PBGH
PACIFIC BUSINESS GROUP ON HEALTH

ISSUE BRIEF

Building Successful SHOP Exchanges

Lessons from the California Experience

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Five Key Lessons from California's Experience With Small Group Exchanges

California's experience with small group purchasing pools such as HIPC/PacAdvantage (1993-2006) is one that should convince those who are developing SHOP Exchanges throughout the country to proceed carefully. It also demonstrates that these exchanges can provide real value to a segment of the market and suggests that those setting them up can take actions that will greatly enhance the long-term viability of the exchanges. If SHOP Exchanges are set up with a goal of sustainability, they have the potential to be a critical part of the effort to improve our system of financing and arranging access to healthcare.

1 The key value proposition of SHOP Exchanges is meaningful consumer choice.

The experience of PacAdvantage shows that expanded choice of health plans was attractive to some small employers. Unlimited choice, however, was not necessary. The most successful offering of PacAdvantage was a hybrid plan that combined employer and employee choice among a limited number of plans. In addition to offering consumer choice, exchanges should structure the choices to enable meaningful comparisons across plans in order to appeal to small employers and their employees.

2 Adverse selection will remain a significant concern post-PPACA.

The HIPC and PacAdvantage became refuges for people seeking to avoid pre-existing condition limitations. Medical screening will no longer be permissible under PPACA, and many other provisions of the federal healthcare reform law reduce the danger of adverse selection. However, selection dynamics between the small group and individual markets will have to be monitored closely, as will the trend toward self-insurance for small businesses. Further, to the extent that individual choice is more pervasive post-PPACA, the issue of adverse selection may become more rather than less troubling.

3 Policymakers must be vigilant and adaptable in preventing risk selection against SHOP Exchanges.

Exchanges are vulnerable to adverse selection. This remains a danger in spite of provisions of the PPACA that are designed to reduce the impact of this dynamic. Exchanges must be very careful about getting too far ahead or behind of the outside market in terms of their rules, practices, and product offerings. Matching the stride of the outside market will improve the viability of the exchanges.

4 Participation in SHOP Exchanges must be attractive for health plans.

Even if SHOP Exchanges are attractive to insurers due to a large number of potential enrollees, they will have to take steps to protect the integrity of the overall exchange pool. It will be important to establish rules and strong risk adjustment mechanisms to protect participating health plans from adverse selection.

5 Successfully marketing SHOP Exchanges means building partnerships.

SHOP Exchanges must build strong partnerships with health insurance brokers and other established delivery channels. Going forward, brokers will play an important role, but the role will be changing. The exchange should work with the rest of the market to determine the appropriate role and compensation structure for brokers.

Small Group Exchanges Before and After PPACA

The Patient Protection and Affordable Care Act ("PPACA") allows each state to develop its own health benefit exchange. The hope is that these new marketplaces for health insurance will allow clearer comparisons among plans, promote affordability, and achieve administrative efficiencies. Although PPACA allows states to combine their individual and small business purchasing pools,[1] most if not all are expected to set up a separate Small Business Health Options Program (or "SHOP") Exchange, at least in the initial phase of implementation.

Small business purchasing pools are not novel. More than a third of small employers purchase their insurance as part of a larger pool.[2] Many states, including Massachusetts, Utah, New York, and Connecticut, already had small group exchanges before the passage of PPACA. These spanned the spectrum from state-run endeavors, such as the Commonwealth Connector in Massachusetts, to private exchanges, such as the Connecticut Business and Industry Association's (CBIA) Health Connections. Both state-run and private exchanges have catered to a small segment of the market, averaging less than 2 percent penetration in the market. The exception has been CBIA, which enrolled at its peak nearly 10 percent of the small businesses in its state.[3]

In 1992, California created a state-run small group purchasing pool, the Health Insurance Plan of California (HIPC), as a part of a broader set of small group market reforms including guaranteed issue and restrictions on variation of premiums among small groups. During its first six years, the HIPC was administered by a state agency, the Managed Risk Medical Insurance Board, which also ran California's children's health insurance programs and its high-risk pool. Although initial projections estimated that it would enroll as many as 250,000 lives within its first two years, its enrollment after five years was approximately 150,000, which may have represented as little as 1 percent of the small group market.[4]

