



# IOWA HBE PMO PROJECT

## PLANNING FOR THE SMALL BUSINESS HEALTH OPTIONS PROGRAM

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# 1. SUMMARY

The Affordable Care Act (ACA) creates Small Business Health Options Programs (SHOP exchanges) in each state, to help small employers find and purchase health insurance for their employees. The ACA as well as recently issued federal regulations lay out a number of requirements for the operation of SHOP exchanges, but give states significant flexibility in exchange design and operation.

In this report, we review the statutory, regulatory, and administrative requirements of the SHOP exchange, including the employer and employee application process, eligibility determinations, enrollment, and premium billing and collection. We discuss three major design decisions facing Iowa's shop exchange:

- What models of plan choice should the SHOP exchange offer to employers and employees?
- How should the SHOP exchange work with brokers?
- Should the SHOP exchange be limited to employers with 50 or fewer employees prior to 2016?

We review two special features of the SHOP exchange that could increase its appeal to small businesses: small business tax credits, and opportunities for administrative simplification. Finally, we outline potential approaches that Iowa could take to procuring parts or all of its SHOP exchange.

In moving forward, the specific features of Iowa's small group market, as well as the needs and preferences of its small businesses, will be important drivers of exchange design. While it is beyond the scope of this paper, extensive interviewing and research into Iowa's small group market would be appropriate next steps to develop and test a specific SHOP design for the State. States certainly face challenges in creating a successful, robust SHOP exchange, but the SHOP exchange also presents an important opportunity to assist small employers and their employees with the purchase of group coverage. If done well, the SHOP exchange could provide employers and employees with more choice of health plans, decrease the administrative burdens to employers, and allow employers to take advantage of new federal tax credits.



## 2. INTRODUCTION

### 2.1 Purpose

The Affordable Care Act (ACA) requires the establishment of a Small Business Health Options Program (“SHOP exchange”) in each state to serve small employers. The design of the SHOP exchange encompasses many features and policy considerations that make it distinct from the individual exchange. We have developed this background document to assist Iowa in its planning for a SHOP exchange.

### 2.2 Background

The Affordable Care Act (ACA) requires the establishment of a Small Business Health Options Program (SHOP or SHOP exchange) in each state to serve small employers. The purpose of the SHOP exchange is to assist small employers “in facilitating the enrollment of their employees in qualified health plans offered in the small group market in the state.”<sup>1</sup> Encouraging more small employers to provide health insurance for their employees is a worthy goal. In 2010, just 36.5% of private employers in Iowa with 50 or fewer employees offered insurance, compared with 97.1% of large employers.<sup>2</sup>

However, for many states, designing a successful SHOP exchange is a challenging endeavor. Unlike the individual exchange, which has a clear value proposition as the sole distribution channel for premium and cost sharing subsidies for low and moderate-income families, the value proposition for the SHOP exchange is less obvious. The design and structure of the SHOP exchange will need to be carefully considered, to increase its chance of success.

The design of the SHOP is governed by statutory requirements set out in the ACA, as well as regulatory requirements issued by the federal government. At the same time, the state will likely have flexibility in several key areas where it can tailor the exchange to better meet the state’s needs. Wakely Consulting Group has developed this background document to assist the state in its planning for a SHOP exchange. We discuss the statutory and regulatory requirements informing the development of the SHOP exchange, review administrative functions the SHOP will be required to carry out, describe some of the key design decisions that Iowa will need to consider in structuring its SHOP exchange, and explore some of the special features of SHOP exchanges. Finally, we outline different approaches to procuring components of the SHOP exchange.

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<sup>1</sup> Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, Title I, Section 1311(b)(1), as amended by the Health Care Education and Reconciliation Act of 2010, Pub. L. No. 111-152.

<sup>2</sup> The Kaiser Family Foundation, *statehealthfacts.org*. Data Source: Agency for Healthcare Research and Quality, Center for Cost and Financing Studies. 2010 Medical Expenditure Panel Survey, Insurance Component. Table II.A.2. Accessed March 15, 2012.



## 3. OPTIONS FOR THE SHOP EXCHANGE

### 3.1 Statutory and Regulatory Requirements

SHOP exchanges will need to carry out many of the same functions as non-group exchanges, such as operating a website and consumer assistance services, and facilitating enrollment in qualified health plans. However, SHOP exchanges have many fundamental differences from non-group exchanges and serve a distinct market segment. In this brief summary, we highlight requirements from the final federal rule issued in March 2012 that governs the creation and operation of exchanges.<sup>3</sup> We have organized these requirements into general categories of governance/structure, eligibility, enrollment, employee choice of plans, rating, and premium billing.

#### 3.1.1 Governance

The federal regulations state that the exchange must be a governmental agency (either an existing agency or an independent public agency) or a non-profit entity. The regulations allow states the option to establish a separate governance and administrative structure for the SHOP (§155.110), although, in the preamble to the notice of proposed rulemaking issued in July 2011, the federal government signaled that it favors a single governance structure, noting, “we believe that a single governance structure for both the individual market exchange functions and SHOP will yield better policy coordination, increased operational efficiencies, and improved operational coordination.”<sup>4</sup> The regulations also note that if there is a separate SHOP exchange, the individual and the SHOP exchanges must serve the same geographic area; i.e., if the state were to have a regional non-group exchange it must also have a regional SHOP exchange (§155.140). Moreover, for reasons of efficiency and leveraging the market power of both exchanges, it may make sense to combine their governance and/or closely coordinate their QHP certification criteria and contracting requirements for serving individuals and small employers in the two exchanges. To date, most states which have moved ahead with establishing an exchange have done so under unified governance, and seem to envision their exchanges as two programs under unitary control.

Exchanges are allowed to contract out exchange functions to other entities; however, one important restriction is that exchanges are not allowed to contract exchange functions to a health insurance issuer (§155.110).

#### 3.1.2 Eligibility

Participation in the SHOP exchange is voluntary for small employers.<sup>5</sup> Coverage for only a sole proprietor, certain owners of S corporations and certain relatives of owners would not be eligible for

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<sup>3</sup> Department of Health and Human Services. Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans; Exchange Standards for Employers (CMS-9989-F), Final Rule. March 27, 2012. Available at: <https://www.federalregister.gov/a/2012-06125>.

<sup>4</sup> Department of Health and Human Services. Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans; Proposed Rule. Federal Register. 2011; 76(136): 41866-41927. See Part 155, Subpart A, subsection d.

<sup>5</sup> One state (Vermont) has proposed requiring small employers to participate in the exchange, but this is a state, and not a federal, requirement.



purchase in the small group market under federal law, and therefore these entities would not be eligible to participate in the SHOP exchange (§155.20).

To participate in the SHOP, an employer must make all full-time employees eligible for coverage in a qualified health plan (QHP) (§155.710). An employer who has multiple worksites can cover their workforce through multiple SHOPS.

To participate, employers must have at least one but no more than 100 employees. States have the choice of limiting participation to employers with 50 or fewer employees until 2016. After 2017, states may choose to allow larger employers to participate in the SHOP. Employers already in the SHOP can remain in the SHOP if their workforce eventually grows to exceed the size limit.

The regulations indicate that employer eligibility could be based on self-attestation of employer size and offer of coverage to all full-time employees. However, the regulations note that the SHOP exchange may opt to require more stringent determination of eligibility. Regardless, the SHOP must notify the employer of the result of their eligibility determination and provide a right to appeal.

### 3.1.3 Enrollment

For enrollment, the SHOP must facilitate special enrollment periods and develop a uniform timeline for the enrollment process. Unlike the individual exchange, the SHOP must allow employers to purchase insurance at any point during the year (§155.725). This mirrors the typical practice in the group insurance market that exists today of rolling anniversary dates for employers throughout the year, and quoting 12-month premium rates (and coverage level) commencing on each employer's particular anniversary date. The SHOP must provide an annual election period (for employers to change their plan/tier selection and contribution level) and an annual enrollment (for employees). The SHOP must notify employers when their annual election period is approaching. New employees are allowed to enroll for coverage when they start their job.

Employees are to apply using a single application. The SHOP must notify employees of their effective date of coverage. The SHOP exchange must also collect enrollment information and report this to HHS.

When an employer terminates coverage, the SHOP must ensure that QHPs terminate coverage and that employees are notified of the termination.

