

# **Small Business Health Options Program (SHOP)**



The Patient Protection and Affordable Care Act (PPACA) requires states to create Small Business Health Options Programs (also called SHOP Exchanges), designed to help small employers access affordable insurance for their employees. The law also allows states to combine their SHOP Exchange with their exchange for individual consumers.

## **Background**

The SHOP exchange provisions of PPACA are designed to help small employers provide health insurance options to their employees. Under the law, states must set up the SHOP exchanges in order to assist “qualified” small employers in enrolling their employees in private health insurance plans.<sup>1</sup> States have the option of defining “small employers” as businesses with up to 100 employees.<sup>2</sup> Starting in 2017, states may allow larger employers to participate in the SHOP exchange.<sup>3</sup> While the statute does not provide much detail on how the SHOP exchanges should operate, the Department of Health and Human Services (HHS) is required to develop regulations to govern the SHOP exchanges, and to provide technical assistance to states on how to create and run a SHOP exchange.

Under the new law, exchanges are required to make qualified health plans available to “qualified employers.” An employer is “qualified” to participate in the exchange if, in addition to being the requisite size, the employer elects to make all its full time employees eligible for one or more qualified health plan.<sup>4</sup>

While the law does not expressly require small employers to provide insurance to their employees, those with over 50 employees would likely have to cover at least 60% of the premium to avoid a potential penalty. The law provides that employers with 50 or more employees are subject to a penalty if they fail to offer insurance to their employees, if the employees must pay more than 9.5% of their income for insurance, or if an employer-sponsored plan fails to cover 60% of the plan and any employees receive premium assistance tax credits.<sup>5</sup> Employers with fewer than 25 employees must pay at least 50% of the premiums in order to be eligible for the small business tax credit.<sup>6</sup>

## **Tax Credits**

The new law encourages small businesses to offer coverage by providing small employers with no more than 25 employees and average annual wages of less than \$50,000 with tax credits to help purchase health insurance.<sup>7</sup> The tax credits will be provided in two phases — one before the establishment of the new exchanges and one after they are established.

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1 Patient Protection and Affordable Care Act (PPACA) § 1311(b)(1)(B).

2 PPACA § 1304(b).

3 PPACA § 1312(f)(2)(B).

4 PPACA § 1312(f).

5 PPACA § 1513, adding new Internal Revenue Code (IRC) § 4980H.

6 PPACA § 1421, adding new IRC § 45R.

7 Ibid.

The first phase (2010-2013) provides a tax credit of up to 35% of the employer's contribution toward insurance, if the employer contributes approximately 50% of the total premium cost. The credit is provided on a sliding scale basis, based on firm size and average wage increases. In the second phase (2014 and later), the tax credit is available to eligible small businesses that purchase coverage through the state exchanges, and contribute at least 50% of the total premium cost. But the credit is only available for the first two years of enrollment through the exchange. These credits are also provided on a sliding scale basis, depending on firm size and average wages.<sup>8</sup>

## Employee “Choice”

The new law appears to contemplate two possible ways for small business employees to enroll in coverage. One option would allow the small business to choose the “level” of coverage for its employees (Bronze, Silver, Gold or Platinum). Each employee would then be allowed to choose any plan within that level.<sup>9</sup> However, the law also provides for a second option, in which the employer can select one or more plans on behalf of its employees.<sup>10</sup>

### Examples

**Employee Choice:** Mary and her sister Jean have a business making custom sailboats. They have 15 full time employees. In 2014, because their average wages are less than \$50,000, they are eligible for the small business tax credit if they purchase insurance through their state’s exchange. They log onto the exchange website and choose the silver level of coverage. Each employee is then given the option to log onto the exchange website and enroll in one of the six “Silver” plans offering policies in their geographic area.

**Employer Choice:** Frank runs a public relations company with 48 full time employees. In 2014, his human resource manager logs onto the exchange website and selects the “Gold” level of coverage for the company. Within the Gold level she is given a choice of 4 plans offering group coverage in their area. She selects the policy offered by Blue Cross Blue Shield, and enrolls the company under a group policy. Each employee is then given the option to opt in or out.

## Issues to Consider

### Making it easy

While the new law requires the creation of SHOP exchanges to facilitate small employers' purchase of health insurance for their employees, it is far from clear whether the SHOP exchange will make the process of selecting, enrolling in, and maintaining coverage easy for these businesses. Because the law contemplates allowing individual employees to choose individual plans within a benefit tier, employers could be faced with paying multiple premium checks to multiple companies. Depending on the number of employees and the number of different choices they make among

8 Ibid.

9 PPACA § 1312(a)(2).

10 PPACA § 1312(f)(2)(A).

plans, this could become burdensome on small employers, many of whom are hard pressed to offer coverage at all.

