



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%+

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

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

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)

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