### 3.1.4 Employee Choice of Plans

The degree of choice among health plans made available to employers and employees is a key design consideration for SHOP exchanges. How the choice of qualified health plans is structured in the SHOP exchange is a critical ingredient to the attractiveness of the exchange, and also has implications for the risk of adverse selection. The ACA states that employers may choose an actuarial tier (platinum, gold, silver or bronze) and that employees may choose any plan within that tier (Section 1312). Federal regulations *require* the SHOP exchange to offer this employee choice model (§155.705). However, the regulations also allow exchanges to offer other models of plan choice. Flexibility around employee choice of plans is discussed further in 3.3, Key Design Decisions.

### 3.1.5 Rating Requirements

Unlike in the non-group exchange, employers will be allowed to enroll in coverage through the SHOP exchange at any point in the calendar year. In group insurance, the rates for a policy are usually locked in for a period of time (typically 12 months). The regulations require that the rate for a given employer



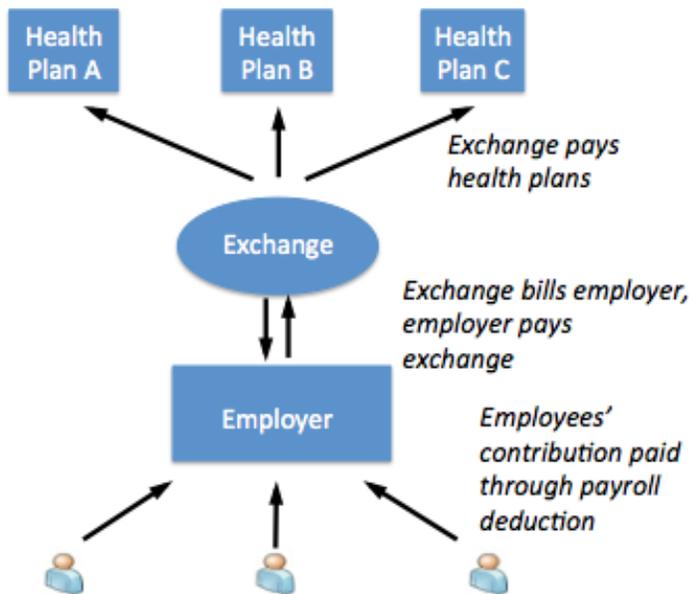
not change for the employer’s plan year (§156.285). In addition, they propose that all QHPs make changes to rates at a uniform time, whether this is monthly, quarterly, or annually.

QHPs must provide new enrollees with enrollment information, and a summary of benefits and coverage using a standard format (§156.285). QHPs must reconcile enrollment files with the exchange at least monthly (§156.285).

### 3.1.6 Premium billing

Because employees in the SHOP exchange may be offered a choice of plans, a given employer’s employees may be enrolled in different plans with different carriers. It would be impractical for the employer to pay bills received from multiple carriers. To mitigate this concern, the federal regulations stipulate that the SHOP exchange must accept the payment of an aggregate premium by a qualified employer (§155.705). The exchange must provide a monthly bill to an employer that identifies the employer contribution, the employee contribution, and the total amount that is due from the qualified employer. Figure 1 illustrates the aggregated payment functionality.

Figure 1 Premium Aggregation Function



## 3.2 Administrative Functions

In addition to meeting statutory and regulatory requirements, the SHOP exchange must develop the administrative and business functions needed to successfully sell insurance to small businesses and enroll employees into plans. In this section, we detail the functions that the SHOP exchange will need to carry out from an operational and administrative perspective.

Many functions, such as those related to plan management, financial management, outreach and marketing, are common to both the individual and the SHOP exchange, although some may be carried out quite differently for small businesses than for individual purchasers. We focus here on functions that



are specific or particularly relevant to the SHOP exchange. In some places, we have also included functions and features that we think would be desirable, though not strictly necessary at start up.

### 3.2.1 Shopping experience and application

Like the individual exchange, the SHOP will have a website which will be a key source for information as well as the main point of entry for most purchasers. Unlike the individual exchange, however, the SHOP website must accommodate the needs of both employers and employees. While the website should allow both employers and employees to browse and obtain general information, the application process itself will need to be two-phased: the employer (or a broker/agent on his/her behalf) must first complete an application and submit the group’s employee census information before his/her employees can select their plan(s) and enroll.

For the application process, the Department of Health and Human Services (HHS) will develop model employer and employee application forms that the SHOP may use. The SHOP may use an alternative application form if it collects the required information and has been approved by HHS.

HHS requires that the SHOP must use a single application to determine employer eligibility (§155.730). The application must collect the following information:

- Employer name and address of employer’s locations
- Number of employees
- Employer Identification Number (EIN)
- A list of qualified employees and their tax identification numbers

The SHOP must use a single employee application form for eligibility determination, selection of a qualified health plan (QHP), and plan enrollment. Information collected must be sufficient to establish eligibility and complete enrollment (e.g., plan selection information and identification of dependents).

Federal regulations state that employer and employee applications may be submitted via the internet, by phone, by mail, or in person, and therefore the SHOP exchange will need to accommodate all of these communication channels.

<b>Employer shopping experience and application (<i>italicized elements denote additional features that would be desirable</i>):</b>
Provide a single, online employer application
<i>Provide field level help for each application data element</i>
<i>Provide access to in-depth on-line help as well as chat support</i>
<i>Provide multiple methods for an employer to build an employee roster (manual entry, file upload)</i>
Provide capability to accept paper documents for SHOP, such as employer/employee applications and verifications
Allow verified individuals to complete employer application on behalf of the employer (i.e.,



**Employer shopping experience and application (*italicized elements denote additional features that would be desirable*):**

administration or finance department staff)

Prompt employer to enter business name associated with the EIN

*Include an option for employers without an EIN to proceed with the application process; allow for suspension of eligibility if EIN remains unverified*

Be able to differentiate/track full-time versus part-time/hourly employees in the employee roster

Validate field-level information for correct data format and completeness

Conduct validation of mailing addresses provided in application

Provide capability to create a single client identifier for each employer

*Return user to the last screen they were working on when they log back in*

Prior to creating a new employer account, determine whether there is an existing user account present based on matching criteria provided in the application (i.e., EIN, name)

Provide capability to validate employee identification information submitted through the employer application

Generate a request to initiate the employer selection of qualified health plan(s) during the application process

Display plan cost and availability based on initial questionnaire completed by the employer

Provide capability to display a detailed quality and cost comparison of available plans

Allow employers to select plans/tier and initiate the participation process

Allow employer to enter contribution amount

Provide information to employers about the small business tax credit

Update employer's account to reflect plan selection and effective plan year

*Provide capability for employer to generate a packet of information to distribute to the employee*

Upon submittal of employer application, provide notification to employees to elect or opt-out of employer sponsored coverage; provide instructions about open enrollment period and SHOP website/customer assistance



**Employee shopping experience and application (additional functions discussed in section on enrollment):**

Produce notification to employee to initiate employee selection of qualified health plan (QHP)
Create user name and password for each employee listed on employee roster
Allow user to define a password
<i>Provide field level help for each application data element</i>
<i>Provide access to in-depth on-line help as well as chat support</i>
Each account should include unique identifier, demographic information, application status, participation status, existing program eligibility
Single identity management for each consumer involved with the non-group exchange, SHOP should integrate with this identity management service
Allow employee to enter information about employee dependents, if employer elects to include dependent coverage

**3.2.2 Eligibility and verification**

To purchase coverage for employees through the SHOP, employers must meet the following criteria:

- Be a small employer
- At a minimum, offer all full-time employees coverage in a qualified health plan through the SHOP
- Either have its principal business address in the exchange service area and offer coverage to all its employees through that SHOP, or offer coverage to each eligible employee through the SHOP serving that employee’s primary worksite

If an employer purchasing through the SHOP increases the number of employees beyond the definition of a small group, they must be allowed to continue SHOP participation, unless they elect to discontinue or become ineligible for another reason.

The SHOP exchange must develop a process to determine the eligibility of employers and employees to purchase coverage through the SHOP, including the acceptance and review of employer and employee application forms. The regulations indicate that employer eligibility could be based on self-attestation of employer size and of offer of coverage to all full-time employees. The SHOP must provide notice of approval or denial of eligibility to employers and employees and must inform employers and employees of their right to appeal such determination.

The SHOP must verify that individual applicants are identified by the employer as employees that have been offered coverage. The SHOP may choose to establish additional methods to verify the information provided by individual applicants.



If the SHOP doubts the veracity of information on either the employer or employee application, it must inform the applicant employer or individual and allow 30 days for the provision of additional information. If satisfactory documentation is not received, the SHOP may deny eligibility and provide notice to either the employer or employee. If enrollment pending verification took place, the SHOP may discontinue coverage at the end of the month following the month in which notice was provided.