One way to mitigate this problem would be to have employers pay one consolidated premium to the exchange. The exchange would then act as intermediary — determining the amount each health plan should receive based on the number of employees enrolled, and transmit payment to each plan on behalf of the employer. In essence, the exchange could act as a back office “HR” department for each small business. This is a possible added function for the SHOP exchanges that each state will need to consider as they begin their planning and implementation process.

### Potential impacts on older workers

Currently, health plans determine premiums for small business insurance based on the health status and age of the entire group. Businesses with older, sicker workers generally pay more than businesses with younger, healthier workers. However, a young, healthy person working in a company that has older, sicker employees would pay the same premium as his or her co-workers. Conversely, an older, sicker person working in a company with lots of young, healthy people would pay no more than his or her coworkers, even though he or she uses more health care services.

Under the SHOP provisions of the new law, however, individual employees may choose their own plan, within a benefit level selected by their employer. This essentially allows plans to individually underwrite those policies, within the new rating bands required under the new law. While the new rating bands prohibit charging people higher premiums based on their health status, they allow plans to charge older workers up to 3 times the amount they charge a younger worker, and a smoker up to 1.5 times the amount they charge a non-smoker. As a result, within the same company, a 64-year old employee could be paying a premium 3 times larger than her 22-year old co-worker sitting next to her.

The federal Age Discrimination in Employment Act (ADEA) prohibits employers from requiring older employees from paying a higher percentage of premiums than younger employees to obtain the same coverage.<sup>11</sup> Thus, employers will likely offer to pay a specified percentage (i.e., 60%) of its employees’ premiums. But older workers could see significant increases in premiums when their employer enters an exchange. A better option may be for states to set up their SHOP exchange so that employers are allowed to choose one or more plan on behalf of their employees, so that plans would assess premiums based on the age of the group, not each individual employee.

### Adverse selection

Because the new law permits a small group insurance market to exist outside of the exchanges, it is possible that the exchange could fall prey to adverse selection. This is a particular risk if small employers with older, sicker workforces decide to enter the exchange while employers with healthier employees remain in the market outside. Indeed, the single most important reason small business purchasing alliances have failed in the past is that they became “victims of adverse selection.”<sup>12</sup>

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11 29 CFR 1625.10(d)(4)(2).

12 Jost, T. *Health Insurance Exchanges and the Affordable Care Act: Key Policy Issues*, Commonwealth Fund, Jul.2010.

The law tries to mitigate this problem by giving states a number of tools to reduce adverse selection.<sup>13</sup> In addition, to encourage the largest and healthiest possible risk pool, it provides tax credits to small employers as an incentive to enroll through exchanges. However, those tax credits are only available to businesses with less than 25 employees and with average wages less than \$50,000. And they're only for 2 years. This may not be sufficient incentive for employers.

In addition, PPACA's tools to combat adverse selection may not be sufficient to counter the strong demand from employers for affordable coverage. This demand could trigger attempts by health plans to "game" the market and deliver the cheapest possible product. First, plans could work with small employers that have healthy groups to ensure they stay "grandfathered", and thus exempt from many of the new market reforms, including the essential benefits package. Second, plans could choose to sell to small employers exclusively outside the exchanges, which would allow them to circumvent many of the tools designed to reduce risk segmentation. Third, some mid- to small-sized employers with healthy groups may decide to "self-insure" in order to escape state regulation and most of the PPACA reforms, including the requirement to cover the essential benefits package. If those healthy groups become sicker, the self-insured employer could simply "dump" them onto the exchange.

States setting up SHOP exchanges will need to expect and guard against this type of "gaming" behavior. They will need to use all of the tools available to them to reduce adverse selection, and continually adjust the rules inside and outside the exchange to ensure its long-term success.

## Conclusion

The SHOP provisions of the Patient Protection and Affordable Care Act have the potential to offer small businesses a reformed marketplace for buying health insurance. Many small companies support giving their employees more choice among plans, and the SHOP exchange could provide an administratively simple way to do that. However, designing and operating a SHOP exchange present a host of complicated challenges, and HHS will need to work closely with states to address them.

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13 PPACA includes a number of provisions to reduce adverse selection, including: (a) requiring many of the new market rules to apply both inside and outside the exchange, (b) requiring all plans (except grandfathered and self-insured plans) to cover a set of "essential benefits", (c) requiring insurers to treat all enrollees, inside and outside the exchange, as members of a single risk pool, and (d) establishing three risk adjustment programs to reallocate risk among insurance companies.