In 1998, the Pacific Business Group on Health (PBGH), a not-for-profit coalition of large purchasers of health benefits, won a competitive bid to administer the HIPC and renamed it PacAdvantage. PBGH expanded the offerings available through the pool, revised its underwriting criteria, and developed stronger relationships with the insurers who participated in the pool and the brokers that sold its products.[5] PacAdvantage ceased operations in 2006, however, mainly due to concerns about adverse selection, both against the Exchange by the outside market and among plans inside the Exchange. A private small group purchasing pool with employee choice, California Choice, is still in operation in the state and caters to a relatively small segment of the small group market.

As was the case for PacAdvantage, participation in SHOP Exchanges will be voluntary. Unlike PacAdvantage, however, there will be strong financial inducements for purchasing insurance through this market during its start-up phase.[6] After 2014, the SHOP Exchanges will be the only place that permits small groups to access federal tax credits for the purchase of health insurance on behalf of their employees. These credits will significantly reduce the price of premiums, particularly for very small employers with low-wage workforces.[7] In the state of California, 80 percent of small businesses will qualify for some relief under this provision and 24 percent of small businesses will be eligible for the full credit.[8] Unlike the permanent subsidies available through the individual Exchange, however, the small group credits are only available for two years.

Lessons from California's Experience

1. The key value proposition of SHOP Exchanges is meaningful consumer choice.

When asked about their highest priorities in the purchase of health insurance, small employers first list

affordability, then access to preferred doctors and hospitals, and finally, choice of insurance plans.[9] Proponents of SHOP Exchanges claim that they will deliver all three. The historical evidence shows, however, that it is difficult for small group purchasing pools to achieve consistently lower prices than those available on the outside market.[10] There are many factors that make lower prices difficult to achieve through these exchanges, including their voluntary nature and the risk profile of groups that tend to participate.[11] The profile of SHOP Exchange enrollees will be influenced by the provision of temporary tax credits to certain small, low-wage businesses and non-profits, and this will likely result in a more balanced pool than in past exchanges. For exchanges to remain viable, however, they must offer something of value over the long term both to this initial core group and to the broader market.

The primary value encountered by employers who have participated in exchanges is more choice—for themselves and their employees—than would otherwise be available to businesses of their size. Choice has two basic forms. Under an "employer choice" model, business owners choose among a number of health plans, perhaps selecting different options for different employees. In the market outside of the exchange there are often tight restrictions on dividing groups in this way; insurers prefer to write the business for an entire group. Another model is "employee choice," in which small employers provide a certain level of premium support and allow their employees to shop for insurance among different offerings. This is how many people conceive of the design of SHOP Exchanges in PPACA.

Employee choice was the main distinction between PacAdvantage and the outside market. PacAdvantage was the only venue at the time that offered unrestricted employee choice if employers chose to offer it. Its underwriting rules placed no minimum on how many employees had to select a particular product, whereas in the outside market a certain subset of employees had to select a product for it to be paired with others—when choice was available at all.

Choice Comes in Different Forms

The experience of PacAdvantage shows that choice can come in many forms. The most commercially successful product offered through this purchasing pool was a hybrid that combined employer and employee choice. The PairedChoice product allowed an employer to select among a number of different PPOs, one of which would be paired with an HMO from the large integrated delivery system, Kaiser Permanente. Employees then chose between the PPO and the HMO paying higher premiums if they wanted lower point-of-service costs.

PacAdvantage developed this product after determining that although employers who participated in this pool were able to offer a wide range of employee choices, few actually did, and most that did so utilized a "paired PPO/HMO" structure. The appeal of this specific product also was based on the price advantage of the Kaiser Permanente HMO. In the past ten years, other HMOs in California and throughout the nation have developed differentiated networks that allow them to become more price competitive. Hence a small group exchange may be able to offer a broader range of choices for a similar "paired" product.

Many employers offered a more limited version of employee choice because they found that the administrative burden was higher[12] when their employees selected from among a large number of health plans. In theory, the administrative burden of employee choice can be outsourced to the exchange or to a broker. Since there is a single bill, the administrative demands on small businesses should be the same whether their employees select among two plans or twelve. In reality, however, employers are often expected to handle employee concerns about access to doctors or coverage decisions of insurers; therefore, the actual administrative hassle is higher when employees select from among a wider range of insurance plans.