Eligibility and verification
Provide capability to generate request to sources of information to verify employer size, business address/worksite
Provide capability to initiate a manual verification process
Provide document imaging capabilities
Create document repository accessible to exchange staff
Track status of employer verification
Produce mailed, written notice to employer to provide additional verification
Provide on-screen notification to employer to provide additional verification
Provide capability to allow employer participation upon initial application, but to terminate participation if original eligibility information is in question and is not verified within 30 days

### 3.2.3 Enrollment

The enrollment process for the SHOP is more complex than that of the individual exchange. The SHOP by definition must accommodate employer groups, as well as special requirements related to enrollment periods. We first discuss general enrollment processes, then special enrollments and employer and employee termination functions.

#### 3.2.3.1 General Enrollment Process

The SHOP must process the applications of qualified employees to the applicable QHP issuers and facilitate the enrollment of qualified employees in QHPs. The SHOP must establish a uniform enrollment timeline and ensure that the following activities occur before the effective date of coverage for qualified employees:

- Determination of employer eligibility
- Employer selection of health plan
- Provision of a specific timeframe during which the employer can select the level of coverage or health plan offering, as appropriate



- Provision of a specific timeframe for qualified employees to provide relevant information to complete the application process
- Determination and verification of employee eligibility for enrollment through the SHOP
- Processing enrollment of qualified employees into selected health plan
- Establishment of effective dates of employee coverage

The SHOP will also need to provide quoting and rating functions. The SHOP must require all health plan issuers to make any change to rates at a uniform time, whether that is quarterly, monthly, or annually. Rates for qualified employers may not vary during the employer’s plan year.

The SHOP must adhere to the initial open enrollment period (October 1, 2013 through March 31, 2014), ensure that enrollment transactions are sent to health plan issuers in a timely way, and ensure that issuers adhere to required coverage effective dates.

Unlike individuals seeking to purchase insurance through the non-group exchange, employers may elect to purchase coverage at any point during the calendar year. The employer’s plan year must consist of the 12-month period beginning with the employer’s effective date of coverage.

To enroll employees, the SHOP must ensure employees are notified of the effective date of coverage and transmit enrollment information on behalf of employees to health plan issuers within the established timeline for employee selection.

The SHOP must reconcile enrollment information and employer participation information with health plan issuers at least monthly.

General enrollment process
Display plan cost and availability, taking into account the employer contribution
Display only plans that have been selected by the employer, are open to additional enrollment, and are available in the employee’s geographic area
Have capability to display a detailed comparison of available employer-selected plans based on employee preferences
Allow access to provider directory
<i>Include provider search function</i>
Provide information about premium tax credits or exemption from the individual mandate; provide link to individual exchange
Update employee account to reflect plan selection and effective plan year
After plan selection, send enrollment information to carriers ( <i>automated enrollment submissions processed upon receipt</i> )
After plan selection, send calculation of final cost to employee



**General enrollment process**

Send automated confirmation of plan selection

Receive and maintain records of enrollment in QHPs

Reconcile information with QHPs at least monthly

Provide capability to make changes to employee contact information, report changes to issuers, and communicate with employee about changes; *(make self-service changes available via web-based portal or secure email, with real-time reconciliation of data with systems)*

**3.2.3.2 Enrollment Changes (open enrollment, renewals, terminations)**

Prior to the completion of the employer’s plan year and before the annual employee open enrollment period, the SHOP must provide an annual election period for *employers*. During this time, employers will have the opportunity to change their participation in the SHOP for the next plan year. The SHOP must provide employers with notification in advance of this period. Possible changes made during this period include:

- The employee choice model
- The employer premium contribution
- The level of coverage offered
- The plans offered

The SHOP must also establish an annual open enrollment period for *employees* prior to the completion of the plan year. Employees hired outside of the initial or annual open enrollment periods must be allowed a specified period to seek coverage beginning on the first day of employment.

At open enrollment, employees will remain enrolled in their plan as long as they remain eligible, unless they disenroll or enroll in another qualified health plan, or if their current qualified health plan is no longer available.

Another distinctive feature for the SHOP is management of qualifying events. Qualifying events are life event changes that affect a person’s eligibility for coverage, and might include change in family size (such as marriage, divorce, or birth of a child), changes to employment status, and changes to access to other insurance coverage. A qualifying event would allow an employee to participate in a special enrollment period, outside of open enrollment. For example, if an employee gives birth to a child, the employee would have a chance to both add coverage for that dependent and select a difference health plan, rather than having to wait until the next annual enrollment period to make these changes.

The SHOP exchange must also be prepared to handle employer and employee withdrawal from the exchange, and under both voluntary and involuntary circumstances. If a qualified employer discontinues coverage through the SHOP, the SHOP must ensure that each health plan issuer terminates the coverage of the employer’s qualified employees and ensure that the employees receive notification prior to termination. Similarly, if any employee terminates coverage from a health plan, the SHOP must notify the individual’s employer.



Enrollment changes (special enrollment, renewals, terminations)
Generate notice to employers of annual election period
Allow employer to look up or reset login information
Track annual renewal date
Determine eligibility for renewal
<i>Provide capability to review small business tax credit eligibility</i>
<i>Calculate a year-to-date average for premiums paid</i>
Within SHOP, seamlessly transition participation and removal of SHOP participation between plans and programs as plan selection changes
Allow employee to look up or reset login information
Produce notification to employee of annual open enrollment
Produce notification to employees regarding the number of days left for open enrollment
Provide capability for employees to submit changes to key eligibility factors
Determine availability of employee's current plan for renewal
Allow employees to submit changes to SHOP plan participation, selected plans, covered dependents, on-line and paper forms
Report changes to health plan issuers
Notify employer of changes in coverage
Determine if an update to an employee account qualifies as a qualifying event
Allow employees to submit changes to employee plan, including add/remove dependents, due to qualifying events
If reported changes do not qualify an employee for a special enrollment, store the changes for use during the next available open enrollment period
Initiate enrollment or disenrollment process for the employee or employee's dependents, depending on the nature of the qualifying event
Prepare and send communication to the employee regarding changes to the employee's account due



<b>Enrollment changes (special enrollment, renewals, terminations)</b>
to a qualifying event
Ensure that monthly report/insurance bill to employer reflects changes due to employee’s reporting of qualifying events
Provide the capability for an employer to request a voluntary termination from QHPs at any time
If an employer initiates a voluntary termination through the Exchange, produce an electronic notification to the issuer to terminate the employer
If an employer initiates a voluntary termination, produce an electronic notification to the employer’s employees to inform them of the termination
Provide capability to image and store documents sent to the employer regarding the employer’s termination
Receive electronic notifications from issuer regarding involuntary terminations and initiate termination process
If involuntary termination initiated by the exchange, notify the issuer to terminate the employer
If involuntary termination, produce electronic notification to the employer to inform the employer of the termination
If termination, produce electronic notification to employees, with capability to differentiate between actual or potential termination
Update user accounts based on termination notification
If an employee disenrolls through the exchange, produce an electronic notification to the employee’s employer to inform them of the employee termination
If employee disenrolls through the exchange, notify issuer to terminate the employee
Update user accounts

### 3.2.4 Premium billing and collections

The SHOP exchange will play an important role in premium billing and collections. Because employees can have a choice of plans, this means that a given employer’s employees may be enrolled with several different carriers. It would be impractical for the employer to pay bills from multiple carriers. Federal regulations require the SHOP exchange to provide employers with a single bill on a monthly basis that



identifies the employer contribution, the employee contribution, and the total amount that is due. The SHOP must collect payments from employers and distribute them to issuers.

Premium billing and collections
Automated data exchange between enrollment and billing systems
Bill generation (paper and/or electronic)
Calculate employer premium
Provide pro-rated invoices for late adds/terminations
Provide simple, easy to understand invoice
Produce and send employer invoice. Invoice should include employer identifying information, monthly balance due and any outstanding premium payments due
Allow employer to flag concerns/discrepancy with bill and to initiate a discrepancy resolution process
Identify unpaid employer premiums and produce report notification for employers
Employer account support available via call center, email, <i>and live on-line chat</i>
Allow employers to make electronic payments (EFT <i>and credit card</i> ) as well as payment by check
<i>Allow walk-in centers to accept payments</i>
Receive and process premium payments
Record receipt of payment in database
Suspense accounts cleared weekly
Bank lockbox activity transmitted daily
Daily sweep of lockbox into interest bearing account
Aggregate payments to issuers
If employee is enrolling through COBRA, the system must be able to determine if COBRA option exists for the employee and allow employee to select COBRA and make COBRA payments
Delinquent accounts identified upon each payment due date
Collections efforts tracked in premium billing system



**Premium billing and collections**

Immediate outstanding payment opportunity available

*Flexible payment plans to accommodate hardship accounts*

**3.2.5 Broker Management**

The employee-choice model is a complicated employer set-up feature and the use of brokers could assist the exchange in explaining this new method of purchasing to employers, especially those “micro-groups” without a human resource function. In order to support brokers, the SHOP will need to provide a number of administrative functions.

