

## Strategy update

# Health care reform's impact on employer benefits

The availability of health coverage through the Exchanges beginning in 2014 will require employers to reassess their employee benefit strategies.

### Background

Starting in 2014, Americans will be able to purchase private health insurance through the Exchanges. Ideally, these Exchanges will be robust marketplaces offering portable, individual policies without pre-existing exclusions or other underwriting restrictions. The range of choices for individuals from carriers and in plan options is expected to be significantly greater than the choices generally available at open enrollment under an employer-sponsored plan.

### To stay... to go... plan sponsorship choices

Once the Exchanges are in place, employers will have the option of terminating their employer-sponsored health plans with the knowledge that their employees will have other health coverage available to them. There are many opinions on what strategies employers will follow. Pending final regulations, some plan sponsors may follow multiple strategies based on business units and there certainly could be opportunities to combine these approaches. We see three business directions emerging:



#### “Financial Stewards”

These employers focus primarily on cost management. They seek to operate low-cost plans and shift costs as aggressively as they can to their employees while balancing cost shifting against attraction/retention/turnover. These employers will maintain their health plans if they can operate them with low overhead. For many, the financial structure of their current plans or modifying their strategy to maintain a modest health plan will be less costly than paying the \$2,000 penalty per full-time employee for failure to provide a health plan.

#### “Participant Engagers”

A variety of companies will continue to offer employer-sponsored plans even when it may be financially advantageous to exit. Some, like hospitals and health systems, are intrinsically tied to health care sponsorship. Others will maintain their plan to match industry or geographical competitors. Still others use their benefit plans as attraction/retention tools and successfully use health analytics and intervention strategies to manage their health budgets to acceptable corporate levels.

### “Exchange Adopters”

These employers will terminate their health plans and exit health care as we know it. A variety of plan sponsors might fit this model, but potential early adopters include companies in financial distress and those in low margin and highly competitive industries.

### New plan design issues for sponsors who retain programs

For those employers who maintain health plans, the structure of health plans will likely change. There will be new factors to consider in designing health plans. Consider the impact of financial income on plan design and employee choice.

Lower income families who purchase coverage through an Exchange will qualify for significant premium and out-of-pocket cost sharing subsidies from the federal government. These subsidies are expected to be available to individuals and families whose annual household income is between 100% and 400% of the federal poverty level (FPL) based on family size (\$22,350 — \$89,400, for example, for a family of four in 2011). Current models estimate that a family of four with income of \$50,000 who purchases coverage through an Exchange will receive a premium tax credit of approximately \$5,400 a year.

Individuals whose household income falls between 100% and 400% of FPL but who are eligible for employer-sponsored health coverage will qualify for the subsidy only if the employer-sponsored coverage is considered “unaffordable” or the coverage does not provide minimum value. Coverage is considered unaffordable if the employee contribution required for self-only coverage exceeds 9.5% of the individual’s household income for the year. Coverage will be deemed not to provide minimum value if it does not cover at least 60% of the cost of benefits.

Employers who offer coverage that is considered unaffordable or who do not provide minimum value will be subject to a penalty of \$3,000 for each full-time employee who purchases coverage through an Exchange and receives the federal premium credit. *That amount will likely be considerably less than the cost of providing health coverage to these employees and their dependents.*

### Reevaluating strategies

The availability of health coverage through the Exchanges will require that employers reevaluate their premium contribution strategies and rebalance compensation and benefits — a process that begins with asking the following questions:

- What portion of our workforce will be eligible for the federal subsidies?
- Will my employees be better off financially if they drop our benefit plan and move to the new health Exchanges?
- Do we have the best mix of cash and benefits?

Consider two specific, and critical, strategies:

### **Premium contribution strategy**

The Patient Protection and Affordable Care Act (PPACA) does not require any specific employer contribution to the cost of health care coverage. This important decision remains with plan sponsors who must then reevaluate their premium contribution strategy. It is no longer just a cost-sharing formula — it becomes an important tool in influencing each employee's decision to opt in or out of the Exchanges. This is particularly true for employers with a significant number of employees who may be eligible for federal subsidies.

Employers with salary-based cost sharing in particular need to review their rewards strategy. Today, about one in five large employers vary employee health care contributions by salary level — a benefits strategy that also serves the broader societal goal of making health care more affordable for many lower-paid workers. However, with salary-based contributions, fewer employees will qualify for the federal subsidies because their employer-sponsored coverage will not exceed 9.5% of their household income. These employees will be more likely stay on the employer's plan (at higher cost to the sponsor).

### **Subsidies for dependent coverage**

Many employers also provide a sizable subsidy towards the cost of dependent coverage. This results in a significant benefit for employees with family coverage that is not available to single employees.

As employees and their families have access to health coverage through the Exchanges, employers will want to reevaluate the manner and extent to which they subsidize dependent coverage. One option, for example, would be to provide employees with a non-elective employer contribution through a cafeteria plan which they could then: (1) apply towards the cost of dependent coverage (2) apply towards the cost of other non-taxable benefits or (3) receive as additional cash compensation.

Under this approach, lower paid employees eligible for the premium subsidy if they purchase coverage through an Exchange would have an additional incentive to forego employer-sponsored coverage. Depending on their household income, they might choose additional non-taxable benefits in lieu of additional cash compensation. Employees who are not eligible for the premium subsidy might also consider Exchange coverage in lieu of employer-sponsored coverage.

## **Conclusion**

There is a growing body of surveys and reports reflecting corporate intentions to terminate health plans. The reality is that plan sponsors do not have sufficient information to finalize their 2014 decisions now but it is time to begin strategy development.

- We can reasonably anticipate that health inflation will be a significant factor in the decision. If medical trend is significantly higher than the health premium index the \$2,000 penalty is tied to, more plan sponsors will find themselves with the financial justification to terminate their employer-sponsored health plans.

- A second set of calculations, and maybe the most important calculations, will relate to human capital issues around recruitment, retention and employee morale. How will recruitment, retention and productivity be impacted by whether an employer continues to sponsor health coverage?
- Third, we don't know yet the Exchange products and how pricing will compare to employer-sponsored plans.
- Finally, new regulations and possibly legislation could appear before 2014.

2014 is just over two years away, not a long time in strategy development, but there is still considerable uncertainty regarding what the landscape will look like at that time. Employers can and should begin developing strategies for improving their benefit programs as a whole while lowering costs.

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