Methods for Premium Allocation among SHOP Issuers & Employer Premium Contribution

March 18, 2013

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1 Introduction

Federal regulations require that, as of 2015, the Small Employer Health Options Program (SHOP) give employers the option to allow employees to choose among all qualified health plans (QHPs) on one actuarial value tier. Several states are contemplating SHOP models that offer more choice to employees than the mandated approach. Even under the mandated approach, there are important decisions to be made regarding composite rates, list bill premiums, or variations of either.

Composite rates generally refer to premium rates that are group-specific and allow for the same premium for all employees, regardless of age. Composite premiums differ by family structure such as employee plus spouse, employee plus child/children, and family. In states that allow rating variation on age, one group's employee-only composite rate will differ from another group's employee-only rate if the groups have employees of different ages. (Similarly, family rates will differ in these states from group to group with the ages of employees and dependents, and the number of enrolled dependents per family.) But, under composite rating, the employer pays the same amount for each employee (for employee-only coverage), regardless of the employees' ages. Composite rates are also broadly thought of as averages. (CMS regulations refer to them as "average rates.") When a group is provided composite rates as a new quote or at renewal, the composite rates in total for the group's census are equal to the sum of the list rates for the group's census, because composite rates essentially represent the average of the list bill rates. In most states, composite rates are the norm rather than the exception for rating groups, although micro-groups are often restricted to list bill rating.

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Composite Invoice from Carrier

GROUP NUMBER	GROUP NAME	INVOICE PERIOD	PAGE NO
			1

SUB NO.	SUBSCRIBER NAME	TYPE CHG	DATE	RATE	COVERAGE TOTAL	TOTAL AMOUNT DUE
	PRIOR AMOUNT BILLED:					$ 7,067.53
	PAYMENTS RECEIVED:					$ 7,000.00
	ADJUSTMENTS / INTEREST:					$ -
	BALANCE FORWARD:					$ 67.53
	COVERAGE TYPE: **HMO BLUE NE DEDUCTIBLE**					
	CHARGES BASED ON RATES AND ENROLLMENT THRU 7/16/12					
123	SMITH, ANN				$ 532.86	
456	DOE, JOHN				$ 1,404.66	
789	DOE, JANE				$ 532.86	
321	JONES, BOB				$ 1,404.66	
654	RAMSEY, OSCAR				$ 532.86	
987	MICHAELS, RICHARD				$ 532.86	
369	JOHNSON, BARRY				$ 1,404.66	

MESSAGE:	CUSTOMER INFORMATION:
CHANGE RATE EFFECTIVE 7/10/12	**Please see reverse side of invoice for customer service contacts.**

CURRENT DUE:	**$**	**6,345.42**
TOTAL DUE:	**$**	**6,412.95**

List bill rates generally refer to group premium rates that are employee-specific i.e., are calculated individually for each employee using applicable rating factors (in 2014, age, geography and possibly tobacco use). The list bill literally shows these individually calculated premium rates to the employer for each employee. List billing makes transparent to the employer what they generally know, but may tend to forget—that older employees cost more and younger employees less for coverage. Also, list billing automatically adjusts premiums mid-year for mid-year changes in the census e.g., when a 64-year-old employee retires and a 25-year-old is newly hired.

List Invoice from Exchange

GROUP NUMBER	GROUP NAME	INVOICE PERIOD	PAGE NO
			1

SUB NO.	SUBSCRIBER NAME	TYPE CHG	DATE	RATE	COVERAGE TOTAL	TOTAL AMOUNT DUE
	PRIOR AMOUNT BILLED:					$ 7,067.53
	PAYMENTS RECEIVED:					$ 7,000.00
	ADJUSTMENTS / INTEREST:					$ -
	BALANCE FORWARD:					$ 67.53
	BENCHMARK PLAN: **HMO BLUE NE SILVER**					
	CHARGES BASED ON RATES AND ENROLLMENT THRU 7/16/12					
123	SMITH, ANN				$ 558.98	
456	DOE, JOHN				$ 1,454.66	
789	DOE, JANE				$ 456.74	
321	JONES, BOB				$ 1,605.33	
654	RAMSEY, OSCAR				$ 608.98	
987	MICHAELS, RICHARD				$ 456.74	
369	JOHNSON, BARRY				$ 1,203.99	