**Broker management**

Define clear broker sales objectives

Set monthly enrollment targets

Develop scalable operations and processes to support increasing sales demands

Establish and administer incentive compensation manually or through spreadsheets *(or via dedicated sales compensation system)*

Define and establish incentive formulas

Provide training to maintain and grow broker skill sets

*Online delivery of sales, product, and compliance training*

*Sharing of sales techniques and knowledge from top-performers via sales calls and forums.*

Ensure that brokers meet certification and compliance requirements

Provide consistent broker evaluations to identify skill gaps and training needs

Provide marketing/sales materials to brokers via paper *(or self-service portal)*

Provide paper-based compensation information in monthly statements *(or online compensation information through emails/web-portal)*

Handle disputes and inquiries manually

*Operate self-service portal to address inquiries via broker FAQs*

Provide outbound notifications and communications via mail/[fax](#)



<b>Broker management</b>
Establish metrics and key performance indicators to track sales performance and broker effectiveness
Report broker information on monthly basis
<i>Provide web-based visibility for brokers to view daily sales and incentive results.</i>

### 3.2.6 Appeals

Both the non-group and the SHOP exchange will be responsible for appeals-related functions. The main appeals-related responsibility specific to the SHOP is appeals of employer eligibility to purchase coverage through the SHOP. The SHOP must provide an employer applying for coverage with a notice of approval or denial of eligibility and the employer’s right to appeal such determination. The regulations require that the SHOP notify both employer and employees of the SHOP’s eligibility determination and the right to appeal.

<b>Appeals</b>
Exchange should maintain an audit trail of all determinations (positive or negative)
In all notices produced by the exchange regarding eligibility determination, notify employers of their rights and responsibilities (including a right to appeal eligibility decisions)
Provide the capability to capture information and details of an employer complaint
Provide the flexibility to extend interim coverage or manage disenrollments based on events such as (a) Flexible grace periods during enrollments and disenrollments (including during appeals process where final eligibility determination is not confirmed) (b) Retroactive eligibility or enrollment/disenrollment based on appeal results
Provide the capability for an employer to request an appeal to the employer eligibility decision
Provide the capability to differentiate between appeals and complaints; default requests to complaints when received by employers
Provide the capability to capture, track, and disposition appeals (including status, assignments, and relevant case notes)
Provide the capability to refer or route appeal requests to entities outside of the exchange as appropriate
Provide capability for an employer to view key employer account information (includes employer details as well as key eligibility factors used to determine eligibility)
Provide the capability to record the detailed results and supporting documentation that result from or



<b>Appeals</b>
support an appeals decision
Generate a formal written notice informing an employer of the details of an appeal decision
Allow employers to request and receive a second appeal review process, providing very similar, if not the same, steps in the second appeal process as the first appeal process

### 3.3 Key Design Decisions

The statutory, regulatory, and administrative requirements for the SHOP exchange leave states with substantial flexibility in the design and operation of their SHOP exchanges. We have identified several key design decisions that Iowa will need to consider in designing its SHOP exchange. We examine each of these decision points, and the implications of these choices for the state.

#### 3.3.1 Employee Choice

One important decision that states will have to make is the degree of employee choice to include in the SHOP exchange. The exchanges will offer qualified small employers and their employees a choice of qualified health plans arrayed on four tiers of actuarial value. Actuarial value represents the percentage of approved claims for covered services which a health plan covers, as distinct from the enrollee’s share (the two should add to 100%.) The four actuarial value tiers range from 60% at the low end to 90% at the high end. For example, the qualified health plans at the bronze level should cover (on average) approximately 60% of expected claims for a typical commercial population; silver 70%; gold 80%; and platinum 90%. Premiums will increase to cover the higher expected claims costs to the health plan for “richer” coverage, as one moves up from bronze toward platinum.

While ACA states that employers “may” choose a tier of actuarial value (platinum, gold, silver or bronze) and employees “may” choose any qualified health plan on that actuarial value tier, the federal regulations state that the exchange *must* include this model of employee choice. That is, this model of employee choice must be offered to qualified employers, whether or not the SHOP exchanges decides to make other models available to them. The regulations do allow exchanges to offer additional models of choice, such as employee choice of any plan in *any* tier, choice of a single plan only, choice from several plans selected by the employer, or choice of plans from a single carrier. These models are illustrated in Figure 2 below:



Figure 2 Models of Employee Choice



The degree of choice offered by an exchange is important for several reasons. First, employee choice of plans (whether that is within a single tier or among multiple tiers) is typically not available in the commercial market, and therefore may add value for employers and employees, that could draw them to the exchange. Indeed, facilitating comparison shopping and employee choice is one of the principal policy rationales for the SHOP exchange. Second, allowing different employees to choose different plans could provide a market for new health plans (such as lower cost or limited network plans), that might not appeal to everyone in a group, but that hold value for some members of the group and add competition among health plans.

The degree of employee choice also has implications for the operations of the exchange. Employee choice of health plans adds complexity, and multiple models of employee choice will be more complex to administer and explain to employers and employees. This may also add to the operational costs of the exchange.



Finally, offering employee choice, particularly choice among plans on different actuarial value tiers, will increase the potential for adverse selection across plans, since people who are sicker and expect to utilize more benefits may be more likely to choose plans with “richer” benefits. This adverse selection, or even fear of adverse selection, could result in carriers either refusing to participate in SHOP or increasing premiums for health plans across the small group market. Estimates by Wakely actuaries done in another state suggest a potential impact within SHOP of premiums increasing 1-6% with employee choice models, though this estimate would vary based on the specific dynamics of the market.

### 3.3.2 Employer Contribution Rules

The SHOP exchange is responsible for invoicing the employer monthly and disbursing his/her consolidated monthly premium payment among the various QHP issuers in which his/her employees are enrolled. Consolidation of employer billing and QHP premium payment is a critical enabler of employee choice in the small group market, since small employers generally lack the administrative capabilities and interest in dealing with multiple issuers. How to establish contribution rules across issuers in SHOP is an important decision, which should facilitate employee choice in small-group insurance while recognizing the context of common practice in the outside small-group market.

Two methods are used in small-group markets: “list” and “composite” rating. Under list billing, employers receive a monthly invoice from the carrier with separate rates listed for each employee, generally reflecting the age, plus other permitted individual rating factors (e.g., gender, where allowed). Commonly, the employer pays a fixed percentage of each employee’s list bill, but because of differences in individual rating, the premium and dollar contributions will differ from one employee to the next. Both the employer and employee contributions will be lower for younger than for older workers, and for males than for women. Through the year, as employee composition and enrollment changes, the employer’s bill will also change because of changes in employee demographics. While the employer’s bill may change month-to-month, this practice more accurately adjusts the premium to predicted costs, and can prevent “rate shock” at annual group renewal, due to significant shifts over the prior year in employee demographics.

Under composite rating, the far more prevalent billing practice in Iowa, the carrier averages the individual rating factors across the group to develop one composite rate for each rating basis type (single, family), and those rates apply for the year. The employer who contributes X% toward that fixed composite rate is somewhat insulated from premium variations during the year as employee composition changes, but may experience a significant rate change for the next year that reflects the accumulated demographic shift of his/her workforce over the current year (e.g. if older workers retire and younger workers are hired). List billing more accurately reflects the expected variation in service utilization and claims costs across the individual beneficiaries than composite rating, but composite rating provides more certainty to the employer about his/her contributions during the year.

With the introduction of employee choice among various QHPs in the SHOP exchange, and the likelihood of systematic risk selection among various QHPs, the case for list billing is strengthened. Absent list billing, QHPs with broader networks and better-known brand recognition will likely attract older, more costly employees, for which they will receive only the average composite premium, and select-network plans with little brand recognition are likely to attract the young healthy beneficiaries, for which they will nonetheless collect the average composite premium. Under such circumstances, the first category of issuers will be reluctant to participate in SHOP, hurting the SHOP exchange’s appeal to small employers.



