Special Report
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# Health Care Reform: How It May Impact Employers, Employees, and Benefit Plans

Health care reform is once again front page news. This article explores the provisions of the bills passed by Congress and the proposal offered by the White House and the impact they might have on employers and their employees and benefit plans.

By the end of 2009, the House of Representatives and the Senate had each passed a health care bill. The House bill (H.R. 3962), known as the "Affordable Health Care for America Act," was passed on November 7, 2009. The Senate bill (H.R. 3590), known as the "Patient Protection and Affordable Care Act," was passed on December 24, 2009. While the details of the bills differ, both bills provide for sweeping changes to our nation's health care system, including market-based reform, Medicare and Medicaid reform, individual mandates, employer mandates, national or state-based insurance exchanges, and financing requirements. Many of these provisions would have a significant impact upon employers and their employees and benefit plans.

Before the January 2010 Senate election in Massachusetts, it was widely expected that some form of health care reform would be enacted in early 2010. Since the Massachusetts Senate election, the passage of health care reform has been far less certain. For the past few months, the President and members of Congress have continued efforts to advance health care reform.

On February 22, 2010, President Obama announced the "President's Proposal," which aims to bridge the gap between provisions of the House and Senate bills. The President's Proposal is designed to make health insurance more affordable, create a new competitive health insurance market, bring greater accountability to health care, and end discrimination against patients with pre-existing conditions. The President's Proposal incorporates provisions from both the House and Senate bills. The President's Proposal includes key changes such as:

- Eliminating the "Nebraska FMAP" provision and providing significant additional federal financing to all states for Medicaid expansion;
- Closing the Medicare prescription drug "donut hole" coverage gap;
- Strengthening the Senate bill's provisions that make insurance more affordable for individuals and families;
- Strengthening provisions to fight fraud, waste, and abuse in Medicare and Medicaid;
- Increasing the threshold for the "Cadillac plan" excise tax from $8,500 to $10,200 for individuals and $23,000 to $27,500 for family coverage starting in 2018; and
- Improving insurance protections for consumers and greater federal review of unreasonable rate increases and unfair insurance practices.

On February 25, 2010, President Obama hosted a health care summit aimed to bring together Republicans and Democrats in an effort to create some common ground. By many accounts, the health care summit appeared to highlight the philosophical differences among members of Congress regarding the substance and process of health care reform.

On March 3, 2010, President Obama called for an "up or down vote" on health care reform within weeks. He also noted in a letter to Congressional leaders his intent to include in his proposal certain provisions requested by Republicans, including engaging medical professionals to conduct random undercover investigations of health care providers, additional funding for alternatives for resolving medical malpractice disputes, increasing Medicaid reimbursement for doctors, and ensuring that health savings accounts (HSAs) are available through the exchange.

As this article goes to print, it is quite possible that some form of health care reform legislation will be presented for vote under the budgetary reconciliation process which would require a simple majority (51) vote. This Special Report examines how health care reform as currently proposed could impact employers and their employees and benefit plans. This report covers the key points of the currently proposed health care reform. *Additional details on the currently proposed health care reform are set forth in the chart at the end of the article.*

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### Health Care Reform Generally

The House and Senate bills and the President's Proposal call for broad-based reform of our nation's health insurance system, including Medicare, Medicaid, and other government-program reform, market-based reform, temporary high risk insurance pools for the uninsured, and insurance exchanges. The House bill calls for a national insurance exchange with optional state-based exchanges, while the Senate bill and President's Proposal would create state-based insurance exchanges. The House bill also calls for a public health insurance option maintained by the federal government. Neither the Senate bill nor the President's Proposal provides for a public option.

Both the House and Senate bills and the President's Proposal would significantly regulate health care insurance companies and require that insurers provide health insurance that meets certain minimum requirements. Both the House and Senate bill prescribe minimum benefit packages with additional options for enhanced benefits. The House bill calls for basic, enhanced, premium, and premium-plus plans with actuarial values ranging from 70 percent to 95 percent of the minimum benefits package. The Senate bill would provide for four levels of enhanced benefits, known as bronze, silver, gold, and platinum, with actuarial values ranging from 60 percent to 90 percent of the minimum benefits package.

