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State Health Reform: The Significance of Utah Health Insurance Reforms

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Utah is currently implementing consumer-centered health insurance reforms enacted in March of this year.[1] The reforms are designed to increase choice, portability, and availability of private health insurance coverage. They are the product of a continuing, multi-year health reform process in that state.

This first set of Utah health reforms includes three key elements:

1. Insurance market reforms to create a new "defined contribution" coverage option for businesses and their workers;
2. A board to design and manage a companion risk adjustment mechanism; and
3. A "virtual" health insurance exchange to coordinate the various administrative functions of a consumer-choice market.

Creating a "Defined Contribution" Option. The centerpiece of Utah's reforms is a new option for employment-based health insurance that will enable employers to offer health benefits to their workers on a "defined contribution" basis.

An employer electing this option will no longer need to manage a traditional "one-size-fits-all" group plan for its workers. Rather, each worker, during the annual open season, will be able to pick from a menu of health insurance plans, all of which will conform to federal standards (such as guaranteed issue to employees and limits on pre-existing condition exclusions) so as to qualify for favorable federal tax treatment as employer-sponsored health benefits.

Utah will make this defined contribution option available to small businesses (those with two to 50 employees) effective January 1, 2010. The legislation also specifies that starting in January of 2012, businesses of any size will be allowed to elect this option.

Employers will still have the option of offering health benefits on a traditional group policy basis—either purchased from a commercial insurer or self-insured by the employer. However, the new defined contribution option will be less costly and less burdensome for employers to offer, and will give workers more choice and control over their coverage.

Employers who elect the defined contribution option must agree to establish a qualified "cafeteria plan" or "health reimbursement arrangement" in accordance with federal tax law, allowing their workers to pay any employee share of the premiums on a pre-tax basis regardless of what the employer contributes or which plan the employee picks.

Starting with Risk Adjustment. A second important element of the reforms is the creation of a "Utah Defined Contribution Risk Adjuster" with a board consisting of representatives of health insurers and private employers as well as the state's insurance

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department, the public employee health plan, and the Governor's Office of Consumer Health Services.

This board was created to determine the insurance rating (pricing) rules for the defined contribution market and to design a mechanism for adjusting (or pooling) risk across all insurers in the market. The objective is to enable consumers to easily compare the benefits and prices for various competing plans on the "front end" while on the "back end" adjusting payments to insurers so that the costs of expensive cases is spread among all insurers and all plans have incentives to compete in offering the best value to both healthier and sicker enrollees.[2]

The board is now finalizing its initial design for both elements. In general, the agreed design will work as follows:

- Plan offerings will be partially risk-adjusted through pricing based on family status and age. There will be four family status categories: single adult, one adult plus one child, couple with no children, and family—which could be either a single adult with more than one dependent or a couple with one or more dependents. Age rating will be in five-year bands for adults between 20 and 64, with insurers permitted to vary premiums by no more than 4 to 1 between the lowest and highest priced age bands. The age of the employee will determine the applicable age band.

  Thus, by simply entering his or her age and choosing one of the four family status categories, an employee will be able to compare competing plan benefits and applicable premiums. There will be no geographic adjustment to premiums as regional differences in health care costs were determined to not be a significant factor in Utah.
- A common underwriting questionnaire will be completed by all employees signing up for coverage as part of a participating employer group in order to construct an insurance profile for the group. This is the same process as is currently used in rating traditional group coverage, and Utah law allows insurers to vary premiums by up to +/– 30 percent on a group basis. Thus, when an employee logs on and enters his or her employer's ID number, the software will automatically adjust the entire schedule of age and family premiums for the competing plans to reflect the rating factor assigned to the worker's employer group.
- After the employees all pick their coverage, the employer will transmit a monthly total amount for all of the chosen coverage. A portion of that total will be what the employer contributes directly to coverage—determined according to the rules established by each employer for its plan—with the balance coming from pre-tax payroll withholding by the employees. The system has been designed to also accept payments from other sources, such as government subsidies for lower-income individuals.
- The amounts transmitted to the insurers will be adjusted further based on which individuals chose which plan. For example, if two individuals have the same employer, are the same age, elect the same coverage status, and choose the same plan, then both will pay the same premium. However, if one is diabetic and the other is not, the insurer will receive a somewhat larger payment for the diabetic employee. Where this will really help is if the two employees opt for different plans. In that case, the differences in the premiums they pay will only reflect the differences in the design of the competing benefit packages—not differences between the employees in health status. Yet the plan chosen by the diabetic will get a somewhat larger slice of the total paid collectively by the employer and all of its workers for coverage.
- Finally, an end-of-year adjustment among all participating insurers will compensate for any insurer ending up with a share of high-costs

1. State of Utah, "H.B. 188 Health System Reform—Insurance Market," 2009 General Session, at *http://le.utah.gov/~2009/bills/hbillenr/hb0188.pdf* (July 29, 2009).
2. For a further discussion of risk adjustment in health insurance, see Edmund, F. Haislmaier, "State Health Care Reform: A Brief Guide to Risk Adjustment in Consumer-Driven Health Insurance Markets," Heritage Foundation *Backgrounder* No. 2166, August 1, 2008, at *http://www.heritage.org/Research/HealthCare/bg2166.cfm*.

enrollees or claims significantly greater than the normal variation. Those adjustments will be done by the participating insurers—who will debit and credit each other in accordance with the rules they collectively established through the board—and will have no effect on the premiums paid by either the enrollees or their employers.

Everyone involved recognizes that this initial risk adjustment design will likely need further refinement and revisions as the insurers gain experience from operating in the new consumer-choice market. For example, the board will likely need to eventually phase-out the employer-group rating factor. That way, when a worker changes jobs but keeps the same coverage, his or her premium will not increase or decrease simply because the new employer has a different group-rating factor than the old employer.