This problem of risk selection within a group, when employees can select among issuers in the SHOP exchange, can be addressed by the use of “list billing.” However, there are disadvantages to list billing, especially in markets that are not accustomed to it.

Whatever billing method is used, employers’ contribution toward employee coverage cannot discriminate against older workers. There are two methods by which the employer in the SHOP exchange can meet the non-discrimination test under list billing: (1) contribute the same percentage of premium for each employee (and toward dependent coverage), as is commonly done under list billing; or (2) contribute a higher percentage for older workers toward a benchmark plan, such that all employees’ dollar premium contribution will be the same toward that benchmark plan, regardless of the beneficiaries’ ages. The two approaches are illustrated below. (For simplicity, we illustrate single coverage only but dependent coverage would work similarly.)

The simpler (first) approach is to have the employer contribute a fixed percentage (for example, 50% for single employee coverage) of the total monthly premium for each employee. However, in this approach, the individual employee’s selection among plans would also affect the dollar amount of the employer’s contribution. This model may appeal to employers because they would share in the savings if an employee were to pick a lower cost plan, but they would also share the extra cost of more expensive premiums, and this approach makes their total annual contribution costs less predictable.

Example: Employer contributes 50% of the list-bill premium of the plan selected by the employee

	Plan W (Benchmark Plan)			Plan X		
	Premium	Employee Contrib.	Employer Contrib.	Premium	Employee Contrib.	Employer Contrib.
Employee A	\$400	\$200	\$200	\$500	\$250	\$250
Employee B	\$500	\$250	\$250	\$700	\$350	\$350
Employee C	\$500	\$250	\$250	\$700	\$350	\$350
Employee D	\$600	\$300	\$300	\$800	\$400	\$400
Total	\$2000	\$1000	\$1000	\$2700	\$1350	\$1350
Average	\$500	\$250	\$250	\$675	\$337.50	\$337.5

Alternatively, under the second approach, the exchange can ensure that the employer’s bill does not change based on the employees’ plan selections, and that older employees are not discriminated against. (However, the second approach is more complex.) This result can be achieved by setting employer and employee contribution levels against a “benchmark” plan whereby the employer selects one benchmark plan for his/her group; the employer and employee each contributes a fixed percentage to the average composite premium rate of the benchmark plan (e.g. 50%/50%); but the employer’s contribution is increased for older workers (with higher benchmark-plan list bills) and lowered for



younger workers (with lower benchmark-plan list bills). As a result, all employees—older or younger—pay the same amount toward their own list *bill for the benchmark plan*. Employees who move from the benchmark plan to a more or less expensive plan pay this same, equal employee contribution toward the benchmark plan, plus or minus the difference between their list bill for the benchmark plan and their list bill for the plan they select. These types of arrangements have been discussed in more detail in guidance issued for the small business tax credit.<sup>6</sup>

Example: Employer contributes 50% (for singles) of the *benchmark, composite-rated premium*, no matter which plan employee selects; all (single) employees pay same amount toward benchmark plan, plus or minus difference in premiums for more or less expensive plan options

	Plan W (Benchmark Plan)			Plan X		
	Premium	Employee Contrib.	Employer Contrib.	Premium	Employee Contrib.	Employer Contrib.
Employee A	\$400	\$250	\$150	\$500	\$350	\$150
Employee B	\$500	\$250	\$250	\$700	\$450	\$250
Employee C	\$500	\$250	\$250	\$700	\$450	\$250
Employee D	\$600	\$250	\$350	\$800	\$450	\$350
Total	\$2000	\$1000	\$1000	\$2700	\$1700	\$1000
Average	\$500	\$250	\$250	\$675	\$425	\$250

As illustrated in the table above, all employees would contribute the same \$250 toward the benchmark plan (column 2); the employer contributes, *on average, \$250 per employee* (row 6)—more for older workers, less for younger workers (columns 3 and 6)—regardless of which plan the employee picks; and the employees who pick a more expensive health plan pay the difference (column 2 vs. 5). Similarly, had we illustrated picking a less expensive plan, the employer’s contribution would remain unchanged and the employees would save monthly contribution dollars.

While list billing is effective in reducing the impact of adverse selection associated with employee choice (especially across carriers), current market rating practices in Iowa may present obstacles to adopting list billing in Iowa’s SHOP exchange. Preliminary research into Iowa’s small group rating practices suggests that few small employers are familiar with list billing, except for micro-employers (fewer than 10 employees). If the exchange were to introduce this complex rating change, employer and employee confusion would need to be anticipated and addressed. Under the first method described above, older

<sup>6</sup> Internal Revenue Service. Section 45R. Tax credit for employee health insurance expenses of small employers. Notice 2010-82. Available at: <http://www.irs.gov/pub/irs-drop/n-10-82.pdf>. Accessed on March 18, 2012.

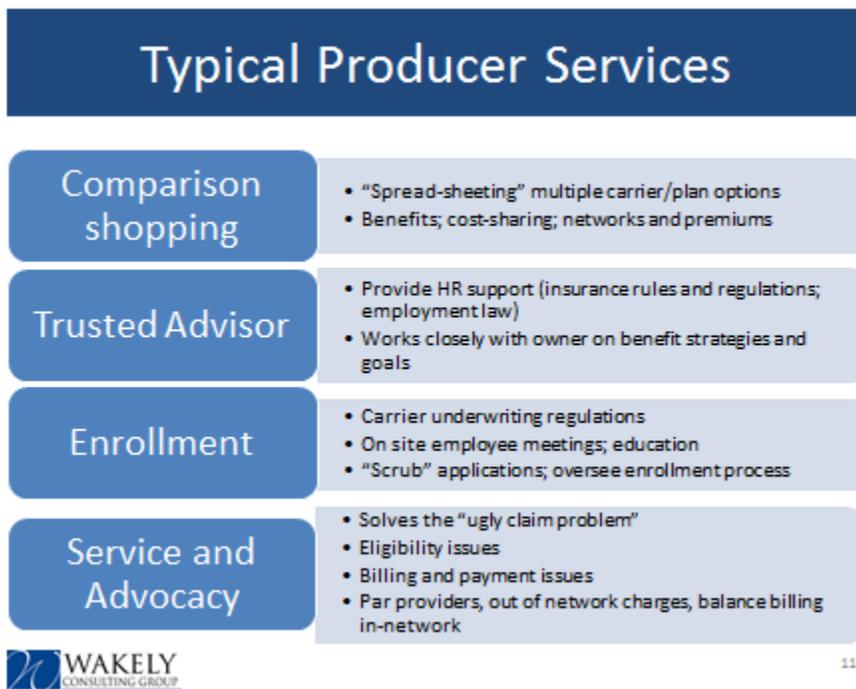


employees would consistently pay more for the same coverage than younger workers, and the second method—while “fairer” to employees and “defining” the employer’s contribution—is far more complicated to explain. Employers and brokers would need to address the confusion and/or complaints.

The employer would also see the changes on his billing statement and his payroll vendor must accommodate different employee deductions. Other adoption issues include the ramification of using list billing inside the exchange and not outside the exchange; while problematic, this is already the case in Iowa where some carriers and some groups use list billing, while others use composite group rating. Moreover, HHS has yet to issue final regulations on rating specifics for exchanges. While list billing is a tool generally used in exchanges that allow employee choice – as required in SHOP -- to anticipate risk selection among carriers, local market familiarity with list billing is low, and moving to list billing may be a change that some employers or employees are not ready to adopt.

### 3.3.3 Broker and Navigator Strategy

In the small group market, brokers and agents play an important role in assisting small employers with selecting and enrolling in group health insurance. While a detailed discussion of their role is beyond the scope of this paper, the table below lists their main functions for employers in summary form:



Under ACA, states may permit agents and brokers to assist employers and employees with enrollment in health plans sold through the SHOP exchange, but the final regulations do not dictate how this relationship should be structured. The ACA also requires states to establish a navigator program, which is designed to assist individuals, employees, and employers with enrollment in health insurance. However, the final exchange regulations state that navigators must not “receive any consideration directly or indirectly from any health insurance issuer in connection with the enrollment of any



individuals or employees in a QHP or a non-QHP” (155.210). This restriction would appear to preclude brokers from being navigators, since brokers and agents in the commercial market are generally compensated by insurance carriers.