PairedChoice split this difference by providing a highly structured set of choices that were attractive to employers while providing some autonomy to employees. Through incorporating elements of cost-conscious consumer choice,[13] it may have helped to encourage price competition among the health plans. Exchanges should consider offering hybrid choice options to employers in addition to unrestricted employee choice.

Choices Must be Meaningful and Allow Informed Decisions by Consumers

Since expanded consumer choice is now more widely available in the market through voluntary associations and private exchanges, initial enrollment in SHOP Exchanges is likely to be relatively small, even with the financial inducement of the federal tax credits. It is not simply the availability of choices, though, that will appeal to potential participants in SHOP Exchanges. It is equally important for these choices to be meaningful and for employees to have access to information in order to make an informed choice. Ideally, employees will have information on the key choice dimensions—premium, out of pocket costs, provider network, quality of providers, etc., and the choices will be arrayed to enable employees to make "apples to apples" comparisons across plans. Employer surveys showed that the steps PacAdvantage took to standardize its offerings were appealing to its participants.

The PPACA contains a number of provisions that will improve the quality of consumer choice of health insurance plans. These include steps to standardize plan offerings—through mechanisms such as tiering by actuarial value—as well as improved consumer decision support tools. The federal law allows states a great deal of leeway, however, to determine the extent to which benefit plans are standardized and consumer choice among health plans is informed and meaningful. States that are designing SHOP Exchanges must focus intently on providing information and decision support tools to enable employees and individuals to make meaningful choices.

2. Adverse selection will remain a significant concern post-PPACA.

The experience of PacAdvantage showed that adverse selection was a very difficult and complex problem. Despite efforts to reverse the impact of the poor risk pool that it had inherited, PacAdvantage was ultimately unsustainable because of adverse selection both against the Exchange and among plans within the Exchange. For SHOP Exchanges to be successful, they must learn from this experience and remain vigilant and adaptable in combating risk.

PPACA contains a number of provisions designed to reduce the impact of adverse selection. The HIPC and PacAdvantage became a refuge for people seeking to avoid pre-existing condition limitations. However these will no longer be permissible under PPACA, so this risk factor should be largely mitigated. The small group tax credits also may attract a reasonably large core population with relatively younger enrollees to SHOP Exchanges. Further, insurers are now required to set premiums based on their entire risk pools for each market and participate in risk adjustment and reinsurance mechanisms that span the market inside and outside of the exchange.[14]

Adverse selection will remain a significant issue for SHOP Exchanges, however, for many reasons. Businesses with fewer than 50 employees are not required to provide insurance, and there are many cases in which it will be more advantageous for their employees to receive subsidies to purchase insurance through the individual exchange.[15] As a result, there will be significant risk selection dynamics between the individual and small group exchanges specifically and between these two markets generally. Second, and perhaps more consequential for SHOP Exchanges, is the increasing trend for small groups to self-insure using stop-loss insurance. Self-insurance tends to be a more appealing option when the risk of a group is lower. Self-insured small businesses will also be exempt from market-wide risk adjustment. As a result, fully-insured businesses and exchanges may end up with worse risk pools.

Choice and Adverse Selection

It is widely understood that benefit design can influence risk selection. In voluntary markets, more expensive, richer benefit packages tend to attract less healthy people who need more comprehensive coverage. But even if benefit plans in the exchanges are standardized, there are a thousand small ways in which the structure of the choices within an exchange can influence selection dynamics for good or for ill. Underwriting rules, consumer choices tools, and marketing strategies can all have an impact on the types of enrollees the exchange attracts and retains.