MESSAGE: CHANGE RATE EFFECTIVE 8/1/12	**CUSTOMER INFORMATION:** **Please see reverse side of invoice for customer service contacts.**

CURRENT DUE:	**$**	**6,345.42**
TOTAL DUE:	**$**	**6,412.95**

Employers generally contribute toward employee premiums by one of two methods: a fixed-dollar amount or a percentage of premium. While many employers decide each year to contribute a certain percentage toward premiums e.g., 75% for the employee and 25% for her dependents, in composite rating this percentage translates into a fixed amount toward the average premium for employees. We refer to this approach as “fixed-dollar amount.” In a multi-plan, employee choice offering, the same fixed-dollar amount typically applies to whichever plan the employee selects. By contrast, under list billing, employers generally contribute a fixed percentage e.g., 75% for employees, 25% for dependents, but because the premiums for each employee vary by allowable rating factors, so do their premiums and therefore so does the employer’s contribution amount.

While it has been possible under list billing for employers to contribute the same fixed dollar amount, rather than percentage of premium, the ACA will apply new non-discrimination rules to employer contributions. Contributing a fixed-dollar amount toward list bills is thought to violate non-discrimination rules under the ACA because older workers' premiums will be higher than younger workers', but all will get the same dollar contribution by the employer. As a result, the employer would contribute a smaller percentage toward an older worker's than a younger worker's premium. As a result of the new non-discrimination rules, for which regulations are still not available, there is now a tie between allowable forms of (a) employer contribution (fixed-dollar vs. percentage of premium) and (b) allowable rating methods (composite vs. list billing). As indicated in the table below, a fixed-dollar contribution under list billing will likely not pass the non-discrimination test under ACA rules.

Employer Contribution	Composite Rating	List Billing
Fixed-Dollar	X	Not Allowed
Percentage of Premium	X	X

This section of the report addresses how premium revenue should be billed and distributed among issuers participating in SHOP, particularly when premium rates need to be provided to employees to help inform their decision, and issuers will not know exactly who within a group will select their plans. In developing proposed approaches we considered the following objectives:

- Optimizing equity among SHOP issuers
- Allowing employers budget certainty through fixed contributions
- Operational simplicity
- Incorporation of billing techniques familiar to employers and brokers
- Complying with the ACA's non-discrimination rules

The following section of the report will address allowable contribution approaches under each of the premium rating and distribution methods discussed in this section.

For states that will allow some rating variation by age in 2014 and beyond, the following is a list of possible operational methodologies for distributing premium revenue among issuers.

1. List Bill (age rating)
2. Risk-Adjusted Composite (average rating)

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3. Reallocated Composite Premium, with the member's buy-up/down premium calculated on the member's list-bill premiums
4. Reallocated Composite Premium, with the member's buy-up/down premium calculated on the member's composite rates
5. List Bill with Age-Stratified Contribution

Each of these approaches is described below, along with their advantages and disadvantages. All the examples displayed reflect a three-life group consisting of employees with ages <25, 45-49, and over 60. All employees select a Silver plan from three different issuers, A, B, and C, respectively.

2 Approaches

2.1 List Bill

- Components of approach:
  - The premium charged for each member would be calculated based on each employee's age (assuming variation of rating based on age is allowed in the state).
  - To avoid age discrimination, the list bill methodology would require employers to contribute a percentage of each member's premium for the plan selected by the employer, rather than contributing a set dollar amount.
  - The following table provides an example of premiums distributed between three issuers.