Iowa should consider what role it would like brokers and agents to play in the SHOP exchange. We describe four different models for structuring the relationship between exchanges and brokers: carriers compensate exchange-appointed brokers; exchange compensates brokers directly, at same rates as carriers pay outside the exchange; exchange compensates brokers directly, but at a “discounted” rate from commercial carriers; or exchange pays “navigators” through grants to provide some of the services that brokers and agents conventionally provide to small employers. Wakely makes no recommendations among these options.

### **3.3.3.1 Carrier pays exchange-appointed brokers, same rates in and out of exchange**

In this model, insurance carriers would pay brokers for enrollment into exchange and non-exchange plans. For example, if issuer A (participating in the exchange) generally pays 3.5% of premium, plus a year-end bonus for increasing volume, to a broker for small groups, and issuer B (also participating in the exchange) generally pays a flat \$15 per subscriber per month to that same broker for small group, then issuers A and B would include in their respective compensation calculations the SHOP exchange’s enrollment for cases where the broker has a broker of record letter.

The advantage of this approach is that it equalizes compensation for brokers whether they place business inside or outside the exchange. However, leaving the exchange out of the broker compensation process gives it less direct influence on brokers. The exchange could develop a more active role with brokers through its contracts with qualified health plans and/or licensure and regulatory standards for carriers and brokers, but lacks the direct financial relationship. The exchange (or the state’s insurance regulators) could also require participating issuers to pay brokers comparably in and out of the exchange. The exchange would also have to develop a mutually acceptable process for identifying, training, and certifying brokers in the exchange. For example, as brokers are generally not appointed to represent all carriers, each exchange-certified broker should be appointed by all the issuers in the exchange for the geography served by that agency. Doing so will require somehow “harmonizing” the participating carriers’ and the exchange’s broker appointment practices, at least for the subset of brokers appointed by the exchange.

### **3.3.3.2 Exchange pays brokers directly, at same rates (on average) that carriers pay outside of the exchange**

In this approach, the exchange will directly compensate brokers for the enrollment of employers and employees into exchange plans. This approach also maintains equity and “neutral” financial incentives for brokers, whether they place business in or outside the exchange. In addition, it places the exchange squarely in the middle, between carriers and brokers, as a direct influencer of brokers. However, if different carriers use different compensation formulas, strict comparability will require the exchange to mirror their various compensation policies. This could become administratively complex. It would also require the exchange to increase its assessment for administrative costs sufficiently to run broker commissions through its own books. While the impact on premiums may be the same, whether broker commissions are paid directly by carriers or by the exchange, the appearance of larger numbers in the exchanges’ operating costs and revenues probably will not go unnoticed.



Whether the exchange or the carriers pay brokers in the two models above, carrier-specific commission schedules should reward brokers equally for selling the various employee-choice models allowed by the exchange.

### **3.3.3.3 Exchange pays brokers directly, at discounted rates**

The exchange may wish to establish a structure where it pays brokers for assisting with enrollments, but at rates lower than what is currently paid in the commercial market. This approach may hold some appeal to policymakers as a way to reduce administrative costs, and reflect the exchange's role in organizing options and saving time and effort for brokers. However, the SHOP exchange will not simplify the brokers' tasks initially, and their dominance of the small-group market gives them leverage in marketing the SHOP exchange. Therefore, a "government discount" for SHOP may prove problematic, unless the exchange can truly save brokers time and effort, thereby allowing them to service more clients with the same effort. Even if the exchange believes that it will assume some of the tasks which otherwise fall to brokers—for example, working with qualified health plans to resolve claims adjudication issues—the exchange will need to demonstrate to brokers that this is truly the case in order to present a credible case for a discount. Even then, the exchange may simply have to match the outside market in order to win broker support.

### **3.3.3.4 Exchange relies on "navigators" and supports them with grants**

Under this approach, the exchange would recruit "navigators" (possibly, current brokers) and hire them to assist employers and employees with exchange enrollment. Given the requirements of the final regulations that prohibit navigators from receiving compensation from insurance carriers, the exchange would essentially have to replace the compensation that brokers previously received from carriers, with grants from the exchange. This is a risky proposition for both the exchange and brokers, and we feel this would be a strategy that is unlikely to hold much appeal for SHOP exchanges, though it may be more feasible to consider for the individual market.

These four models represent a considerable range in how the SHOP exchange might incorporate and compensate brokers. Within each model, there are many additional aspects of a broker management strategy to consider. For example, regardless of whether brokers are paid by the exchange or by carriers, they will need detailed training on how the exchange works. Exchanges will also need to flesh out other elements of broker management, such as how to solicit and certify brokers, how to generate leads and track them, how to incorporate brokers' market knowledge into SHOP design features and QHP standards, and how to monitor their productivity and ensure their advocacy of the exchange. Both the basic approach and many of these other features should be carefully developed for the SHOP exchange.

### **3.3.4 Small group definition**

ACA defines the small group market as 100 or fewer employees. Until 2016, states can choose to limit access to the SHOP exchange to employers with 50 or fewer employees.



Allowing larger employers to enter could theoretically expand the size of the SHOP. However, recently published analysis by the Urban Institute finds that changing the definition of small group will have little overall impact on the size of the exchange.<sup>7</sup>

There are also several potential risks. Specifically, as the employer's size increases, opportunities for skimming off good risks through self-insurance arrangements also increase. Because there is no tax credit or other enticement for larger employers to join the SHOP, there is more concern that there could be adverse selection dynamics whereby larger employers with worse health risk join the SHOP while those with better health risk stay in their current coverage or self-insure.

In addition, the definition of group size would also affect the applicability of insurance market reforms (such as rating requirements and essential health benefit requirements) in the small group market. Extending the opportunity for SHOP to small groups of over 50 employees will also require extending adjusted community rating regulations to these same size employer groups.

## 3.4 Special Features of SHOP Exchanges

### 3.4.1 Tax credits

The ACA provides tax credits to small businesses with low-wage workers who provide insurance for their employees. From 2010 through 2013, these tax credits are 35% of the employer contribution to insurance premiums, for employers with 10 or fewer employees, and with average wages of \$25,000 or less. These amounts are phased out for employers with up to 25 employees, and average wages up to \$50,000.

Starting in 2014, the tax credit will increase to 50% of the employer contribution, but can only be claimed for insurance purchased through the exchange. The tax credit therefore serves as an incentive for employers to purchase their health insurance through the SHOP exchange. However, the tax credits will phase out based on employer size and average wage, as shown in the table below. Moreover, the *marginal* effect of the employer tax credit will be less than the amounts shown in the table, because the health expenses reimbursed by the credit cannot also be counted as a business deduction. In addition, starting in 2014, the tax credit can only be claimed for two years.

Take-up of the tax credit to date has been far less than expected.<sup>8</sup> It is hard to predict whether the changes to the credit in 2014 (net increase in amount of credit, but credit available only for insurance purchased through the exchange and for two years only) will have a net result of increasing or decreasing take-up, but it is likely that the appeal and applicability of the tax credit will remain limited.

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<sup>7</sup> Blavin F, Blumberg LJ, Buettgens M, Holahan J, McMorro S. How choices in Exchange design for states could affect insurance premiums and levels of coverage. *Health Affairs* 2012; 31(2): 290-298.

<sup>8</sup> Treasury Inspector General for Tax Administration. Affordable Care Act: efforts to implement the Small Business Health Care Tax Credit were mostly successful, but some improvements are needed [Reference Number: 2011-40-103]. September 19, 2011. Available at:

<http://www.treasury.gov/tigta/auditreports/2011reports/201140103fr.pdf>. Accessed on: February 22, 2012.



**Table 1: Phase-out of small business tax credit in 2014 by average wage and firm size**

Firm Size	Up to \$25,000	\$30,000	\$35,000	\$40,000	\$45,000	\$50,000
Up to 10	50%	40%	30%	20%	10%	0%
11	47%	37%	27%	17%	7%	0%
12	43%	33%	23%	13%	3%	0%
13	40%	30%	20%	10%	0%	0%
14	37%	27%	17%	7%	0%	0%
15	33%	23%	13%	3%	0%	0%
16	30%	20%	10%	0%	0%	0%
17	27%	17%	7%	0%	0%	0%
18	23%	13%	3%	0%	0%	0%
19	20%	10%	0%	0%	0%	0%
20	17%	7%	0%	0%	0%	0%
21	13%	3%	0%	0%	0%	0%
22	10%	0%	0%	0%	0%	0%
23	7%	0%	0%	0%	0%	0%
24	3%	0%	0%	0%	0%	0%
25	0%	0%	0%	0%	0%	0%

### 3.4.2 Potential for administrative simplification

A common theme that arises in employer interviews and focus groups is that the selection and administration of a health insurance plan creates significant burdens for employers.