Employee choice itself can exercise a substantial influence on relative risk across insurers. When employees have the ability to choose, they gravitate toward the insurer that provides the benefits that are the best suited to their needs. In many cases, this is a virtuous cycle that rewards the health plans that do the best job of tailoring their offerings to a broad set of consumers. In some cases, though, often unbeknownst to insurers, a specific feature or benefit design attracts people with extraordinarily high healthcare needs, such as people suffering from certain cancers and multiple[16] chronic conditions. These outliers drive a substantial amount of healthcare spending; attraction of a disproportionate number of these high utilizers is extraordinarily problematic from a risk standpoint for individual insurers or for an entire purchasing pool. Systems of risk adjustment, which will be discussed in greater detail below, still do a relatively poor job of accounting for these outliers. Exchanges will have to remain vigilant about how these choices affect the relative risk profiles of the participating insurers. They will also have to continue to carefully evaluate how their choices affect the overall risk of the exchange versus the outside market and the risk of the state-regulated small group market as compared to other markets.

In summary, employee choice within the SHOP Exchanges creates a paradox. Employee choice is one of the most attractive features of a SHOP Exchange, and it allows employees to choose products that best suit their needs rather than pooling them together. Yet it is this precise dynamic of high utilizers splitting off from their groups that exacerbates selection issues in ways that may create serious risks for these marketplaces. What this suggests is that to the extent that individual choice is more pervasive post-PPACA, adverse selection may be a more troubling rather than less troubling issue for exchanges as well as the broader insurance marketplace.

3. SHOP Exchanges must be vigilant and adaptable in combating adverse selection.

Adverse selection was a primary factor that contributed to PacAdvantage closing. Some accounts of why this Exchange was subject to adverse selection, however, may overemphasize the role of outside groups in contributing to this dynamic. PacAdvantage was certainly subject to "steerage," in which insurance agents directed to it groups expected to have high utilization or groups that would not have passed standard underwriting guidelines. There were also instances of outright fraud. When one senior member of the PacAdvantage team took a closer look at one two-person group, she determined that for the date on the original application to be correct, one of employees of the firm would have had to have been two years old at the time.

PacAdvantage becoming a target for steerage was not at all uncommon or unexpected. Insurance businesses must always guard against developing bad risk pools. It is the job of insurance brokers to seek out the best, most affordable coverage on behalf of their clients; if we create a more transparent market with better consumer tools, individuals will be just as ruthless in seeking out deals on their own behalf. If any insurer or pool has underwriting criteria that are not as tight or an oversight structure that is not as strict as those of other insurers, it will inevitably develop bad risk in relation to the rest of the market.

When the HIPC was created, it did not immediately use all of the tools (e.g., modulating premiums across groups

based on their expected utilization) that were allowed under the enabling legislation. As a result, it was possible for brokers representing groups with worse risk to get better prices through the HIPC than in the outside market. The HIPC simply was not as aggressive in screening the groups that applied for coverage as other insurers and pools were. When the PacAdvantage team took over, therefore, the pool included a host of groups that should not have qualified for coverage. By the time the leadership of PacAdvantage was able to scrub these groups, however, it was not possible to pull out of the adverse selection death spiral that their presence helped to initiate.

For example, one result of the HIPC's lack of aggressive vigilance related to risk was its higher proportion of guaranteed associations compared to the rest of the market. Guaranteed associations are groups of independent professionals that band together to purchase health insurance; this arrangement provides a number of advantages, including getting around the preexisting conditions exclusion of the individual market. Although associations are completely legal and have been a good tool to provide coverage, they tend, by their nature to have bad risk.

Matching Market Guidelines and Practices

The lesson from California's experience is that small group exchanges must match as closely as it possible the underwriting guidelines of the rest of the market and be equally vigilant in terms of policing risk. If SHOP Exchanges develop the capacity to do this and focus on this task, they may be able to largely mitigate concerns about risk. Adverse selection death spirals that have occurred for many exchanges in the past were not inevitable; they were in fact a predictable outcome of policymakers focusing on exchanges primarily as vehicles for coverage expansion and only secondarily as insurance marketplaces.

Another critical policy issue that will influence the ability of exchanges to effectively manage risk is the underwriting guidelines across the small and mid-sized group markets. In California, as in many other states, the small group market (2-50 employees) and the mid-sized market (51-100 employees) have different pricing and underwriting regulations. States must take action to standardize rules across these markets, particularly if mid-market groups are added to the exchanges (at state option) with small groups before 2016. After 2016, all states with SHOP Exchanges are required to combine these group sizes. If the regulations continue to differ across these markets once SHOP Exchanges span them, it will be difficult if not impossible for them to get a handle on risk since the system will be ripe for gaming versus the outside market. On the other hand, the expansion to the 51+ market is a potential advantage for SHOP Exchanges, since increasing the size of the pool may help to provide a more balanced risk pool. PacAdvantage worked to develop—but did not roll out to the market—a version of the PairedChoice product for the 51+ market and felt that it could have been a substantial market opportunity. Having access to a broader group of businesses should be a significant advantage for the exchanges as compared to their predecessors.