As described below, each of the House and Senate bills and the President's Proposal would impose individual and employer "play or pay" mandates.

### Individual "Play or Pay" Mandate

One of the most significant aspects of the proposed health care reform is the individual mandate. The House bill would require that all individuals attain "acceptable coverage" or pay a penalty equal to 2.5 percent of modified adjusted gross income (AGI) above a certain threshold amount, limited to an amount tied to the applicable national average premium for health coverage. "Acceptable coverage" would generally include qualifying or grandfathered coverage under an insurance company or employer-sponsored plan, government-sponsored program such as Medicare or Medicaid, or an exchange.

The Senate bill would require each individual to maintain "minimum essential coverage" or pay a penalty. The penalty would equal the greater of (1) one-half of one percent of AGI or \$95 per person in 2014, (2) one percent of AGI or \$495 per person in 2015, and (3) two percent of AGI or \$750 per person in 2016, indexed for inflation in later years. "Minimum essential coverage" would generally include coverage under a qualifying or grandfathered insurance company or employer-sponsored plan, government-sponsored program such as Medicare or Medicaid, or an exchange. The penalty for each family would be capped at 300 percent of the adult individual's penalty. The penalty for dependents under the age of 18 would be capped at 50 percent of the adult individual's penalty.

The President's Proposal follows the Senate approach, with several modifications. First, it lowers the amount of the flat dollar penalty to \$325 in 2015 and \$695 in 2016. Second, it would increase the percentage of the AGI-based penalty to one percent in 2014, two percent in 2015, and two and one-half percent in 2016 and later years.

The House and Senate bills and the President's Proposal contain exemptions from the individual mandate for individuals with income below certain thresholds. The House bill and the President's Proposal would exempt individuals with income below the tax filing threshold, while the Senate bill would exempt individuals with income below the federal poverty limit threshold. The Senate bill and the President's Proposal also contain hardship exemptions for individuals who are unable to afford insurance. Finally, both the House and Senate bills would exempt from the individual mandate certain individuals based on religious beliefs, unlawful presence in the United States, overseas residency, and certain other reasons.

### Employer "Play or Pay" Mandate

Under the proposed health care reform legislation, employers would be required to offer health care coverage for their employees or pay a penalty. This is often referred to as the employer "play or pay" mandate.

Under the House bill, employers would be required to offer qualifying health coverage and pay for at least 72.5 percent of the premium cost for individual coverage and 65 percent of the premium cost for family coverage. If such coverage is not provided, the employer would be required to pay a penalty in an amount equal to eight percent of its payroll to the federal government. Employers with average annual payrolls ranging from \$500,000 to \$750,000 would pay reduced penalties. No penalty would apply to employers with average annual payrolls of less than \$500,000. The House bill would also impose a penalty in an amount equal to eight percent of average payroll for each employee who opts for exchange coverage in lieu of employer-based coverage.

Under the Senate bill, large employers would be required to offer qualifying health coverage or pay a penalty of \$750 per full time employee. For this purpose, "large employers" are employers that employ an average of at least 50 full time employees on business days during the preceding calendar year. "Full time employees" are limited to employees who average at least 30 hours of service per week. Smaller employers would be exempt from the "play or pay" mandate. The Senate bill would also impose a penalty in an amount equal to \$3,000 for each full time employee with income

below 400 percent of the federal poverty level who opts for exchange coverage in lieu of employer-based coverage. Finally, the Senate bill would require employers to offer a "free choice" voucher to certain lower income employees if the employee's cost of health coverage ranges from 8 percent to 9.8 percent of AGI.

The President's Proposal generally follows the Senate bill, with certain modifications. The President's Proposal would increase the $750 penalty to $2,000 per full time employee if the employer does not offer qualifying health coverage, but would not impose the penalty on the first 30 employees. For example, an employer with 75 full time employees that does not offer health insurance coverage would pay an annual penalty in an amount equal to $90,000 (75-30 = 45 x $2,000).

### Qualifying Health Coverage

Both the House and Senate bills set minimum requirements for individual mandated and employer-provided health coverage.

