The Progress and Potential of Private Exchanges
Evaluating an Emerging Marketplace and Its Opportunities for Employers

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Introduction

Few healthcare industry developments in recent years have had more far-reaching effects on U.S. organizations and individuals than the emergence of public and private healthcare insurance exchanges. The news media’s nonstop coverage of the Patient Protection and Affordable Care Act (PPACA), better known by its household name “Obamacare,” has raised widespread awareness of the subsidized public exchanges associated with this legislation.

Private exchanges, operated by private businesses, have come to the forefront more gradually and selectively. Employers have been cautious about abandoning their traditional approach to providing healthcare benefits, but with the steep rise in healthcare costs showing no sign of easing, many are taking a closer look at the strategic potential of private exchanges. Organizations need to find a way to offer an employee benefits package that is both affordable and competitive.

In a benefits marketplace that has proven difficult to predict in recent years, employers want to understand private exchanges and how they fit into this changing landscape. This whitepaper provides an introduction to insurance exchanges with a focus on employer-sponsored group exchanges, looks at the current state of the market, and offers a basis for evaluating and understanding the potential of a private exchange for better supporting organizational goals and objectives.

Private Exchanges vs. Public Exchanges

Exchanges are marketplaces for benefits. Public exchanges, created and operated by states or the federal government, enable consumers and small businesses to enroll in PPACA-based private insurance health plans or state Medicaid plans. Based on 2014 open enrollment, approximately one-third of U.S. states (including D.C.) run their own PPACA exchanges and two-thirds are served through the federal exchange Healthcare.gov.

Typically provided by broker/consultants, carriers and other healthcare industry organizations or third parties, private exchanges are sponsored by an employer or an association. These exchanges offer group plans, individual plans or both types of plans, and the medical, ancillary, voluntary or other benefits they make available can be fully insured or self-insured.

Private and public exchanges were once seen as competitors because government subsidized plans are only available for purchase in public exchanges, but that line has begun to blur. While private exchanges mostly serve employers as well as consumers that purchase coverage outside of PPACA, some have worked with public exchange operators to also allow the purchase of PPACA-based subsidized coverage. In addition, group plans offered by employers through a private exchange must be affordable and meet the minimum PPACA requirements.

Private exchanges can also support PPACA compliance. Some observers speculate that employers may look to private exchanges for a range of health plans, including a “skinny plan” that would satisfy their PPACA obligation.
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to offer a plan to 95 percent of their employees. Although this plan might not meet the minimum value or affordability standards, in most cases the penalty would be much less severe than the penalty for no plan at all.

Reporting requirements for employers subject to the postponed employer mandate will include verification that employees were offered adequate and affordable coverage, and private exchanges may be asked to provide this proof. While the delay of the mandate has reduced the urgency of this issue, private exchanges will soon need to prepare to support the reporting requirements.

<table>
<thead>
<tr>
<th>Governance</th>
<th>Public Exchange</th>
<th>Private Exchange</th>
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<tbody>
<tr>
<td>Governance</td>
<td>State/federal governments</td>
<td>Exchange providers:</td>
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<tr>
<td></td>
<td></td>
<td>• Broker/consultants</td>
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<td>• Carriers</td>
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<td>• Other</td>
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<thead>
<tr>
<th>Market Segments</th>
<th>2- to 50-person employee groups and consumers; will increase to 100-person employee groups in 2016</th>
<th>All group sizes, consumers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product offerings</td>
<td>Health and dental</td>
<td>Health, dental, life, wellness and other ancillary offerings</td>
</tr>
<tr>
<td>Carrier choice</td>
<td>Determined by state</td>
<td>Determined/controlled by exchange and participating employers</td>
</tr>
<tr>
<td>Subsidies</td>
<td>Government subsidies for consumers and tax credits for businesses</td>
<td>Employer defined contribution or defined benefit</td>
</tr>
</tbody>
</table>

Types of Private Exchanges

Driven by aggressive capital investments and supported by solid marketing and extensive public relations, private exchanges are rapidly evolving. Private exchanges can currently be categorized by four types:

1. Pre-65 Group Sponsored Exchanges
2. Post-65 Group Sponsored Medicare Exchanges
3. Pre-65 Consumer Exchanges
4. Post-65 Consumer Exchanges