To assist small employers, exchanges should explore ways to reduce the administrative burden of providing health insurance to employees. The employee choice model could help by taking away the burden of selecting a plan, since under this model, employees can compare plans and choose their own plan. In addition, the exchange should recognize that the employer is responsible for a host of issues/services—ranging from COBRA to claims resolution issues—and the value-add of SHOP to the employer may depend upon SHOP’s credible commitment to relieve the small employer of these hassles.

## 3.5 Procurement Strategy

In order to implement and operate a SHOP exchange, Iowa will need to develop and operate a number of business functions. Given the timeframes involved and the existence of private-sector solutions, Iowa may want to procure assistance from outside vendors. In structuring its procurement, the state should consider several approaches, taking into consideration the inter-relationship between SHOP exchange functionality and the functionality needed for the individual exchange.



One paradigm for thinking about structuring a procurement approach would be to identify and procure a “total solution” or a subset of cross-cutting functional layers, such as eligibility determination, customer service, enrollment and premium billing and collection, and financial management and reporting, across the individual and SHOP exchanges. In this approach, the individual and non-group exchange could jointly procure a particular set of services that would then serve both exchanges (Figure 3).

One potential advantage to this approach is that the processes would be well-integrated across both the individual and SHOP exchange, because they would be implemented by the same vendor. At the same time, this approach could limit the state’s ability to leverage the specific expertise of vendors who may have significant expertise in either the individual exchange or SHOP exchange, but not both.

**Figure 3 Schematic for "horizontal" procurement strategy**



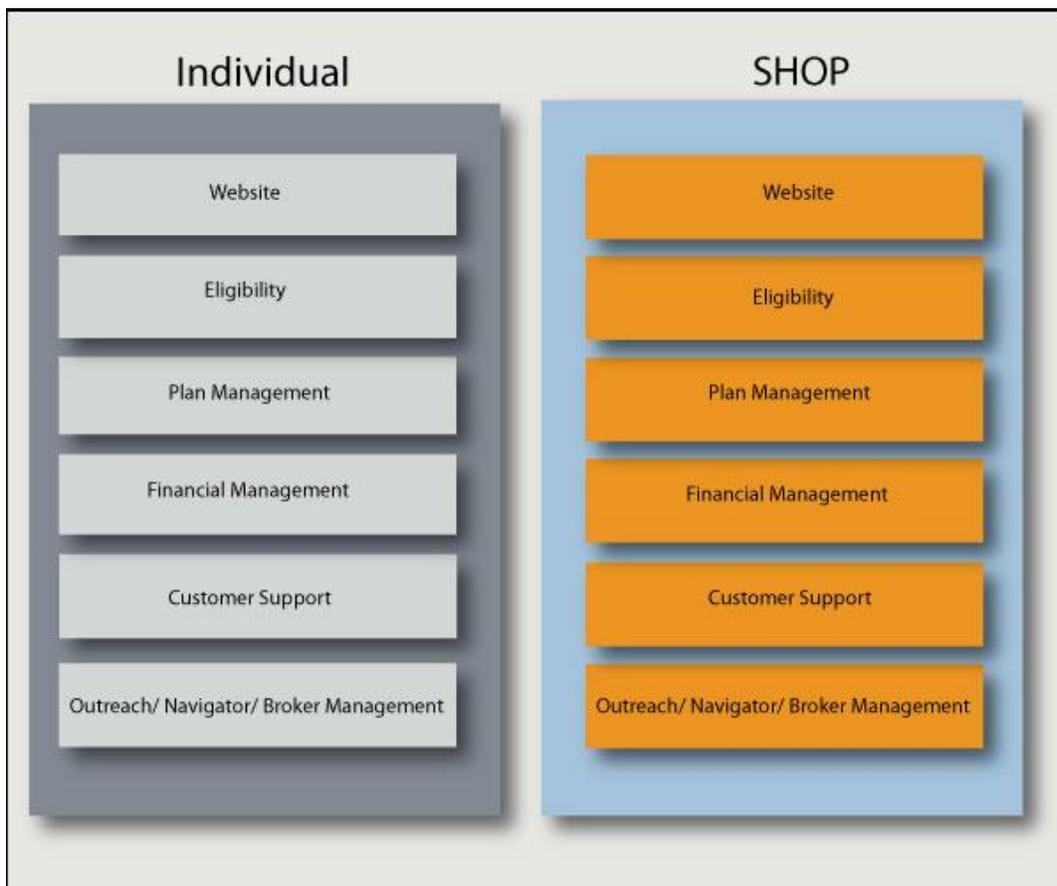
An alternative approach would be to procure the entire SHOP, carved out from the individual exchange (Figure 4). In this case, the state might seek a vendor who is already running a SHOP exchange. Examples of vendors who could potentially offer a complete SHOP solution would be organizations like Small Business Service Bureau, Inc., Choice Administrators, or the Connecticut Business and Industry Association. General agencies could potentially also compete in this space.



Advantages to this approach would be the chance to contract to a vendor with SHOP-specific expertise and who could build and operate a cohesive SHOP exchange. Because the marketing, sales and servicing challenges for SHOP are quite distinct from the non-group exchange, building on the experience of an entity that has successfully operated a SHOP-like exchange is appealing. One that knows the Iowa small-group market would bring a significant advantage as well.

On the other hand, a major challenge of subcontracting separately to operate the SHOP exchange, in whole or in part, would be coordinating seamlessly at a technical level with the individual exchange at points of integration. For example, there will need to be identity management to make sure that each person only has one record, and the exchange will need to share data back and forth with the contractor. Moreover, even if the entire SHOP is outsourced to a contractor, the state should plan for adequate state staff and resources to provide oversight to the contractor, to make sure that SHOP operations meet state and federal requirements, achieve the goals/mission of the state, and are well-coordinated with other Exchange and state agency functions.