The House bill would require that each qualifying health insurance plan cover: hospitalization; outplacement hospital and clinic services, including emergency services; physician and other health professional services; medical equipment, services, and supplies; mental health, substance abuse disorders, and behavioral health; prescription drugs; rehabilitative and habilitative services; maternity, well-baby and well-child care, and other child services to age 21; and durable medical equipment and supplies. The Senate bill contains a list of similar services. The President's Proposal does not specifically address what types of minimum benefits must be covered.

Each of the House and Senate bills and the President's Proposal would require automatic enrollment (with opt-out rights), prohibit pre-existing condition exclusions and lifetime maximums and extend coverage for dependents. The House and Senate bills would also limit annual out-of-pocket maximums to certain dollar amounts. The Senate bill and the President's Proposal would also prohibit waiting periods of more than 90 days.

Fortunately for employers and insurers, each of the House and Senate bills would provide some form of grandfathering for plans in effect on the date of enactment. Grandfathered plans would not be subject to most of the requirements of the new legislation. The House bill would provide temporary relief for grandfathered plans until the year 2018, subject to certain restrictions on new enrollment, changes in coverage, and premium increases. The Senate bill has no stated time limit for grandfathered plans and contains fewer restrictions on modifications than the House bill. The President's Proposal also provides for grandfathered plans, subject to certain limits.

The House and Senate bills contains several provisions that would impact retirees, including elimination or reduction of the Medicare Part D "donut hole," and a reinsurance program for early retirees. The House bill would also prohibit the reduction of retiree health benefits unless a similar change is made for active employees.

Both the House and Senate bills would impose new reporting and disclosure requirements on employers. These provisions are summarized briefly in the accompanying chart.

### Health Care Financing

The House and Senate bills differ significantly on how to pay for health care reform.

The House bill would impose a tax surcharge on any individual with modified AGI of $500,000 (single filers) or $1,000,000 (joint filers) in an amount equal to 5.4 percent of AGI over the tax filing threshold.

The Senate bill would impose a 40 percent excise tax on "Cadillac" plans with premiums greater than $8,500 for individual coverage and $23,000 for family coverage, indexed for subsequent years at the general inflation rate plus one percent. Higher thresholds would apply to retirees and those in high risk professions such as law enforcement officers and first responders.

The President's Proposal adopts the Senate bill's 40 percent tax on "Cadillac" plans starting in the year 2018, but would raise the amount of premiums that are exempt from the assessment to $10,200 for individual coverage and $27,500 for family coverage, indexed for subsequent years at the general inflation rate plus one percent. The President's Proposal would also include an adjustment for employers whose health costs are higher because of the age or gender of their employees, and would not count dental and vision benefits as potentially taxable benefits.

The Senate bill would also increase the threshold for itemized deductions from 7.5 percent to 10 percent and would increase the Medicare payroll tax from 1.45 percent to 2.35 percent for those with annual income over $200,000 (single filers) or $250,000 (joint filers). The President's Proposal follows the Senate bill and adds a 2.9 percent tax on unearned income for those with annual income over $200,000 (single filers) or $250,000 (joint filers).

Both the House and Senate bills would:

- Limit annual contributions to health flexible spending accounts (FSAs) to $2,500;
- Increase the excise tax on distributions from HSAs not used for qualified medical expenses from 10 percent to 20 percent;
- Prohibit HSAs, Archer MSAs, FSAs, HRAs, and other reimbursement programs from covering nonprescription drugs (except insulin); and
- Prohibit the payment of exchange premiums from cafeteria plans.

### Impact on Employers and Employees

At the time this article goes to print, it is unclear whether health

care reform will be enacted. If health care reform is enacted in the near future, it is expected that it will be based upon the provisions outlined in the President's Proposal. If health care reform is enacted, many employers may be required to restructure their health insurance plans to comply with the new minimum coverage requirements and/or to take steps to preserve grandfathering treatment for existing health plans to avoid paying "play or pay" penalties. Certain employers may find it less costly to pay the "play or pay" penalties rather than to offer mandated health care coverage. If the "Cadillac" excise tax is enacted, many insurers and companies may consider limiting plan benefits to avoid the excise tax. It is also unclear at this time whether health care reform proposals, such as prohibitions on pre-existing exclusion limits and annual and lifetime maximums, may be enacted through the reconciliation process. What is clear is that, if health care reform is enacted, it will have a significant impact on employers and their employees and benefit plans.

