STATEMENT BEFORE

CALIFORNIA STATE SENATE AND ASSEMBLY HEALTH SUBCOMMITTEES

IMPLEMENTATION OF FEDERAL HEALTHCARE REFORM: STATE EXCHANGES

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I'm John Arensmeyer, founder and president of Small Business Majority, a five-year-old nonprofit organization founded and run by small business owners to present a research-driven, non-ideological, pragmatic view of public policy issues affecting small businesses.

California is moving quickly to make decisions on healthcare reform provisions, some of which, although not effective for several years, will require substantial work to implement. This hearing is an important first step to gather views from stakeholders. We appreciate the opportunity to discuss healthcare reform issues of importance to the small business community.

Our surveys of small business owners have consistently found that the No. 1 problem facing small businesses is the cost of healthcare. Small businesses pay an average of 18% more in healthcare costs than larger businesses and health insurance premiums have risen 113% over the last nine years. Small business owners have told us of premium increases this year that range from 20% to more than 62%. This is an unsustainable trend for both small businesses and their employees.

In California, 4 million employees don't have health insurance; half of these work for employers with fewer than 20 employees. Businesses with fewer than 10 workers, only 40% of which can afford health insurance, employ just 11% of the workforce, but employ 35% of the working uninsured. Moreover, California also has 2.8 million self-employed entrepreneurs, 30% of whom don't have health insurance—almost twice the rate for the population as a whole.

Major decisions rest with the state, which has the flexibility to design important features of reform, including the insurance exchange. Today, I'd like to comment on the structure, benefits and governance of the exchange.

A well designed state insurance exchange is paramount for small employers and the self-employed. It must create maximum competition, choice and transparency—and remedy the undue administrative burden and lack of economies of scale that currently result in higher costs.

The exchange will:

- Help control costs and stabilize price fluctuations.
- Offer an array of options, and remedy the problem that many small employers are limited to offering one plan.
- Provide convenience for small employers and their employees with one-stop shopping, enrollment, eligibility and premium payments.
- Promote transparency with a clear explanation of cost, benefits, performance and satisfaction rates.

- Drive innovation and improvements in the healthcare system as a whole, which, in turn, will bring down costs.
- Eliminate job lock and enhance portability by enabling individuals to keep a plan they like even if they leave the employer they're with when they first choose it.

The exchange structure is critical; it must be robust over the long term. California knows from past experience (specifically that of Pac Advantage) that, to be successful, the new state exchange must be structured in a way that prevents adverse selection and other problems that can lead ultimately to a death spiral. The new game-changer—the individual mandate—will solve many, but not all, of the problems the state faced in the past; other rules and regulations will be necessary to ensure that the exchange is successful.

First, size matters, and bigger is better when it comes to the exchange.
Creating a large exchange maximizes purchasing power, creates managed competition, reduces administrative cost through economies of scale and pools more enrollees to spread risk. The larger the exchange, the more the efficiencies are maximized and the better that risk can be managed.

Therefore, we recommend that the state:
- Combine the small business and individual exchanges.
- Include employers with up to 100 employees from the start in 2014.
- Expand the exchange to all employers beginning in 2017.

Second, the state must require that all coverage be sold through the exchange, or, if this is not possible, ensure that the same rules apply inside and outside the exchange.
The best way to ensure the strength of the exchange—and minimize the risk that the exchange will attract the majority of the bad risk, while plans outside the exchange attract the good risk (i.e. "adverse selection")—is to require that all coverage be purchased through the exchange. However, we recognize that this may not be politically feasible, so if insurance can still be sold outside the exchange, the same rules must apply inside and outside. Moreover, benefit design must be standardized across different classes of plans; and the state must set extremely clear standards for creditable coverage at different levels. Otherwise the competition will not be among purchasers seeking value but among benefit designers seeking less risk. (It would also allow purchasers to compare apples to apples.)

The state must create a framework to:
- Specify minimum standards for coverage across tiers of plans,
- Require insurers who offer plans in the market served by the exchange to offer identical products both within and outside of the exchange, and
- Forbid insurers from giving an advantage, in any way, to individuals and small groups who purchase plans outside of the exchange.

Third, the exchange must be active.
To be most effective, the exchange will need the ability to negotiate with entrants on price and quality, as CalPERS has. For example, on quality, the exchange could negotiate specific quality targets for preventive care or chronic illness. In contract, a passive exchange would allow entry by any plan meeting the qualified plan definition—regardless of price or quality.

Fourth, the exchange must strike a balance in defining required benefits.
Benefits should be comprehensive but affordable. The U.S. Department of Health and Human Services secretary will determine which specific covered services will be required under the broad categories set in the law. We expect that some groups may urge California to add to this minimum benefit package, but we suggest that affordability (and the minimization of additional cost to the state) be a priority in considering these decisions.

Finally, the governance of the exchange should be independent.
A nimble independent nonprofit entity, subject to regulation by the state, should be established to run the exchange. It is important that the exchange board include all stakeholders—including small employers and self-employed individuals. The ability to make decisions in a reasonable time frame about exchange structure and operations—where permitted—is important. We expect there will be operational aspects we will want to watch from the start that may require adjustment, such as assuring that there is sufficient choice within the exchange and that adverse risk selection is avoided.

Small Business Majority plans to be actively engaged as we move to the next phase of this process, assuring that the needs of small business owners are heard as regulations are developed and implementation begins. As part of this effort, we will be conducting a statewide small business listening tour, beginning May 27, 2010 in San Diego, and continuing throughout the state. We look forward to sharing the results with you.