

The Exchange Equation: Avoiding a Death Spiral with a Balance of Risks

By John Reichard, CQ HealthBeat Editor

Liberals need not lament the fate of a public plan in health care. Experts say that creating insurance “exchanges” that offer a menu of competing plans would do a better job of controlling premium costs in any case.

But lawmakers writing the details of the exchange provisions in the health care overhaul should be worried nonetheless. The way they design exchanges will have to be bulletproof — because insurers don’t like them and are aces at killing them off.

The big health care overhaul attempt in the 1990s led to a number of state-based exchanges, called “alliances,” that withered despite high hopes of policy makers.

The idea was irresistible — invite individuals and small businesses to shop in a new marketplace of health plans, and watch premiums fall as insurers fought it out to win market share in a big new purchasing pool.

“Our system pooled small employers into purchasing groups large enough to obtain the lower wholesale insurance rates that big companies get,” Cappy McGarr recalled in a recent op-ed piece in *The New York Times*. McGarr ran a state exchange created by the Texas legislature in 1993. “Initially, the alliance worked as planned,” he said. Six years later, the alliance was dead.

The problem was that insurers were able to offer policies inside and outside the exchange. They “cherry-picked relentlessly, signing up all the small businesses with generally healthy employees and offloading the bad risks — companies with older or sicker employees — onto the exchange.”

Exchanges in California, Florida, and North Carolina similarly succumbed to such “adverse selection” and fatally high premiums in a phenomenon insurers call “the death spiral.” But lessons from the real world also show that lawmakers can design exchanges that mix good and bad risks to make premiums affordable. David Riemer, who was involved in the design of the exchange credited with lowering premiums paid by state employees in Dane County, Wis., says the key to success is having a chunk of business too big for insurers to ignore. It also must mix good and bad risks.

Riemer, director of policy and planning at the Community Advocates Public Policy Institute in Milwaukee, says exchanges must have at least 20 percent of the local insurance market to work. The state employee exchange has 25 percent of the non-Medicare, non-Medicaid market in Dane County, the home of Madison, the state capital.

But parts of the exchange serving state employees elsewhere fall far short of 20 percent. The result: Family premiums cost state workers \$3,000 less in Dane County.

By Riemer’s calculation, the exchanges contemplated by Congress would be too small, with a 14

percent market share. He recently joined with Stanford University economist Alain Enthoven, widely regarded as the father of the exchange concept, in saying that the exchanges need to be open to employers with up to 100 workers.

Making Them Big Enough

Ideally, the exchanges would be the sole market for individuals and small businesses, said another Enthoven protégée, Portland-based health care consultant Bill Kramer. But that may not be realistic politically because of insurer and employer objections. Analysts like Kramer say that undersized exchanges make it much more important for Congress to adopt specific provisions to keep insurers from segregating risk by enrolling healthy people in plans outside the exchange and steering sick ones to plans inside.

Insurers can do that with tactics such as charging lower premiums outside the exchange to employers with good risks. Or, they could contract with too few medical specialists, which would have the effect of forcing companies employing workers with costly medical conditions to use the exchange. They could also simply raise deductibles for sicker people, forcing people into the exchange.

Elliott Wicks, a senior economist at the consulting firm Health Management Associates, said a flaw of the House-passed bill ([HR 3562](#)) is that it would let insurers charge lower rates outside exchanges. In contrast, the Senate bill ([HR 3590](#)) would require insurers to charge the same premium rates inside and outside the exchanges, Wicks noted.

The Senate bill “greatly reduces the likelihood that insurers could send their bad risks to the exchange,” he said. But in tilting toward state-based rather than national exchanges, the measure might create exchanges that are too small in sparsely populated areas, he added. Kramer, Enthoven, and Riemer said in a recent study by the Committee for Economic Development that the Senate bill should add House language prohibiting “improper steering” of high risks. Employers with up to 100 workers should be required to use exchanges, as should uninsured people ineligible for Medicare, Medicaid or other federal programs, they said.

Sens. Ron Wyden, D-Ore., and Olympia Snowe and Susan Collins, both Maine Republicans, are pushing to increase the size of exchanges as overhaul negotiations continue. Wyden professes optimism. “This cake isn’t baked yet,” he said.

The stakes are large, Kramer said: “If we don’t have robust and sustainable exchanges, we will be missing an essential element of comprehensive reform.”

In addition to size, Riemer sees two other features critical to a successful exchange that are missing in current legislation.

One is ensuring participation by those who are eligible, and the other is creating strong incentives to pick efficient, high quality plans.

The second is making sure that individuals using exchanges use their own money to pay for the added cost of picking a higher priced, less efficient plan. That will help put pressure on insurers to offer better organized health care delivery systems that hold down the costs of care, he says.

While exchanges in overhaul legislation aren't mandatory, subsidies to buy coverage to comply with a mandate that people have health insurance could only be used for plans offered in exchanges. That feature is expected to help draw in good risks.

- [Committee for Economic Development Study](#) (pdf)

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