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| Summary of Health Care Reform Provisions Affecting Employers and Employees | | | |
|---|---|---|---|
| **Provision** | **House Bill** | **Senate Bill** | **President's Proposal** |
| **STATUS AND EFFECTIVE DATES** | | | |
| Legislation/Proposal | Affordable Health Care for America Act—H.R. 3962 | Patient Protection and Affordable Care Act—H.R. 3590 | The President's Proposal |
| Status | Passed 11/7/09 | Passed 12/24/09 | Announced 2/22/10, enhanced 3/3/10 |
| General Effective Date[1] | 2013 | 2014 | 2014, with certain provisions effective in 2018 |
| **INDIVIDUAL "PLAY OR PAY" MANDATE** | | | |
| "Play or Pay" Mandate | Maintain "acceptable coverage" or pay penalty | Maintain "minimum essential coverage" or pay penalty | Follows Senate approach with modifications |
| Coverage Required | Public option, exchange, government-sponsored, insurance market or employer-sponsored qualifying or grandfathered coverage | Exchange, government-sponsored, insurance market or employer-sponsored qualifying or grandfathered coverage | Follows Senate approach |
| "Play or Pay" Penalty | 2.5% of modified adjusted gross income (AGI), starting in 2013<br>Subject to certain caps and adjustments | Greater of:<br>.5% of AGI for the taxable year or $95/person in 2014<br>1% of AGI for the taxable year or $495/person in 2015<br>2% of AGI for the taxable year or $750/person in 2016<br>After 2016, indexed for inflation<br>Family flat dollar penalty limited to 300% of adult penalty; under age 18 dependent flat dollar penalty limited to 50% of adult penalty<br>Subject to certain other caps and adjustments | Follows Senate approach with following modifications:<br>Lowers flat dollar penalty to $325 in 2015 and $695 in 2016<br>Increases % of AGI penalty to 1% in 2014, 2% in 2015 and 2.5% in 2016 and later years |
| Individuals Exempt from Mandate | Individuals below tax filing threshold<br>Hardship exemption study<br>Religious, nonresident aliens, individuals not residing in U.S. and certain other individuals | Individuals below federal poverty limit (FPL) threshold<br>Hardship exemption<br>Religious, health care sharing ministry, individuals not lawfully present in U.S., individuals residing outside U.S. and certain other individuals | Individuals below tax filing threshold<br>Hardship exemption |
| Minimum Actuarial Value of Employer Coverage | Starting in 2018, 70% of employer coverage | Staring in 2014, 60% of employer coverage | Not specified |