List Bill Premiums in a Multi-Issuer Environment

Employee	Age	Issuer	Plan (AV)	List Bill Premium
1	<25	**A**	Silver	$119
2	45-49	**B**	Silver	$300
3	60+	**C**	Silver	$430
Total				$849

- Advantages:
  - All issuers are "made whole," meaning that each issuer will receive premiums according to the age of the employees who enroll in their products. Issuers are made whole even if there is a mid-year census change.
- Disadvantages:

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- Older employees pay more than younger employees for the same plan.
- Composite premiums are typical in most states. Changing to list billing could present an operational challenge for issuers and significant change to how employers and brokers consider premium rates.
- Employers would need to be careful in establishing contributions in order to pass non-discrimination rules under this approach. For example, many employers are accustomed to paying the same amount per employee (toward employee-only coverage). However, our understanding is that doing so in 2014 in conjunction with a pure list bill premium methodology would be discriminatory since older employees would pay more than younger employees for coverage (more as a dollar amount and as a percentage).

2.2 Composite with Risk Adjustment

- Components of approach:
  - Composite rates are calculated for all plans that employees of a group could select e.g., all QHPs on the Silver tier. Rates for any one plan are calculated based on the assumption that all employees of a group enroll in that plan.
  - Premiums are paid by employees and employers according to the contribution schedule i.e., fixed-dollar or percentage of premium. Issuers receive composite rated premiums for each member enrolled in their plans.
  - Risk adjustment incorporates the demographic differences between who enrolled (member-specific) and who was incorporated in the rating (group in total).
    - In risk adjustment, the concept is that risks beyond what can be used to vary premium rates should be calculated and spread retroactively through cash transfers. Therefore, in "standard" risk adjustment techniques, the demographic variation of employees, limited to 3:1, should be removed from the net risk score for an issuer (in states that allow age rating variation of 3:1). In this Composite with Risk Adjustment approach, since issuers rate based on the demographics of the group rather than the individual member who selects their plans, the demographic variation of the group would be removed from each risk score of the members enrolled in their plans.

- CMS' requirement to use standard demographic (age) factors in rating, just as the federal risk adjustment model uses standard coefficients for demographics, simplifies this approach.

Multi-Issuer Composite Rates: the Risk Adjustment Solution

Step 1: Calculation of Composite Rates Assuming 100% of Group Enrolls in Plan

Employee-only	
Issuer	**Silver**
A	$250
B	$275
C	$300

Step 2: Employee Selections

Employee	Age	Issuer	Plan (AV)	Premium	Ee Age Factor
1	<25	A	Silver	$250	0.50
2	45-49	B	Silver	$275	1.14
3	60+	C	Silver	$300	1.50
Average				$275	1.05

Step 3: Risk Adjustment ("Correction")

Issuer	Premium (A)	EE Age Factor (B)	Age Factor in Rates (C) = Average (B)	Risk Score Adjustment (D) = (B) - (C)	**Risk Adjustment (E) = (D) * Average (A)**	**Net Revenue (F) = (A)+(E)**
A	$250	0.50	1.05	(0.55)	**-$151**	**$99**
B	$275	1.14	1.05	0.10	**$26**	**$301**
C	$300	1.50	1.05	0.45	**$124**	**$424**
Total	$825	1.05	1.05	-	**$0**	**$825**

- Advantages:
  - All employees would pay the same amount for the same plan, regardless of age or plan selected.
  - For states already planning on administering risk adjustment, this is an easy "fix" to a potentially complex issue.
  - For states where composite rates are prevalent, the Composite with Risk Adjustment methodology allows employers and brokers to keep composite rates, something to which they are accustomed.
  - A defined contribution approach is possible. This means that an employer could choose a set dollar amount, and employees could select a plan. All employees purchasing the same plans would pay the same amount (for employee-only

coverage), regardless of age. The employer contribution would be a fixed dollar amount per employee, regardless of employee age. This could possibly mean that employers would not need to select a reference plan, depending on how the state-specific SHOP operates.
    - Issuers' ultimate revenue is adjusted to reflect their actual SHOP enrollment (but revenue will not equal list bill premiums).
- Disadvantages:
    - Issuers are not "made whole" with respect to the list bill premiums for the employees who enroll in their products.
    - For states which have HHS administer risk adjustment, the reconciling calculations would need to be performed by the SHOP which collects demographic information for groups as part of SHOP enrollment.