Health Insurance Exchange. The law also established the Office of Consumer Health Services (within the Governor's Office of Economic Development) and gave it the job of designing and administering an Internet-based health insurance "portal" to function as Utah's health insurance exchange.[3] Any insurer will be able to offer coverage through the exchange if it is licensed in Utah and the plan it offers meets state and federal standards.

The exchange will be an online administrative system for employers to offer the new defined contribution coverage option to their employees; for workers and insurance brokers to use in comparing and choosing coverage; for employers, insurers, individuals, and intermediaries such as banks to use to collect and transmit premium payments from multiple sources; and for the state government to use to administer any premium assistance payments for private coverage on behalf of low-income individuals.

Utah's particular innovation is that rather than creating a single entity to perform all of the different administrative functions, the state is using a contracting process to simply network the different pieces and vendors, both existing and new, into a "virtual" health insurance exchange.

Current plans are for the exchange to begin signing up employers who want to participate the week of August 17, with the rest of the system in place for employees to choose coverage during the first open season in November, and for the coverage to take effect January 1, 2010.

The legislation also contains a number of other provisions that augment the key reform elements, including:

- Consumer transparency requirements for insurance agent compensation and insurance plan benefits and practices;
- Authorization of new "mandate-lite" health insurance policies; and
- Authorization of a new lower-cost "conversion" policy for individuals eligible under federal or state law to elect conversion coverage following employment termination.

Benefits of Utah's Approach. Utah is looking to derive a number of benefits from this insurance reform approach.

More Employers Offering Health Coverage. Nationally, only 43 percent of employers with 50 or fewer workers currently offer employer-sponsored health insurance, and Utah's rate (32 percent) is even lower.[4] A major reason is that traditional one-size-fits-all group coverage puts most of the risk on the employer. In essence, the decision by a small business to start offering health insurance to its employees is a decision to jump onto the health cost escalator. Before deciding to offer group coverage, the employer has to be confident that it can handle future cost increases and also be willing to endure the annual hassle of finding or negotiating coverage that 75–80 percent of its employees will take, and then dealing with their complaints.

Utah's "defined contribution" option will allow employers to offer their workers quality health ben-

3. Additional information can be found at the Utah Office of Consumer Health Services Website at *http://goed.utah.gov/programs/consumer-health-services* (July 29, 2009).
4. Kaiser Family Foundation, "Percent of Private Sector Establishments That Offer Health Insurance to Employees, by Firm Size, 2006," at *http://www.statehealthfacts.org/comparemaptable.jsp?ind=176&cat=3* (July 29, 2009).

efits while avoiding most of the associated risks and hassles. Under a defined contribution arrangement each employee gets to decide which plan best suits his or her needs and situation. Furthermore, employees can reevaluate their decisions each year at open season. When faced with a premium increase for the plan he or she picked last year, it is the worker who will decide whether the benefits are worth the extra cost or if another plan offers a better cost-benefit proposition.

A new insurance option that takes most of the risk off of the employer, combined with shared administrative functions through an exchange that also relieves the employer of most of the hassle factor, could eventually result in almost every employer in the state offering at least that coverage option to its workers.

A New Risk Management Tool for Workers. While it is true that defined contribution shifts risk to the employee, it also gives the employee a new tool to manage that risk: annual choice of coverage from a menu of plans with different benefit designs and premiums offered by different insurers. From the employees' perspective, that is a far better option than the current situation in which their employer picks a plan that is probably not their first choice and, as the premiums go up year after year, shifts more of the cost onto them by requiring them to pay higher co-pays or larger shares of the premium.

Better Value. As seen from the experience of the Federal Employee's Health Benefit Program—the country's largest and longest operating defined contribution health insurance system—a consumer choice market puts simultaneous downward pressure on prices and upward pressure on benefits/quality, the only effective way to attain better value in a health system.[5]

Protecting and Assisting Consumers. Under Utah's defined contribution approach, all the insurance sold through the exchange will be state regulated and meet federal standards for employer-sponsored coverage. Participating employers and their workers can be certain that all the policies offered will be quality coverage from responsible insurers. In addition, insurance agents will be compensated not just for helping the employer offer coverage to its workers but also for helping the workers compare plans and select the ones that best meet their individual needs. Thus, employers can be confident that their workers will have access to licensed and trained professionals for help with picking their coverage.

Increased Portability. Over time, as more employers opt to offer health benefits on a defined contribution basis, more and more workers will be able to take their coverage with them from job to job.

Reducing the Number of Uninsured. Utah lawmakers view the creation of a defined contribution option for employer-based coverage as a first step in covering more of the uninsured. Making it both easier for employers to offer coverage and easier for workers to find and keep the coverage they prefer should result in fewer individuals experiencing gaps in coverage and thus being uninsured.

An Innovative Approach. Other states are pursuing their own variations of consumer-centered health reform. What Utah will soon offer is a working model of how states can design and implement a consumer-centered health insurance market that leverages existing resources with minimal regulation or disruption to existing arrangements.

Of particular interest to other states should be Utah's technological solutions for creating a "virtual" health insurance exchange and the lessons and insight that will come from its experience in designing a robust risk adjustment mechanism to support a consumer-choice market.

Utah's approach is, in effect, a marriage of advanced health care reform with advanced information technology.

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5. For a more detailed discussion of FEHBP's performance, see Walton Francis, "The FEHBP as a Model for Medicare Reform: Separating Fact from Fiction," Heritage Foundation *Backgrounder* No. 1674, August 7, 2003, at *http://www.heritage.org/Research/HealthCare/bg1674.cfm.*