



RSC Policy Brief: **Health Insurance Connectors** *July 21, 2008*

The RSC has prepared the following policy brief analyzing various proposals to construct a health insurance “Connector” or Exchange.

History and Background: The 2006 Massachusetts health reform act signed into law by Republican Gov. Mitt Romney contained several concepts designed to expand insurance coverage and access. These ideas included a health insurance “Connector,” which would allow employees at businesses not offering coverage to their workers to purchase insurance on the same tax-free basis as those covered under a group insurance plan.¹ Because the Connector’s structure ensures that participants would be eligible for the federal tax subsidies provided to employer-sponsored coverage through the use of cafeteria plans (also named Section 125 plans after their location in the Internal Revenue Code), the state-based program provides a “back door” way to equalize the tax treatment of health insurance in the absence of federal legislation to do so.

Public vs. Private: Although one of the more innovative concepts behind the Massachusetts plan, some conservatives may view the Connector as one of the least necessary. While the head of a leading organization supporting the Massachusetts plan called the Connector concept “fairly unprecedented in US insurance history” for its ability to allow individuals to comparison shop between and among plans online, the private marketplace has provided that service to consumers for over a decade.² Companies like eHealthInsurance, created in 1998, and Revolution Health have served for years as online insurance clearing-houses, enabling and empowering consumers to compare the features of plans offered in their area and select a plan best meeting their needs.

¹ While the Massachusetts Connector also offers access to state-subsidized Commonwealth Care plans for low-income individuals, references to “Connectors” in this paper speak solely to mechanisms that facilitate the purchase of unsubsidized insurance from the private marketplace.

² Statement of John McDonough, Executive Director, Health Care for All, Alliance for Health Reform briefing on “Massachusetts Health Reform: Bragging Rights and Growing Pains,” (Washington, DC, May 19, 2008), available online at <http://www.allhealth.org/briefingmaterials/Transcript-1219.pdf> (accessed July 1, 2008), p. 9.

Given the private marketplace's willingness to offer services comparable to the Massachusetts Connector, some conservatives may therefore view its creation as a symptom of two larger problems: the inequitable tax treatment of health insurance by the federal government and costly regulations imposed by state governments. In an attempt to encourage younger individuals to take the step of buying insurance coverage, the Connector does sell streamlined benefit packages to 19-26 year-olds at lower costs—but some conservatives may believe that these individuals, and all Massachusetts residents, would be better served by more comprehensive insurance reform that repeals costly benefit mandates entirely, rather than loosening them only for certain populations under certain conditions.

Likewise, while the Connector concept provides an innovative way to extend current-law tax incentives for the purchase of health insurance to all individuals, some conservatives may be concerned that, should such an idea extend to other states, such a development would have the effect of perpetuating a system that depresses cash wages, encourages over-consumption of care, and results in hundreds of billions of dollars of tax subsidies annually—more than \$168 billion in FY09, and more than \$1.05 trillion over the next five years.³ Were the tax subsidies reformed, and the state benefit mandates streamlined, pre-empted, or eliminated, some conservatives may believe that the need for a government-run bureaucratic entity such as the Connector to administer health insurance plans would be minimized.

Legal Issues: Although the Connector received significant attention from both the press and policy-makers at the time the Massachusetts plan was unveiled, some within the insurance community have raised potential concerns about the implications of super-imposing the Connector purchasing model on the existing legal framework for health insurance. The National Association of Health Underwriters has released a paper raising several questions about the ramifications of Connector-based coverage, including whether Connector-purchased policies meets the current definition of group health insurance under applicable federal laws.

It is also possible that state-based health insurance Connectors, whether in Massachusetts or other states, could have provisions interfering with language in the Employee Retirement Income Security Act of 1974 (ERISA) pre-empting “any and all state laws insofar as they may now or hereafter relate to any employee health benefit plan.”⁴ Given the potential legal scrutiny, as well as the implications for individuals who may need to transfer their Connector-based coverage to another state or employer, some conservatives may urge caution with any state efforts to enact other versions of Massachusetts' creation.

Connector vs. Regulator: The relative novelty of the Connector concept has resulted in several attempts in the two years since the Massachusetts plan was first adopted to capitalize upon its perceived success by creating similar sounding models in other states and venues. However, these models often vary widely in their structure and approach, with the major differences lying in the extent to which the Connector or Exchange represents an attempt by a bureaucratic entity

³ Table 19-1, Estimates of Total Income Tax Expenditures, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2009*, available online at <http://www.whitehouse.gov/omb/budget/fy2009/pdf/spec.pdf> (accessed July 1, 2008), p. 302.