2.3 Reallocated Composite with Buy-up/down Equal to Difference in List Bill Rates

- Components of approach:
    - Issuers receive list bill premiums. The only exception to this may be with regard to mid-year census changes.
    - Composite rates are calculated for all plans that employees of a group could select. Rates for any one plan are calculated based on the assumption that all qualified employees of a group enroll in that plan.
    - A reference QHP and contribution amount is selected by the employer.
    - The employer pays the same dollar amount for each employee, regardless of age or plan selected by the employee.
    - For employees who select the reference plan, their premium payments are the same dollar amount, regardless of age.
    - In addition to the employee contribution for the reference plan, if an employee selects a plan other than the reference plan, the employee pays (or receives) the difference between the list bill of the selected plan and the list bill of the reference plan.

Multi-Issuer Composite Rates: Reallocated Composite

Buy-up and Buy-down is based on the difference in List Bill premiums

Step 1: Calculation of Composite Rates Assuming 100% of Group Enrolls in Plan

Employee-only	
Issuer	**Silver**
A	$250
B	$275
C	$300

Step 2: Employer Selects Benchmark Plan and Contribution

Issuer	**A**
Metal Tier	**Silver**
% Contribution	**70%**

Step 3: Employee Selections

Employee	Age	Ee Age Factor	Issuer	Plan (AV)	List Bill Premium
1	<25	0.50	A	Silver	$119
2	45-49	1.14	B	Silver	$300
3	60+	1.50	C	Silver	$430
Average		1.05			$849

Step 4:Calculate Premiums and Reallocate Revenue

	Benchmark Plan				Selected Plan			Total
Selected Issuer	**Composite Rates (A)**	**List Bill (B)**	**Paid by Employer (C) = 70% * (A)**	**Paid by Employee (D) = (A) - (C)**	**List Bill (E)**	**Additional Amt Paid by EE (F) = (E) - (B)**	**Total Premium Collected (G) = (C)+(D)+(F)**	**Reallocated Premium (H) = (E)**
A	$250	$119	$175	$75	$119	$0	$250	$119
B	$250	$273	$175	$75	$300	$27	$277	$300
C	$250	$358	$175	$75	$430	$72	$322	$430
Total	$750	$750	$525	$225	$849	$99	$849	$849

- Advantages:
  - All issuers are "made whole," meaning that each issuer will receive premiums according to the ages of the employees who enroll in their products. The only exception to this could be mid-year changes in the census.
  - Employers pay the same amount for each employee (for employee-only coverage), regardless of age or plan selected by the employee.
  - This methodology allows employers and brokers to keep composite rates, something to which they are accustomed in many states.
- Disadvantages:
  - Older employees pay more than younger employees for more expensive plans (and save more than younger employees for less expensive plans) than the reference QHP.

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  - This approach may not pass non-discrimination rules. There certainly is compliance with non-discrimination rules when the reference plan is selected by employees. However, older employees who select a plan richer than the benchmark will pay more than younger employees who select the same plan.

2.4 Reallocated Composite with Buy-up/down Equal to Difference in Composite Rates

- Components of approach:
  - Composite rates are calculated for all plans that employees of a group could select. Rates for any one plan are calculated based on the assumption that all qualified employees of a group enroll in that plan.
  - A reference QHP and contribution amount is selected by the employer, which determines the employees' contribution to the reference plan.
  - In addition to the employee's contribution for the reference plan, if an employee selects another plan, the employee pays (or receives) the difference between the composite rates of the reference plan and of the selected plan.
  - Issuers receive adjusted list bill premiums. Premiums are composite rated for purposes of employee choice, but revenues are allocated to issuers on an age-adjusted basis.
  - The total of the composite rates collected from the employer will not equal the list bill premiums calculated. The difference between those two totals, is the percentage adjustment applied to each issuer's list bill collections.

