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Issue Brief
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State Experiences in Developing Purchasing Pools

Overview

Some states have supported the development of purchasing pools to increase health insurance offer rates among small employers. Small employers can gain greater bargaining power in the market for health insurance, negotiate lower rates, and achieve administrative cost savings by purchasing insurance as a larger group. Ideally, purchasing pools can expand the range of health plan options offered to employees, and provide for investments in technology and quality monitoring activities that were not possible for small employers individually. The success of large employers in instituting purchasing pools has fueled enthusiasm for this concept among states with low rates of employer-sponsored insurance.[1]

In this issue brief, we discuss the effectiveness of state purchasing pools. We also outline barriers to successful outcomes, with a special focus on obstacles unique to Montana. Finally, using the lessons learned in other states, we map out various ways Montana can encourage the development of viable purchasing pools for small employers and their employees.

Effectiveness of Purchasing Pools

Several states developed small employer purchasing pools as part of a broader movement to reform the small group health insurance market in the mid-1990s. Most pools to date have been voluntary, meaning that small employers in the state have the option, but are not mandated, to participate.

In general, purchasing pools have been characterized by: a standardized benefit set; health insurance contracts with at least two managed care plans or insurers; competitive contract bidding process based on price, quality, or access; and centrally administered enrollment and billing processes.

However, states have encountered some formidable obstacles in the development and implementation of small-group purchasing pools. There are only about 20 small-group cooperatives or alliances, providing coverage for a total of roughly one million employees and dependents across the U.S.[2] In particular, states have had limited success in increasing the number of individuals with health insurance coverage, making insurance more affordable, gaining substantial membership, and achieving substantial administrative cost savings for members.

Barriers to the Success of Purchasing Pools

States have encountered several barriers to success in pooling health care expenditure risk among employers. Perhaps most elusive has been overcoming problems associated with adverse selection. Adverse selection occurs when healthier individuals or groups leave the pool and sicker individuals remain, driving up the cost. Pooling risk among employers should have the effect of making premiums more affordable for small groups that contain individuals who utilize health care services to a greater extent than others. Yet because

these pools are voluntary, lower cost groups have the incentive to look outside of the pool for lower cost offerings. As more and more low-cost groups leave the pool, the remaining group becomes more costly. To be economically viable and to avoid adverse selection, pools must use the same risk-rating mechanisms inside the pool for its members as is used in the general market outside of the pool.

Unfortunately, pools that implement such rating of risk also have more difficulty demonstrating administrative cost savings. Many of the costs inherent in serving small groups continue to exist despite the shared organization. For example, many plans, struggling to reach the size needed to begin achieving administrative efficiency, have required subsidies during start-up as well as initial operation due to unexpected marketing expenditures. Some pools have attempted to gain savings by eliminating the role of sales brokers, but as a result, brokers have actively marketed against pools. Small employers depend heavily on brokers as a source of information, and successful pools have learned that they need to work with these agents in order to meet growth objectives.

Purchasing pools have also had mixed success in their ability to offer employers a choice of health plans. Pools must demonstrate strong enrollment growth and market share to attract the attention of health plans, and at the same time offer a choice of health plans to be attractive to employers. With over 150,000 enrollees, California's PacAdvantage is an example of a pool that has been successful in both adding health plans and continuing to build enrollment. However, a number of state-sponsored pools—for example, pools in Florida, Colorado, North Carolina, Colorado, and Texas—have increased enrollment in their early years of implementation, but have been unable to retain the participation of enough health plans to sustain needed enrollment in the long term.[3]

Along with the general challenges described above, a frontier state like Montana—with low population density and a predominantly rural population—faces additional barriers to developing a viable purchasing pool. Among the key factors contributing to Montana's high rate of uninsurance are a prevalence of small, independent businesses, large numbers of part-time workers, and low wages. The majority of employed Montanans lacking coverage (56%) were employed by small employers with ten or fewer employees.[4]

A large proportion of Montana's small businesses currently not offering insurance (40%) would likely participate in a purchasing pool, according to the results of the 2003 Montana Employer Survey. Yet with few insurance carriers to write policies for small-employer purchasing pools, low Health Maintenance Organization (HMO) penetration, and limited competition in the health care market in general, Montana has thus far had little success in promoting the concept. While the 1995 Montana Legislature authorized group purchasing cooperatives, only one coalition of large employers has been formed and its functions have varied over time.

Ways States Can Encourage and Sustain Purchasing Pools

Rising uninsurance rates and growing concern about employers' ability to offer coverage in the current economic climate have prompted states to look again at the potential of purchasing pools to address issues of access for small group employers. Given the limited success of these initiatives in boosting employer offer rates,

policymakers have increasingly looked at various ways states could encourage the development of pools through direct subsidies or tax incentives. Some analysts have argued that because the benefits of these pools accrue to society as a whole—rather than to individuals or their employers alone—public subsidies are warranted.[5]

States have experimented with various mechanisms to help small-employer purchasing pools get enough enrollees to remain viable. Generally speaking, these strategies fall into two major categories: (1) those that reduce financial risk, including the risk of adverse selection for participating health plans, and (2) those that reduce costs to employers or to employees that participate in the pool. Below, we provide descriptions of these strategies, as well as examples of states experimenting with them.[6,7]

- **Provide adequate sponsorship.** Success in the marketplace is dependent on getting buy-in of all the players involved, including employers, health plans, brokers, and state regulatory agencies. Sponsorship by an appropriate entity to begin the momentum and provide start-up funds is needed. Successful examples of sponsorship include: plans started by state government, either through a government agency or separate quasi-governmental body (such as PacAdvantage); plans initiated as public-private partnerships such as New York City's HealthPass Purchasing Alliance; and plans sponsored by business coalitions such as the Connecticut Business and Industry Association (CBIA), and Colorado's Cooperative for Health Insurance Purchasing (CHIP). In some cases, start-up purchasing pools have borrowed executives from the business community who have the requisite expertise in insurance sales and marketing. In states like Colorado and California, large businesses have championed the purchasing pool model as a solution for small employers.