4. For the SHOP Exchange to be successful, it must be attractive to insurers.

PacAdvantage eventually collapsed when health plans chose to pull out of the Exchange. This was primarily due to concerns about adverse selection into the pool; health plans also felt vulnerable to adverse risk selection among participating plans. Even if SHOP Exchanges are attractive to insurers due to a large number of potential enrollees, they will have to take steps to protect the integrity of the overall exchange pool such as those described above.

One tool to mitigate adverse selection problems is risk adjustment. The PPACA mandates a system of risk adjustment in which insurers will make payments to each other based on the relative risk of their entire pool of enrollees in each market segment. Risk adjustment is used in some insurance markets in the United States as well as nationwide in countries such as the Netherlands and Germany.[17] The HIPC and then PacAdvantage

had evolving systems of risk adjustment for its participating insurers. Its system moved from one in which insurers paid each other at the end of the year once relative risk was assessed to one in which all insurers paid 1 percent of premiums into a pool that was distributed at the end of the year based on relative risk. PacAdvantage cycled through several different ways of calculating the relative overall health of enrollees, adapting a model based on DxCG scores commonly used in the industry.

Some observers suggest that it was primarily difficulties with the system of risk adjustment that led insurers to pull out of PacAdvantage. The fundamental problem is that risk adjustment is an imprecise undertaking. The imperfections of the risk adjustment mechanisms in PacAdvantage created considerable strain among insurers. Actuaries from different health plans disagreed on the amount of money that should have changed hands; there were even some insurers who felt that they were receiving too much in payments through this mechanism. As a result of this experience demonstrating the limitations of risk adjustment mechanisms, several observers with substantial experience running or participating in small group exchanges suggested that the SHOP Exchanges may have to apply risk management mechanisms beyond those included in PPACA. It should also be noted that administering risk adjustment in a closed system such as PacAdvantage was much simpler to develop and administer than a market-wide system will be. The data and technological infrastructure requirements for risk adjustment are daunting, particularly for systems that may involve the participation of community-based health plans and newly-developed non-profit co-ops.

Health plans were also hesitant to participate in the HIPC/PacAdvantage due to the unique rules of this Exchange. If an insurer wanted to participate in PacAdvantage, it had to agree to a set of underwriting provisions, known as the PacAdvantage Governing Rules. Some insurers bowed out of this pool because they believed the underwriting rules—specifically the lack of restrictions on employee choice—exposed them to too much risk. These governing rules can be analogized to the requirements to become a Qualified Health Plan. To the extent that these requirements are extensive and distinct from the rest of the market, SHOP Exchange may have a supply problem in which it is difficult to find insurers willing to participate.

Partnering with Health Plans

It will be necessary to work closely with insurers to maintain the stability of the exchange. Although many advocates are enthusiastic about the proposition of using the active bargaining powers of the exchange to extract low prices from health plans, the California experience shows that it is necessary to work closely with insurers to make sure that they do not price their products so low that it destabilizes the exchange market. In the case of PacAdvantage, a PPO significantly underpriced its product one year which led to a large increase in its enrollment. However, this also meant that the insurer lost a significant amount of money. It attempted to make up the difference by dramatically increasing its price in the following years, but these price increases drove healthier people out of the product leading to an adverse selection problem for this insurer.

This kind of instability is not desirable in any health insurance market, and it is particularly so in a market with fewer choices, as may be the case with state-based SHOP Exchanges. What this suggests is that even states that choose not to pursue an active purchaser model for the SHOP Exchange need to provide their exchanges with adequate capacity to work closely with insurers to make sure that they are offering an appealing and stable set of choices for exchange enrollees. In other markets, if a particular company goes out of business or stops being price competitive, consumers can easily switch to another product and get comparable service. Switching health insurers, even in a post-PPACA world, is much more disruptive for consumers. This is particularly true if insurers in the exchanges contract with narrow networks of providers.