| | | | |
|---|---|---|---|
| Subsidized Exchange Coverage—For Employees Under 400% of FPL | Available if employee's cost of employer's health plan coverage exceeds 12% of AGI | Available if employee's cost of employer's health plan coverage exceeds 9.8% of AGI | Not specified |
| "Free Choice" Opt-Out Vouchers | Not included | Available to full-time employees (FTEs) under 400% of FPL if (1) cost of coverage under employer's health plan ranging from 8% to 9.8% of AGI and (2) employee opts out of employer coverage | Not specified |
| Exchange Subsidies | Tax credits for families up to 400% of FPL<br>Maximum % of income qualifying families would pay for premiums ranges from 1.5% to 12% | Tax credits for families up to 400% of FPL<br>Maximum % of income qualifying families would pay for premiums ranges from 2% to 9.8% | Tax credits for families up to 400% of FPL<br>Maximum % of income qualifying families would pay for premiums ranges from 2% to 9.5% |
| **EMPLOYER "PLAY OR PAY" MANDATE** | | | |
| Employers Subject to Mandate | All employers (small employers subject to reduced or no penalties), starting in 2012 | Large employers—employers who employ average of at least 50 full-time employees (FTEs), starting in 2014 | Follows Senate bill, starting in 2013 |
| "Play or Pay" Mandate | Offer "acceptable coverage" and subsidize at least 72.5% of cost of individual coverage and 65% of cost of family coverage or pay penalty. | Offer "minimum essential coverage" or pay penalty | Offer "minimum essential coverage" or pay penalty |
| Penalty for Not Offering Minimum Coverage | 8% of pay, phased-in for employers with annual payrolls from $500K to $750K; no penalty for employers with annual payrolls of <$500K | $750 per FTE, indexed for inflation | $2,000 per FTE; penalty exception for first 30 employees |
| Penalty for Employees Who Opt for Exchange Coverage in Lieu of Employer Coverage | 8% of average payroll of employer for each opt-out employee | $3,000 per opt-out FTE who receives subsidy; maximum penalty of $750 times number of total FTEs | Not specified |
| Automatic Enrollment | Required for all employers offering health coverage | Required for employers with over 200 FTEs offering health coverage | Required for "larger companies that offer coverage" |
| Waiting Periods | Not included | Permitted up to 60 days; not permitted after 90 days<br>$600 penalty per FTE for waiting periods imposed between 61 to 90 days | Permitted up to 90 days only |
| **QUALIFYING HEALTH COVERAGE** | | | |
| Grandfathered Plans | Grandfathered plans permitted to 2018; restrictions on new enrollees, changes in coverage and premium increases<br>Exempt from minimum health coverage requirements (except lifetime limits) | Grandfathered plans permitted, subject to fewer restrictions on modifications than House bill<br>Exempt from minimum health coverage requirements, waiting period limits, wellness incentives and certain other requirements | Grandfathered plans permitted, subject to certain restrictions |

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### Summary of Health Care... continued

| Provision | House Bill | Senate Bill | President's Proposal |
|---|---|---|---|
| Types of Benefits | Minimum prescribed benefits including: hospitalization; outpatient hospital and clinic services, including emergency services; physician and other health professional services; medical equipment, services and supplies; mental health, substance abuse disorders and behavioral health; prescription drugs; rehabilitative and habilitative services; preventive; maternity, well-baby and well-child care and other child medical services to age 21; and durable medical equipment and supplies | Minimum prescribed benefits similar to House bill | Not specified |
| Pre-Existing Condition Exclusions | Prohibited, starting in 2013 | Prohibited, starting in 2014 | Prohibited, starting in 2014 |
| Out-of-Pocket Maximum Limit | $5,000/individual, $10,000/family, subject to annual increases | Tied to HSA limit ($5,950/individual and $11,900/ family, for 2010), indexed for inflation after 2014<br>$2,000/individuals and $4,000/family for small group plans | Not specified |
| Lifetime Maximums | Prohibited, starting in 2010 | Prohibited, starting 6 months after enactment | Prohibited, starting in 2014 |
| Expanded Dependent Coverage | Through age 26, starting in 2011 | Through age 25, starting 6 months after enactment; unmarried dependents only | Through age 25, starting 6 months after enactment |
| COBRA | Extends COBRA until qualifying beneficiary is eligible for exchange coverage | Not included | Not specified |
| Non-Discrimination | Domestic violence, children with congenital developmental deformities or disorders, mental health or substance abuse | On basis of salary or health status | On basis of salary or health status |
| Prohibited Cost-Sharing | Preventive care; well-baby and well-child care | Preventive care | Preventive care |
| **RETIREES** | | | |
| Medicare Part D "Donut Hole"[2] | Phases out donut hole over 10 years<br>Increases dollar amount by $500 before donut hole begins, starting in 2010 | 50% discount for certain drugs in the donut hole<br>Increases dollar amount by $500 before donut hole begins, starting in 2010 | Phases out donut hole by 2020<br>Replaces $500 increase in donut hole trigger with $250 Medicare rebate, starting in 2010 |
| Reinsurance Program for Early Retirees (Ages 55 through 64) | Federal subsidy of 80% of retiree's costs between $15,000 and $90,000; subsidy capped at $10B funded through trust | Federal subsidy of 80% of retiree's costs between $15,000 and $90,000; subsidy capped at $5B | Not specified |
| Uniform Retiree Coverage | Prohibits reduction of retiree health benefits unless similar change is made for active coverage, effective upon enactment | Not included | Not specified |