<table>
<thead>
<tr>
<th>Pre-65</th>
<th>Post-65</th>
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<tbody>
<tr>
<td>Group-Sponsored</td>
<td>Sponsored by employers or affinity groups</td>
</tr>
<tr>
<td>• Offer group and individual coverage</td>
<td>• Offer group and individual coverage</td>
</tr>
<tr>
<td>• Offer traditional health products and other lines of coverage (dental, vision, etc.)</td>
<td>• Offer Medicare health and Rx products and other lines of coverage (dental, vision, etc.)</td>
</tr>
<tr>
<td>• Fully insured and self-insured products</td>
<td>• Fully insured and self-insured products</td>
</tr>
<tr>
<td>• Offer multiple plan designs, but may not offer multiple carriers</td>
<td>• Offer multiple plan designs and typically offer multiple carriers for individual coverage</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Consumer</th>
<th>No sponsorship—retail offering</th>
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<tbody>
<tr>
<td>• Offer individual coverage only</td>
<td>• Offer individual coverage only</td>
</tr>
<tr>
<td>• Offer traditional health products and other lines of coverage (dental, vision, etc.)</td>
<td>• Offer Medicare health and Rx products and other lines of coverage (dental, vision, etc.)</td>
</tr>
<tr>
<td>• Fully insured products only</td>
<td>• Fully insured products only</td>
</tr>
<tr>
<td>• Offer multiple plan designs and multiple carriers for most products</td>
<td>• Offer multiple plan designs and multiple carriers for most products</td>
</tr>
</tbody>
</table>
Private Exchange Variables

Within the four main categories of private exchanges, there are a number of variables that distinguish one private exchange from another.

Carrier selection model

The carrier selection model is an especially significant variable for employer group exchanges and includes three model variations:

- **Group-selected**—the sponsoring employer selects a carrier from the broker/consultant’s or other exchange provider’s participating carriers. Each carrier makes a proposal to the employer through the exchange provider and the employer ultimately decides which proposal to accept. This model closely parallels group insurance market operations.

- **Employee-selected**—the employee participant in an employer-sponsored group exchange selects a carrier from a group of carriers offering a set of identical plan designs.

- **Exchange-selected**—a geographic-based model uses different carriers to serve different regions.

Each carrier selection model has advantages and disadvantages, and private exchanges are expected to achieve a greater level of innovation as their providers look to assemble the most cost-effective value proposition for their customers.

Decision support

Private exchanges typically provide participants with a greater number of plan choices than a traditional health plan offering. Because browsing more options often involves more detailed comparisons, this task requires good decision support tools. Different levels of decision support are available from exchanges and many provide tools to help simplify the plan selection process. For example, self-guided interactive experiences engage employees in a dialogue about their personal benefit needs, preferences and approaches to risk, and Amazon.com-style recommendations show what “people like me” are purchasing. Targeted plan recommendations are also developed based on “big data” claims and usage analysis. Because exchange operators see decision support offerings as competitive differentiators, this element of private exchanges should continue to evolve rapidly.

Plan choice

Private exchanges offer a selection of medical plan designs to employees and are still experimenting to find the best way to communicate the distinctions. Some use a “medal” structure (Bronze, Silver, Gold and Platinum) similar to the PPACA exchanges. Others offer filtering and decision support tools to participants.

Individual or group coverage

Currently, most private exchanges specialize in either group or individual coverage although some exchanges that focus on individual coverage also offer coverage for small employers. Within the group market,
there is movement to expand into individual coverage to fully meet the comprehensive needs of employers—including part-time employees, retirees and COBRA-eligible former employees.

**Active employee or retiree coverage**

Much of the early exchange activity in the employer market centered on retirees and private exchanges were built to support this group. Coverage for active employees emerged later and is sometimes handled through separate exchanges because of unique requirements. Over time, these exchanges will likely merge.

**Defined contribution methodologies**

Private exchanges may either require a defined contribution approach or make it available as an option. Either way, these exchanges provide employers with a framework that is well-suited for implementing a defined contribution strategy, including the ability to use different defined contribution methods to support employees’ plan purchases. Some employers provide a lump sum that employees allocate based on their needs and preferences, and others provide a specific amount for different product lines.

A defined contribution model for exchanges is not an escape route for avoiding complex employee benefits laws; for instance, it will not relieve employers of their compliance responsibilities under ERISA (Employee Retirement Income Security Act of 1974). However, the upside potential for benefits cost containment and stability is strong. Organizations can gain control of the increases in their benefits spend by setting a defined budget. Each year, the employer can increase the defined amount it chooses to spend on its employees’ benefits based on revenues, sales, cost of living and other factors.

**Single or multiple product lines**

Many smaller employer-sponsored private exchanges offer only medical coverage but the trend is toward offering additional product lines. The expanded coverage options include several benefit categories in addition to wellness programs.