Figure 4 Schematic for "vertical" procurement strategy

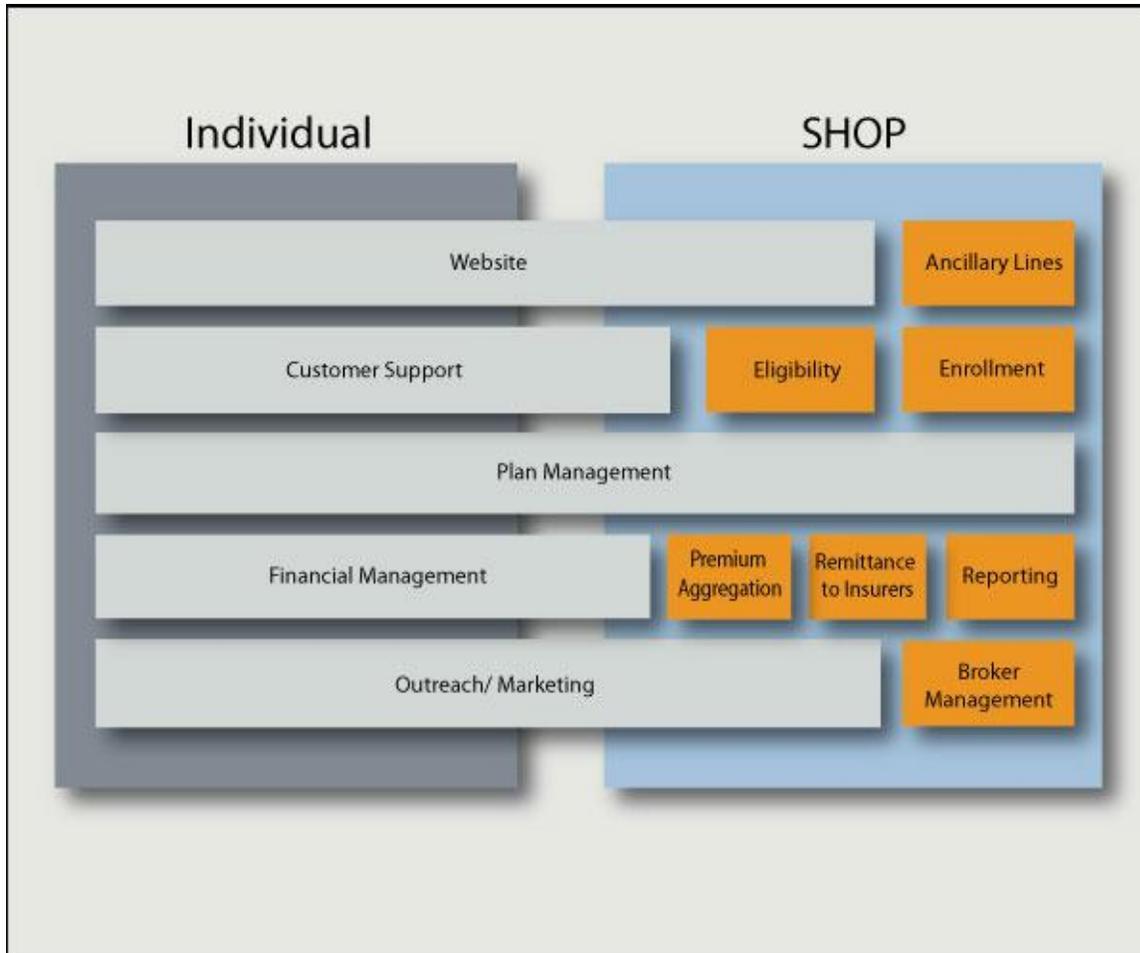


A third strategy is a hybrid approach, where some functional layers are shared by the individual and SHOP exchange, but with additional modular elements of a SHOP that are outsourced to other vendors (Figure 5).



In this case, some SHOP-specific functions such as broker management might be handled by a particular vendor (potentially a general agency), with these modules “plugged into” the core exchange processes. The challenge in this model will be coordination across multiple vendors to ensure a seamless experience for enrollees, but the benefit of the model is the ability to leverage specific expertise of different vendors.

Figure 5 Schematic for "hybrid" procurement strategy



In designing a strategy to develop and operate a SHOP exchange, an important additional consideration is how the state anticipates its needs to evolve over time. A state may wish to take a different approach to procurement for implementation, than for on-going operations. For example, a state may procure services to assist with the initial build (for example, for the website), but then procure separate vendors for on-going operations and hosting.



## 3.6 QHP Procurement and Certification for SHOP

For the individual exchange, there are substantial federal subsidies available, in the form of advance payable tax credits (for qualified individuals up to 400% FPL) and cost-sharing subsidies (up to 250% FPL). Therefore, substantial new enrollment in QHPs can be projected for Iowa's Health Benefits Exchange. The prospect of new, highly subsidized enrollment should suffice to attract the interest of issuers in applying for certification as QHPs for the individual (direct purchase) exchange.

However, Iowa may face a greater challenge in attracting issuer interest in SHOP exchange. Getting dominant carriers to participate in the exchange is a major risk factor for Small Business Health Options Program and will be crucial to selling employee-choice to small employers.

Starting in 2010, the ACA provides tax subsidies for group insurance to small employers of low-wage employees, and as of 2014 these tax credits will be available only through the SHOP exchange. However, this subsidy will be relatively modest, time-limited and narrow in its reach. In its first year, 2010, when employers need simply file with the IRS to claim the credit, utilization was under 15% of the Congressional Budget Office's projections.<sup>9</sup> As of 2014, the value of the tax credit will increase, but it will be available only for two years to small employers in the exchange. It is unlikely to attract much volume to the SHOP exchange.

Only firms with 1 to 10 full-time equivalent employees, earning on average less than \$25,000 per year, qualify for the full 50% tax credit on their contributions. Only one-quarter to one-half of such firms offer ESI and about 4/5ths of their employees take-up that offer, so the full tax credit can help employers of only 20-40% of eligible workers in a relatively small slice of the economy<sup>10</sup>.

Beyond this segment, the value of the special employer tax credits declines rapidly as average wages and/or the number of employees rise. It is only 20% for 10 or fewer employees paid \$40,000, for 15 employees averaging \$31,500, or 19 employees earning under \$25,000. It is zero for firms with 25 or more employees or firms with average compensation of \$50,000 or more.

Even at the full subsidy level, the tax credit replaces tax deductibility, so its value may be substantially reduced. For example, if a 10-worker firm with wages averaging \$25,000 contributes half the group premium of \$8,000 per employee (\$4,000 per worker, or \$40,000 for all ten), then this small employer is eligible for a \$20,000 tax credit (50 percent of \$40,000). However, the firm cannot deduct that same \$20,000 from the earnings on which it pays corporate taxes; if its marginal federal and state corporate tax rate is 39%, the firm foregoes tax deductions worth \$7,800 for the \$20,000 tax credit -- a net tax benefit of \$12,200 (15.25% of premiums).

Such modest subsidies for two years are better than nothing, but not the sort of relief that will induce a large volume of employers to offer coverage through the SHOP exchange.

On the other hand, the SHOP exchange must provide multiple issuers to small employers as an employee-choice offering. (See figure 2, section 3.3.1.) Most carriers generally prefer to sell and

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<sup>9</sup> Treasury Inspector General of Tax Administration, "Efforts To Implement the Small Business Tax Credit Were Mostly Successful, but Some Improvements Are Needed" (September 19, 2011), Reference #2011-40-103.

<sup>10</sup> See tables 2 and 3 in Gruber J. Taxes and health insurance. Cambridge (MA): National Bureau of Economic Research; 2001 Dec (NBER Working Paper No. 8657) [cited 2011 Aug 31]. Available from: <http://www.nber.org/papers/w8657>



underwrite an entire small business, rather than be offered as a “slice” alongside competing carriers in the same small group. In particular, very strong carriers with considerable brand recognition and market share may have very little interest in the SHOP’s employee choice model. This has been the case with Blue Cross Blue Shield in the Massachusetts Health Connector.

Therefore, promoting broad participation by Iowa carriers in the SHOP exchange may present a challenge and merits special attention. Of course, making the SHOP exchange an effective, attractive distribution channel to reach small employers would help, and is highly desirable in its own right, but this is a chicken-and-egg problem: if the health plans with the greatest appeal to small employers do not participate in the SHOP exchange, then it cannot be an effective, attractive distribution channel for Iowa’s small employers. Beyond operational excellence, there are several steps which Iowa might consider for inducing carrier participation in SHOP. Each has some advantages and costs.

1. The carriers and small employers rely on brokers to place this business and to assist with a variety of related functions, so working cooperatively with brokers and ensuring that they are paid comparably to the commissions received outside SHOP for small employers will be an important way to attract small employers and therefore carriers to the SHOP exchange. In section 3.3.3, we set forth the rationale for SHOP exchange to utilize agents and brokers, and several models for paying brokers. The cost of doing so is simply that brokers and agents would be paid at the market rates prevailing outside the SHOP exchange, even though it may be argued that the SHOP exchange could perform some of the functions otherwise provided by brokers.
2. In its certification criteria for QHPs, Iowa’s exchange might require that all issuers that are licensed to operate in the state’s small group market and apply for certification as QHPs for the individual Health Benefits Exchange also apply for certification to market on the SHOP exchange. Market share and leverage are concentrated in the heavily tax-subsidized, non-group exchange: by tying designation as a qualified health plan to serving the Small Business Health Options Program, the exchange can encourage large, broad-network, health plans with major market share and appeal to participate in an employee-choice model. This option would seem to be a fairly straight-forward leveraging of the exchange’s total “purchasing power” in attracting QHPs to serve all potential exchange customers.
3. The State of Iowa might require that, as a condition of licensure, insurance carriers that participate in the small group market as of 2013 and represented at least a minimum percentage of small group enrollment as of 2012 (e.g. 5%) also participate in the SHOP exchange. (Both the minimum percentage criterion and the participation requirement could be broadened to include non-group and small-group markets.) Massachusetts required all health plans with a minimum of 5,000 enrollees in the merged non-group and small-group markets to participate with the Health Connector, but did not make this an explicit requirement to participate in the Health Connector’s small business program, nor did it make participation a condition of continued licensure. (Ch. 58 of the MGL of 2006)



## 4. CONCLUSION AND NEXT STEPS

In this document, we review the key features of the SHOP exchange and discuss a number of design decisions that Iowa will need to make in developing its SHOP exchange. The specific features of Iowa's small group market, as well as the needs and preferences of its small businesses, will be important drivers of exchange design. While states face challenges in creating a successful, robust SHOP exchange, the SHOP exchange also presents an important opportunity for the state. If done well, the SHOP exchange could provide employers and employees with more choice of health plans, decrease the administrative burdens to employers, and allow employers to take advantage of new federal tax credits. Important next steps for the state include engaging with stakeholders, designing its SHOP, and moving toward a procurement strategy.