⁴ 29 U.S.C. §1144a.

to use its collective purchasing power to regulate or otherwise influence private insurance markets.

Sen. Barack Obama's health care plan would establish a National Health Insurance Exchange, to allow individuals who do not wish to purchase coverage through his proposed new public health insurance program a choice of privately-run plans from which to buy a policy. However, the language of his proposal makes clear that the Exchange would perform a highly active role as both a facilitator of coverage and a regulator of those plans participating in it:

The Exchange will act as a watchdog and help reform the private insurance market by creating rules and standards for participating insurance plans to ensure fairness and to make individual coverage more affordable and accessible....Insurers would have to issue every applicant a policy, and charge fair and stable premiums that will not depend upon health status. The Exchange will require that all the plans offered are at least as generous as the new public plan and meet the same standards for quality and efficiency. Insurers would be required to justify an above-average premium increase to the Exchange. The Exchange would evaluate plans and make the differences among the plans, including the cost of services, transparent.⁵

The clear language of the Obama plan may give some conservatives pause that a purported health insurance "Exchange" will in fact serve more as a regulator than a mere facilitator for the purchase of insurance policies, imposing additional mandates and controls on carriers that will stifle the innovation of new insurance products and raise the cost of coverage. Some conservatives may also be concerned that the Obama plan could in time turn into a government-run monopsony, where the Exchange as the largest and/or sole purchaser of health insurance would use its power to dominate the insurance marketplace, imposing arbitrary and damaging price controls on plans as a precondition to their participation in a venue where many Americans would seek to purchase coverage.

By contrast, several Republican Senators produced legislation (S. 1886) last year with language ensuring that state-based Connectors serve only as a purchasing tool and not as a blunt instrument to allow the federal government to intervene in health insurance markets. The legislation provides that the health insurance tax credits created under the bill would be refundable (i.e. extended to those individuals with tax liability less than or equal to the amount of the credit) only in the case of policies purchased through a state-based Exchange. Title II of the legislation establishes strict parameters on the actions that an Exchange may take with respect to insurance policies offered through it, prohibiting the Exchange from setting prices, imposing additional benefit mandates or guidelines, or restricting participation for any state-licensed plan. The legislation also provides the opportunity for health insurance plans or other third parties to contract with states to organize the exchange, rather than forcing states to spend additional taxpayer resources to create something readily available in the private marketplace, as occurred in Massachusetts.

Conclusion: Although a significant element of the Massachusetts reform law, some conservatives may believe that the Connector's creation achieved little in practice that the private marketplace was not already working to develop—namely, an easy method for individuals to

⁵ "Barack Obama's Plan for a Healthy America," available online at <http://www.barackobama.com/issues/pdf/HealthCareFullPlan.pdf> (accessed July 1, 2008), p. 4.

find, compare, and purchase health insurance plans. While the tax advantages of purchases made through the Connector (as opposed to on the individual market) cannot be denied, the advisability of using the Connector as anything more than a stopgap solution until Congress debates and passes fundamental tax reform—including reform of the inequities of the tax treatment of health insurance—may be questioned. Moreover, Internal Revenue Service guidance released last August found that individual health insurance policies purchased through tax-free Section 125 cafeteria plans established by employers need not be acquired solely by means of a Connector mechanism to receive favorable tax treatment, raising additional questions as to whether an additional state-based bureaucracy for the purchase of health insurance is necessary or desirable.⁶

To the extent that Connector-like mechanisms provide additional information and transparency to potential purchasers of health insurance, some conservatives may support these efforts as one way to replicate the information and advice which individuals may previously have received solely from employers. However, to the extent state or federal lawmakers seek to utilize the Connector concept in an attempt for government to dominate the private insurance marketplace, many conservatives may oppose these efforts as antithetical to the principles of freedom and likely unworkable in practice.

For further information on this issue see:

- [*McCain Health Care Plan*](#)

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⁶ Internal Revenue Service Notice of Proposed Rulemaking issued August 6, 2007 and available online at <http://edocket.access.gpo.gov/2007/pdf/E7-14827.pdf> (accessed July 1, 2008). Language relating to reimbursement of individual health insurance premiums is in proposed 26 CFR §1.125-7(m) at pp. 43952-53.