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Multi-Issuer Composite Rates: Reallocated Composite

Buy-up and Buy-down is based on the difference in Composite Rates

Step 1: Calculation of Composite Rates Assuming 100% of Group Enrolls in Plan

Employee-only	
Issuer	**Silver**
A	$250
B	$275
C	$300

Step 2: Employer Selects Benchmark Plan and Contribution

Issuer	**A**
Metal Tier	**Silver**
% Contribution	**70%**

Step 3: Employee Selections

Employee	Age	Ee Age Factor	Issuer	Plan (AV)	List Bill Premium	Composite Premiums
1	<25	0.50	A	Silver	$119	$250
2	45-49	1.14	B	Silver	$300	$275
3	60+	1.50	C	Silver	$430	$300
Average		1.05			$849	$825

Step 4: Calculate Premiums and Reallocate Revenue

	Benchmark Plan			Selected Plan					
Selected Issuer	**Composite Rates (A)**	**Paid by Employer (B)= 70%*(A)**	**Paid by Employee (C) = (A) - (B)**	**Composite Rates (D)**	**Additional Amt Paid by EE (E) = (D) - (A)**	**Total Premium Collected (F) = (D)**	**Total List Bill Premium (G)**	**Adjustment to List Bill (H) = Total (F) / Total (G) - 1**	**Total Reallocated Premium (I) = (G) * (1+(H))**
A	$250	$175	$75	$250	$0	$250	$119	-2.8%	$116
B	$250	$175	$75	$275	$25	$275	$300	-2.8%	$292
C	$250	$175	$75	$300	$50	$300	$430	-2.8%	$417
Total	$750	$525	$225	$825	$75	$825	$849	-2.8%	$825

- Advantages:
  - All employers would pay the same amount for all employees, regardless of age or plan selected.
  - Employees would pay more (or less) for more (or less) expensive plans than the reference plan, but all employees would pay the same amount for the same plan, regardless of age.
  - Employers and brokers, who are accustomed to composite rates in many states, would continue to see composite rating.
  - A defined contribution approach is possible. This means that an employer could choose a set dollar amount, and employees could select a plan. This could possibly mean that employers would not even need to select a reference plan, depending on how the state-specific SHOP operates. Employees would pay the difference between the composite rate of the plan selected and the defined contribution paid by the employer.

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  - Issuers' ultimate revenue is adjusted to reflect their actual SHOP enrollment (but revenue will not equal list bill premiums).
  - This approach optimizes the equity of payment among issuers. All issuers would have the same percentage adjustment to list bill rates.
- Disadvantages:
  - Issuers are not "made whole" with respect to the list bill premiums for the employees who enroll in their products i.e., their ultimate adjusted revenue will not equal their list bill premiums.
  - Issuers will not be able to calculate their revenue with only the information they have. The SHOP will need to perform these calculations and provide support of the premium transfers to issuers.

2.5 List Bill with Age-Stratified Contribution

- Components of approach:
  - The employer chooses the reference plan. Composite rates are calculated for the reference plan, and the employer determines her percentage contributions (X%) toward the composite rates.
  - All employees who choose the reference plan pay the same amount [(1-X%) x composite rate], regardless of age (for employee-only coverage).
  - The employer actually contributes the difference between each employee's *list bill* premium and the employees' contribution toward the reference plan. This methodology results in employers making an age-stratified contribution -- higher percentage of list bill premiums for older members and lower percentage for younger employees.
  - As employees buy-up or buy-down to other QHPs, rather than selecting the reference plan, their employer contributions stays constant (a fixed allowance). Therefore, the employee pays the difference between list bill of the selected QHP and the fixed allowance paid by the employer.