It will also be important to sort out the overlapping responsibilities and priorities of SHOP Exchanges and other state insurance regulators in this regard. These regulators are charged with protecting the overall financial solvency of insurers. Depending on the number of offerings within a SHOP Exchange, however, and its relative size versus the outside market, an insurer could choose to price a product in a way that ultimately destabilizes the exchange without compromising its overall financial solvency enough to trigger action by conventional regulators. As a result, the exchange will need to oversee pricing practices within the exchange in order to maintain a reasonably stable marketplace.

5. Successfully marketing SHOP Exchanges means building successful partnership.

When considering the steps that have to be taken to design and administer SHOP Exchanges, it is important to remember that these choices are not being made in a vacuum but rather within a dynamic marketplace. In particular, there are a set of delivery channels for small group health insurance products that SHOP Exchanges will have to evaluate. Throughout the course of their existence, California's small group purchasing pools evolved in terms of their relationships with insurance brokers. Initially, the HIPC had a different set of incentives for brokers than the outside market did. This included allowing employers to avoid commissions by buying directly from the exchange, paying commissions that were below market rates, and making the commissions transparent to the buyer.[18]

In order to promote affordability, it is important for the exchange to examine the value that each channel brings and use market tools to help price each channel accordingly. It is not clear, however, that exchanges—particularly those that are likely to appeal to a small part of the market such as SHOP Exchanges—are a good vehicle for imposing change unilaterally. The HIPC and PacAdvantage ultimately returned to working very closely with insurance brokers and engaged in an aggressive outreach strategy to court them and to push the exchange products through this delivery channel. It is worth noting that the HIPC found that it was more expensive to sell insurance directly than it was to pay broker commissions.[19]

PacAdvantage eventually invested very heavily in its sales team which would sell to brokers and general agencies who would then sell to groups. This was necessary because exchanges, by their nature, generally offer a more complicated product. In fact, by the end of its life cycle, this outreach effort was so successful that many brokers and general agents commented that they had a better experience interacting directly with the staff of PacAdvantage than with many insurance companies. It is important that the new SHOP Exchanges learn from this lesson and not attempt to get ahead of the market in terms of negotiating a different relationship with brokers and agents who remain a key delivery channel for small group insurance in most states.

On the other hand, exchanges should move with the rest of the market to the extent that the relationships with general agents and brokers are being restructured. The policy change that has had the biggest impact on compensation for brokers is the inclusion of commissions in the administrative costs of insurers that are subject to the medical loss ratio (MLR) requirements. Policy tools such as the MLR as well as market developments such as the increasing use of online technologies may dramatically rework the delivery channels for insurance products. Exchanges will be a part of these changes and may either benefit or be harmed by them. But the experience of PacAdvantage suggests that it is unwise to attempt to unilaterally drive changes to how insurance is marketed and sold, particularly in the small group market.

It should be noted that PacAdvantage was not linked formally to an individual exchange such as those created through federal reform. Due to their substantial subsidies and likely large size, the individual exchanges may

be in a better position to drive changes in the delivery channels for insurance. However, some caution should be exercised in this area. Since these exchanges will be, in most cases, administered by the same entity with the same management as SHOP Exchanges, whatever choices the individual exchanges makes in terms of compensation for enrollment and retention will have a major impact on the SHOP Exchanges.

Health Insurers and Healthcare Providers Also Shape Attitudes About Exchanges

In addition to thinking about the delivery channels at the front end of the health insurance purchase, the experience of PacAdvantage shows that SHOP Exchanges will have to think very carefully about the "back-end" experience that the users have, including their interaction with health insurers and healthcare providers. A world-class customer service experience, therefore, is not limited to the quality of the exchange's call-center and website. The reputation that the exchange builds, which will be extremely important in the early going, will also depend heavily on the consumer service experience that exchange enrollees have at the health plans and healthcare providers they are able to access through exchange coverage.

It is important to restate, however, that great customer service will not be enough for the exchange to survive if it suffers from adverse selection. PacAdvantage invested heavily in creating excellent customer service protocols for enrollees, insurers, and brokers, and it developed an outstanding record in this area. But these capacities did not help prevent the closure of the business once adverse selection made it impossible for the Exchange to remain price competitive.