**State of the Market for Employer-Sponsored Private Exchanges**

Recent industry surveys highlight the increased awareness and interest in private exchanges. According to Gallagher’s 2014 Benefits Strategy and Benchmarking Survey, 23 percent of respondents are considering moving to a defined contribution arrangement in the next three years— a strategy that supports private exchange adoption.

HR and benefits administration consulting firm Gruppo Marcucci estimates the current private exchange enrollee count at 1.3 to 1.9 million people. When spouses, children and other dependents are tallied, total coverage increases to two to three million. This adoption and participation data shifts the question about the future of private exchanges from “Will private

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1 Arthur J. Gallagher & Co. 2014 Benefits Strategy and Benchmarking Survey
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New players in the private exchange arena are steadily entering the market and large capital infusions support growth and development. In fact, according to Gruppo Marcucci, upwards of 200 companies with private exchange products and services have already created a very crowded marketplace. They range from traditional broker/consultants and insurance carriers to independent exchanges and technology platform providers.

Considering economic and industry factors, and the evolutionary progress of private exchanges to-date, the market seems likely to realize a growth rate consistent with other recent benefit innovations, such as consumer-directed health plans (CDHP). Based on America’s Health Insurance Plans’ (AHIP) 2013 census, CDHPs grew from one million enrollees in 2005 to 15.5 million enrollees in 2013. Employers’ willingness to accept a new business model, as well as their technological capacity, will factor into the pace of private exchange growth.

Private exchanges experienced significant development in 2014 as employers became more familiar with the concept and its strategic potential, and broker/consultants started to cement their positions. Retiree exchanges are currently making faster headway than active employee exchanges because the market for Medicare Supplement/Part D plans is already firmly established. Despite this uneven growth, overall, exchanges have strengthened their foothold within the benefits market and adoption is expected to increase over the next few years across all exchange populations—large employer, small employer, retiree and consumer. As the private exchange market matures, employers can expect to see fewer variations in operating models. The dominance of certain models will be established as market needs become clearer.

Private exchanges have started to make headway with employees as well as employers and appear to be driving a higher level of employee engagement than historical benefit offerings. SHRM reported that more than half of respondents are considering moving to a defined contribution arrangement in the next three years — Gallagher 2014 Benefits Strategy and Benchmarking Survey

As private exchanges continue to gain traction, employers will benefit from considering how these marketplaces can help them add value to their relationship with employees.

Augmenting private exchange health plan offerings with other benefit products and services is one way to strengthen the employee-employer value proposition. Wellness options are expected to become increasingly important as more employers use wellness to enhance their defined contribution.

2 AHIP Center for Policy and Research, “January 2013 Census Shows 15.5 Million People Covered by Health Savings Account/High-Deductible Health Plans (HSA/HDHPs),” June 2013, p. 3.

strategy and incent employee participation. Ancillary and voluntary lines of coverage are also adding consumer value to employer-sponsored exchanges, with employees buying less costly medical plans to free up defined contribution dollars for ancillary purchases.

In addition to providing employees with a more extensive selection, employers can offer “consumer advocacy” tools that provide the ongoing support employees need to make optimal use of the health plans and other benefits they purchase. These tools aim to involve employees more actively in their benefits, helping to meet their immediate needs, strengthen their engagement and satisfaction, and ultimately support retention.

Analyzing the Potential Fit of a Private Exchange
The task of identifying the healthcare benefits strategy that will serve the best interests of employees and help secure an organization’s financial well-being and competitive position has never been more perplexing. New healthcare reform legislation and taxes, rising healthcare costs and other factors have not only changed the rules of compliance but have also challenged the success of employers’ familiar approaches to balancing the employee-employer value proposition. Employers need help navigating PPACA and are seeking that guidance from their broker/consultant.

With the complexities of the current benefits marketplace, few employers will realize an advantage from taking a prepackaged approach. Workforces are growing more diverse and employees will continue to favor benefit packages that offer more selection for meeting their individual needs and preferences. Private exchanges are designed to allow flexibility and choice. They can be customized to the needs of an employer and its workforce, and the employer decides how much the organization contributes to the cost of employees’ benefits.

Considerations for moving to a private exchange
While it’s critical for a private exchange platform to complete employee transactions effectively, the sum of the exchange is more than its technology. This benefits solution is a collaborative process that involves the employer, its workforce and the exchange provider. Properly designed, an exchange helps to balance the best interests of employers and their employees through:

- Flexible, personalized choices for enrollees—a desired level of benefits vs. one-size-fits-all.
- Potential cost control for employers when using defined contribution.
- Potential reduction in ongoing costs of benefit administration for employers.

