

Private Exchanges 101

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By now most everyone is familiar with the public exchanges mandated by the Affordable Care Act beginning January of 2014; these are state specific, government run health insurance exchanges. Locally, the Health Connector will serve as the public exchange offering for the state of Massachusetts. At its core an exchange is an online marketplace where individuals can shop for health insurance. Public exchanges market a mandated menu of insurance offerings to individuals.

Over the past 12-24 months employers have started to become exposed to what I would describe as an alternative and emerging health insurance distribution system, the “Private Exchange”. These models represent a more contemporary form of the old defined contribution approach to providing employer sponsored benefits (including health insurance) that had gained traction in the 90’s, but never achieved the success that was forecasted. The advent of the “Public Exchange”, coupled with sophisticated technology, has enabled private organizations like insurance companies, insurance brokers, business and industry associations to begin to market employee benefits to employer groups via an online marketplace. A private exchange will extend an employer the ability to offer its employees a fixed dollar contribution, which the employee can then use to shop for their employee benefits via an interactive online portal that will provide a robust menu of alternatives chosen by the employer.

Appealing features to an employer include: a fixed budget (cost certainty), the ability to enable employees to choose the benefits that are most important to them, less administration, and fewer employee issues. In theory, all that the employer needs to decide each year is how much do they budget for their employees to spend and what choices they offer to them to spend it on. One vendor described the exchange as a store; the employer gives their employee money to spend, provides them with access to the store (the online portal) and decides what is offered for sale in the store. After that it is up to the employee to utilize the tools that are provided them to decide what offering best suits their budget and personal needs.

So far it sounds pretty good; however, here are some of the uncertainties:

Keep in mind, this is a brand new frontier and many organizations are diving in because they are looking to garner market share. Their bet is that they have enough influence over their current constituents to steer the necessary volume to make the exchange viable. If viable, they hope to expand their influence over others, grow the platform and ultimately make money.

Offerings for small to mid-sized employers will be insured products that, in some instances, will include multiple insurers, offering multiple plan designs, which will inevitably create adverse selection issues that could force insurers to increase cost or perhaps withdraw from the platform altogether. It is inevitable that a number of these models will fail. So choosing the right model is going to be crucial.

Adverse selection could also lead to an overall cost structure that is much more expensive than the more traditional current group model. In this scenario the employer will be left with a difficult decision, contribute more to the overall cost or let the employees suffer the financial hardship.

The online platform is a critical component to the success of any private exchange. It is “the store” before anything is put in to sell. One of the major players in this market is an organization called Liazon; they are serving as the online platform for many of the emerging private exchanges. For example, BCBS of MA recently contracted with them to serve as the platform for their new private exchange called My Blue Choices. We have viewed the technology and it is fairly impressive. Like most technologies that are sold, the sales person will make it sound real good on the front end. Experience tells us you really need to start using it to fully understand what works real well and what does not.

The private exchange model, with its dependence on technology, will likely present a hardship for companies with significant non-English speaking populations or organizations with significant blue collar populations where online access may be limited.

Making the move to a private exchange will represent dramatic change from current employer sponsored plan offerings. Once committed to this type of platform it will be very difficult for an employer to return to a more limited selection of plans without creating employee relation issues.

If effective, the online platform that you engage may prove more difficult to pull away from than the insurance offerings themselves. So a platform that works well and has access to multiple exchanges could prove beneficial if insurance costs become a problem down the road.

Additional expense; the online platform is not free, it comes at an expense. Will that expense add to the cost of benefits or will there be administrative efficiencies that will offset the cost?

Our goal today was to simply provide you with a high level overview of an emerging market for employee benefit distribution. At this juncture it is far too early to predict the ultimate impact. We will keep you posted as the market unfolds. Stay tuned!