Included in several Presidential candidates’ health reform proposals