List Bill with Age-Stratified Contribution

Step 1: Calculation of Composite Rates Assuming 100% of Group Enrolls in Plan

Employee-only	
Issuer	**Silver**
A	$250
B	$275
C	$300

Step 2: Employer Selects Benchmark Plan and Contribution

Issuer	**A**
Metal Tier	**Silver**
% Contribution	**70%**

Step 3: Employee Selections

Employee	Age	Ee Age Factor	Issuer	Plan (AV)	List Bill Premium
1	<25	0.50	A	Silver	$119
2	45-49	1.14	B	Silver	$300
3	60+	1.50	C	Silver	$430
Average		1.05			$849

Step 4: Calculate Premiums

	Benchmark Plan				**Selected Plan**		
Selected Issuer	**Composite Rates (A)**	**List Bill (B)**	**Paid by Employee (C) = 30% * (A)**	**Paid by Employer (D) = (B) - (C)**	**List Bill (E)**	**Additional Amt Paid by EE (F) = (E) - (B)**	**Total Premium Collected (G) = (C)+(D)+(F)**
A	$250	$119	$75	$44	$119	$0	$119
B	$250	$273	$75	$198	$300	$27	$300
C	$250	$358	$75	$283	$430	$72	$430
Total	$750	$750	$225	$525	$849	$99	$849

- Advantages:
  - All issuers are “made whole,” meaning that each issuer will receive premiums according to the age of the employees who enroll in their products.
  - All employees selecting the reference plan pay the same amount, regardless of age.
  - The employer makes a fixed dollar contribution for each enrollee i.e. her contribution is fixed, so long as the

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- Disadvantages:
    - If employees select a higher cost plan than the reference plan, older employees pay more than younger employees for the same plan. (As in methods 2.1 and 2.3, this “inequality” is symmetrical i.e., older employees also save more than younger employees for selecting a less expensive plan than the reference plan.)
    - The employer’s contribution will change throughout the year with changes in the enrollee census
    - Composite premiums are typical in most states. Changing to list billing could be an operational challenge for issuers, and a significant change to how employers and brokers consider premium rates.
    - The complexity and newness of age-adjusted employer contributions is hard to explain to employers and employees alike.

3 Conclusion

There are many things for a state to consider when selecting an approach, and there are many things for issuers to consider when pricing products offered within each of these approaches. The main differentiations among approaches are:

- Issuers generally prefer methods that result in obtaining list bill, or age-specific revenue in accordance with the members who actually enroll in their plans. Of the methods listed in this report, the ones that meet this objective are:
    - List Bill
    - Reallocated Composite Premium, with the buy-up or buy-down premium calculated as the difference between the member’s list-bill premium for the reference plan and the selected plan
    - List Bill – Age-Stratified Contribution
- Some stakeholders think that having a methodology in which employees of all ages pay the same amount, for each plan, is important. Of the methods listed in this report, the ones that meet this objective are:
    - Composite with Risk Adjustment
    - Reallocated Composite Premium, with the buy-up or buy-down premium calculated as the difference between the composite rates of the benchmark plan and the selected plan
- Appeal to employers (and possibly brokers) is paramount to creation of a thriving SHOP. Based on the concept that employers generally prefer paying a set dollar amount for

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each employee (for employee-only coverage), the following methods meet this criteria best:

  - Either of the Reallocated Composite Premium methodologies
  - Composite with Risk Adjustment

- Minimizing the operational complexity is an important consideration in selection of an approach. It is important to consider the operational complexity and transparency of each approach from the perspective of the SHOP and the issuers. Of all considerations, this criterion is the most subjective and is heavily influenced by other related decisions, such as: Will the state administer risk adjustment? Will an issuer who currently bills on a composite basis operationalize a list bill system regardless of one state's decision?