Employers are well positioned to increase employees’ engagement and satisfaction by actively involving them in their health plans, and giving their workforce more relevant choices with their benefit options. Organizations also stand to gain from the potential to “bend the cost curve” through the use of a defined contribution consumerism model, as well as the ability to extend benefits to those who are ineligible for group coverage.

More than half of employees would be interested in purchasing their benefits through a private exchange
— National Business Group on Health (NBGH) Survey

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However, private exchanges are not a panacea for all employers. Evaluating certain criteria can help employers decide if a private exchange benefits solution is the right fit for their organization. Readiness to move to a private exchange may be indicated when an employer:

- Has committed to a defined contribution strategy for benefits.
- Believes a private exchange aligns with the organization’s total rewards philosophy and organizational strategy.
- Needs greater control over the impact of rising benefit costs.
- Experiences a relatively long period between hiring and full productivity, and competition for talent is strong.
- Places a priority on creating or reinforcing a culture of employee engagement and empowerment.
- Wants a vehicle for offering employees more benefit choices that can also help them make the most appropriate decisions.

**Essentials for implementing a private exchange**

Any employer decision to transition to a private exchange model for health insurance should include a commitment to employee “consumer” education and marketing. Just like any other change management strategy, setting realistic expectations up-front and explaining and emphasizing the benefits of the change fosters acceptance and trust.

Many employees, especially those with more years in the workforce, could be wary of new approaches if they already know first-hand the impact of reduced benefits from rising costs. For this reason, it’s very important to establish a clear, specific and consistent understanding about the move to a private exchange—what is happening, why and when it will happen, and how it will occur. The goal is to create a positive experience that starts with employees’ introduction to the exchange and is reinforced with each interaction. Surveying employees before and after they have shopped for benefits can provide valuable insights that support continuous improvement and increased satisfaction.

Once a decision is made to transition to a private exchange that uses a defined contribution approach, the employer needs to establish a budget that considers the organization’s total rewards philosophy. Wellness should also be taken into account. Other essential steps include properly addressing regulatory and legislative concerns with a compliance evaluation, and contending with actuarial and underwriting issues that are critical to determining appropriate pricing. This is important for both self-insured and fully insured platforms that involve plan pricing by the carrier.

Finally, beyond assistance with the employee communication, budgeting and compliance components of a private exchange, partnering with broker/consultants that provide specialized expertise and holistic benefit capabilities can help organizations make the most of the solution’s flexibility and customization potential. Insight into industry nuances combined with a total rewards perspective, which considers all employee benefit components in alignment with business goals, supports fully informed decisions.
Conclusion

Employers are closely watching the emergence of private exchanges as they look for viable solutions for two continuing challenges. With no end in sight to the upsurge in medical costs, tighter management of benefit budgets has become an ongoing priority, and an increasingly diverse workforce also makes a traditional “one-size-fits-all” solution for health and other benefits impractical. These factors, combined with many organizations’ desire to seek an alternative to public health insurance options, are influencing employers to take an active interest in private exchanges.

Although few employers have wanted to be first onboard, the line for second is fast-forming. Exchanges are likely to become the primary mechanism for providing health plan options and other benefits, regardless of the speed of adoption, as the private exchange marketplace continues to crystallize over the next few years. In a highly regulated, changing benefits landscape, broker/consultants will continue to provide a critical link in translating employer and employee needs to viable exchange models, helping organizations minimize risk, maximize rewards and drive growth.
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Mr. Rick Strater is the Benefits & Human Resources Division Vice President & National Exchange Practice Leader at Arthur J. Gallagher & Co. where he leads the execution of the company’s private exchange strategy in support of Gallagher’s revenue growth objectives. He is also responsible for the coordination of carrier and vendor selection, plan designs and products and services for the Gallagher Marketplace private exchange platform. Prior to joining Gallagher, Rick held senior leadership roles at insurance, consulting and technology companies. Rick earned his Bachelor of Science and Master of Business Administration from Indiana University in Bloomington, Ind. He also holds multiple professional licenses and certifications, including that of ISCEBS (International Society of Certified Employee Benefit Specialists) Fellow.

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GPM works directly with brokers/consultants, employer groups, insurance carriers, service providers, investors and exchange sponsors. A deep working knowledge of the market and its many players, coupled with professional independence, allows GPM to bring together the right players to provide the right solution for the client’s needs. An established industry thought leader, Rhonda has authored articles on a range of benefits administration technology and outsourcing topics for several leading industry journals. She is also a regular speaker at industry events.

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