| REPORTING | | | |
|---|---|---|---|
| Reports to Federal Government | Health insurance coverage information for each participant and beneficiary<br>Certification of whether employer offered FTEs the right to enroll in qualified health benefits plan or current employer-based health plan and related information | Health insurance coverage information for each participant and beneficiary<br>Excess amounts subject to "Cadillac Plan" excise tax; information on excess amounts must also be reported to insurers and third-party administrators<br>On Form W-2, cost of health, dental, vision, employer HSA contribution and HRA contribution | |
| Notices to Participants | Health insurance coverage information employer provided to IRS<br>Automatic enrollment and opt-out rights<br>Notice of extended COBRA rights<br>Notice of right to cover children's congenital or developmental deformities or disabilities | Health insurance coverage information employer provided to IRS<br>Automatic enrollment and opt-out rights<br>Explanation of exchange coverage and premium subsidy rights | |
| HEALTH CARE FINANCING | | | |
| "Cadillac Plan" Excise Tax | Not included | 40% excise tax on cost >$8,500 for individuals and >$23,000 for families, starting in 2013<br>Higher thresholds for retired and high risk occupations and temporary higher thresholds for individuals in 17 designated high cost states | 40% excise tax on cost >$10,200 for individuals and >$27,500 for families, starting in 2018<br>Higher thresholds based on age and gender and high risk occupations |
| Income Tax Surcharge | 5.4% tax surcharge on high income individuals ($500K/single filers and $1M/joint filers), starting in 2011 | Not included | Not specified |
| Limit on Itemized Deductions | Not included | Increases itemized deduction threshold from 7.5% to 10%, generally starting in 2013 | Follows Senate bill |
| Medicare Hospital Insurance Tax | Not included | Increases tax rate from 1.45% to 2.35% for high income individuals ($200K/single filers and $250K/joint filers), starting in 2013 | Follows Senate bill plus 2.9% tax on unearned income for high income individuals ($200K/single filers and $250K/joint filers) |
| Health FSA Limits | Limits contributions to Health FSAs to $2,500 per taxable year, indexed for inflation after 2013 | Limits contributions to Health FSAs to $2,500 per taxable year, indexed for inflation after 2011 | Limits contributions to Health FSAs to $2,500 |
| Additional Tax on Non-Qualified Health Account Distributions | HSAs: Increased from 10% to 20%, starting in 2011 | HSAs: Increased from 10% to 20%, starting in 2011<br>Archer MSAs: Increased from 15% to 20%, starting in 2011 | HSAs: Increased from 10% to 20%, effective date not specified<br>Archer MSAs: Increased from 15% to 25%, effective date not specified |

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## Summary of Health Care... continued

| Provision | House Bill | Senate Bill | President's Proposal |
|---|---|---|---|
| Other Excise Taxes | 2.5% excise tax on medical devices | 10% excise tax on indoor tanning; 5% excise tax on elective cosmetic procedures | Excise tax on medical devices and indoor tanning services |
| No Health Related Account Coverage for Non-Prescription Drugs | HSAs, Archer MSAs, FSAs, HRAs and other reimbursement programs may not cover non-prescription drugs (other than insulin) | HSAs, Archer MSAs, FSAs, HRAs and other reimbursement programs may not cover non-prescription drugs (other than insulin) | Not specified |
| Prohibition on Cafeteria Plan Exchange Coverage | Prohibits payment of exchange coverage from cafeteria plan | Prohibits payment of exchange coverage from cafeteria plan | Not specified |
| Tax Credit for Small Businesses | Applies to small employers with up to 25 employees and average wages <$40,000; 50% premium tax credit for up to 2 years; 100% premium tax credit for employers with <11 employees and average annual wages of <$10,000 | Applies to small employers with up to 25 employees and average annual wages of less than $50,000; 35% premium tax credit if employer pays at least 50% of premium for first 3 years; increases to 50% after first three years | Not specified |

[1] These are the general effective dates. Certain provisions have a different effective date as specified in the chart.

[2] Medicare stops paying for prescriptions after plan and beneficiaries have spent $2,830 and starts paying again after out-of-pocket expenses exceed $4,550. This is often referred to as the "donut hole."

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