Building on California's Experience

The main lesson of California's experience with small group exchanges is that they must be run in a way that ensures they will be viable insurance marketplaces. They should not deviate substantially from the rules and practices of the outside market and must match the stride of private purchasing pools in developing innovative services and managing risk. By the end of its life cycle, PacAdvantage was adept at risk mitigation, risk adjustment, and had outstanding customer service. However, these capacities were developed too late. The SHOP Exchanges created by federal reform must begin where PacAdvantage left off rather than relearn the lessons of this experience.

This underscores a dynamic tension that is at the core of the public project of designing and running exchanges. The new health insurance markets are a critical part of the coverage expansion in federal reform. As such, the expectation will be that the exchanges should take a major role in this expansion, bringing the security that comes with health insurance coverage particularly to those individuals and small businesses that are currently uninsured. This is a vital public project on which the lives of many people depend, since insurance coverage is linked to lower morbidity and mortality.[20] This focus on coverage, though, should not lead exchanges to be less stringent in their business practices than the outside market. If that occurs, the SHOP Exchanges will be unsuccessful and will have failed to assist everyone that depends on them.

If the administrators of SHOP Exchanges have the appropriate expectations and run a very tight ship from the beginning, the exchanges could provide value to a niche segment of the small group market. They would then be poised to play an even more important role to the extent that we move toward a more exchange-based system for coverage through, for example, allowing large groups into exchanges or adding Medicaid, or even Medicare, to exchanges. The goal must be to create a structure that is both sustainable and adaptable. This structure will be part of the foundation for the necessary transformation of our healthcare system, a process that is not the product of any single law or reform, even one as sweeping as the PPACA.

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9 "Taking the Pulse of Main Street: Small Businesses, Health Insurance, and Priorities for Reform," *The Main Street Alliance*, January 2009.
10 Competition from exchanges, though, may drive down premiums for the entire small group market. See Jill Yegian, et al, "The Health Insurance Plan of California: the first five years," *Health Affairs*, 19, no.5 (2000):158-165.
11 See Curtis and Neuschler, 2009, and Karen Shore and John Bertko, "Comparison of Small Group Rates in California: HIPC vs. Non-HIPC," *California HealthCare Foundation*, September 1999. California's enabling exchange legislation requires premiums to be equal for comparable products sold inside or outside of the exchange and requires all insurers to sell all tiers of products. This may help reduce adverse selection against the exchange but also appears to preclude lower prices through the exchange except from insurers that offer products exclusively through the exchange.
12 Insurer expenses for selling to small businesses should also be lower which should drive down administrative costs for the exchange. In the experience of PacAdvantage and other small group exchanges, however, this has not translated into lower premiums for participants. Instead of assuming increased administrative efficiencies, SHOP Exchanges will have to work to achieve them. See Yegian et al., 2000; Curtis and Neuschler, 2011.
13 Alain Enthoven, "Consumer Choice Health Plan: Inflation and Inequity in Health Care Today: Alternatives for Cost Control and an Analysis of Proposals for National Health Insurance," *New England Journal of Medicine* 1978;298:650-658 & 709-720.
14 Rick Curtis, "SHOP Exchange Issues," Presentation at the California Health Benefit Exchange Board Meeting, May 11, 2011.
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17 Wynand van de Ven, et al., "Risk Adjustment and Risk Selection on the Sickness Fund Insurance Market in Five European Countries," *Health Policy* (Amsterdam, Netherlands) 65, no. 1 (July 2003): 75-98.
18 Yegian et al., 2000.
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20 Institute of Medicine, *Uninsurance in America* (Washington, D.C.: National Academies Press, 2003).

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Founded in 1989, Pacific Business Group on Health (PBGH) is one of the nation's leading non-profit business coalitions focused on health care. We help leverage the power of our 50 large purchaser members who spend 12 billion dollars annually to provide health care coverage to more than 3 million employees, retirees and dependents in California alone. PBGH works on many fronts to improve the quality and affordability of health care, often in close partnership with health insurance plans, physician groups, consumer organizations, and others concerned about our health care system. To learn more please visit www.pbgh.org.

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