- **Subsidize initial development, marketing, and administrative costs**. Start-up funds must be adequate to build the infrastructure needed to administer the plans, and to perform necessary marketing activities so that small employers are aware of the option. Some states establish and fund pools as a division of state government or as a quasi-governmental body. Other states work collaboratively with businesses to establish nonprofit entities. While fiscal support from some sponsoring source is essential for the initial development phase, it is not sufficient to guarantee success. A favorable insurance market climate, for example, is equally important.

- **Provide risk sharing for high cost cases.** Minnesota has recently authorized a pilot project for state-subsidized stop loss coverage for rural purchasing alliances established to serve businesses and farm families with 1-10 employees. For employers who have not offered insurance for at least 12 months, the state will provide partial reinsurance for claims between $30,000-$100,000.[8] New York also has a similar program of subsidizing high cost cases.

- **Exempt purchasing pools from benefit mandates.** This strategy is aimed at enabling purchasing pools to offer lower rates and encourage employers not currently providing health benefits to begin providing them. This vehicle should be used with some caution, as it

may attract a disproportionate share of employers with high-risk employees who are unable to obtain insurance at a reasonable rate elsewhere.

- **Provide individual tax credits to low-income workers**. Because the size of a tax subsidy will affect the number of individuals who choose to purchase coverage, this strategy may be more effective if federal as well as state tax credits are available.

- **Require plans that participate in the small group market also join the purchasing pool.** A variant on this strategy is to designate a purchasing pools as the sole vehicle through which health plans can offer coverage to small group employers. New Jersey has provided a precedent for this type of legislation, requiring health plans that sell insurance in the state to also participate in the individual insurance market or absorb a portion of the losses incurred by insurers that do serve this market.[9]

- **Combine purchasing pool enrollment with other state purchasing groups such as state government employees.** This model has been examined by states as a means to cover various uninsured groups. Kentucky enacted, but later withdrew, this type of pooling mechanism. The Governor of New Mexico also recently proposed a comprehensive health plan for employees and retirees of state governments, local units of government, and universities. States should exercise caution with this option because if the pool attracts higher risk groups, the rates for state employees could increase substantially. Another option is to requiring that health plans that wish to bid for state employees also offer their products to the purchasing pool. An example of this strategy can be found in recent legislation in Florida.[10]

In Summary

Given the experience of other states in developing and sustaining purchasing pools, and the unique barriers faced by a frontier state like Montana, it is unlikely that this policy strategy alone will result in significant progress toward helping residents access affordable health insurance. As part of a broader health care reform agenda, or if coupled with other initiatives such as small employer tax incentives, further efforts and investments in the development purchasing pools may be worthwhile. Because previous efforts in Montana to initiate group health care purchasing cooperatives have had limited success, the discussion of new efforts to develop small-employer purchasing pools should include consider: possible state investments in the pools; employer mandates or incentives; individual or small employer tax credits; and combined state purchasing group strategies.

The opinions expressed in these briefs represent those of the authors. Any questions or comments are welcome and should be directed to shadac@umn.edu.

References

[1] One successful large-group employer pool is the State of California's California Public Employee Retirement System (CalPERS) which offers health insurance to state employees and retirees. As of 1999, CalPERS had over 1 million enrollees. Other examples include the Federal Employee Health Benefits Plan (FEHBP), the Pacific Business Group on Health Negotiating Alliance (California), and the Buyers Health Care Action Group (Minnesota).

[2] Stephen H. Long and M. Susan Marquis. "Pooled Purchasing: Who Are the Players?" *Health Affairs*, Volume 18 (July/August 1999), pp. 105-111.

[3] Elliot K. Wicks, Mark A. Hall and Jack A. Meyer. "Barriers to Small-Group Purchasing Cooperatives." Economic and Social Research Institute, March 2000. Also Elliot K. Wicks, "Health Insurance Purchasing Cooperatives." The Commonwealth Fund, November 2002.

[4] "Final Report on 2003 Household and Employer Survey", University of Montana.

[5] Laura Tollen and Robert M. Crane. "The Role of Health Care Purchasing Pools in Improving the Functioning of the Small Group and Individual Markets." Kaiser Permanente, March 2001.

[6] Wicks et al., 2000, pp. 130-135.

[7] Rick Curtis, Rafe Forland, and Ed Neuschler. "The Potential for a Small-Employer Purchasing Pool in Wisconsin: Issues and Options for Overcoming Barriers to the Development fo the Private Employer Health Care Coverage Program." Institute for Health Policy Solutions, January 2003, pp. 7-13.

[8] Minnesota Session Laws 2003, Chapter 20—House File #266.

[9] Wicks et al., 2000, p. 133.

[10] Ibid., p. 135.