WHITE PAPER

MODELING THE IMPACT OF "PAY OR PLAY" STRATEGIES ON EMPLOYER HEALTH COSTS

CHRISTOPHER JUSTICE, MS

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TRUVEN HEALTH ANALYTICS

EXECUTIVE SUMMARY

For the past two years, the Patient Protection and Affordable Care Act (PPACA) has been at the center of one of the fiercest political debates in this country's history. Signed into law in March 2010, everyone from physicians to business owners to individual healthcare consumers have been trying to gauge what kind of impact the new law will have. For U.S. employers, part of that process has been trying to navigate how to best address their employees' group health plans when further reform takes effect in 2014.

Speculation that the Act will make it more cost-efficient for employers to simply drop group health coverage for employees and pay the allotted fines has been prevalent among industry pundits. This paper uses the MarketScan® Research Databases from Truven Health Analytics℠ to test that hypothesis.

By examining the real-world healthcare experiences of large American employers and their employees and testing various group health coverage scenarios against these datasets, we are able to determine how different approaches to post-reform healthcare benefit design will affect bottom-line operating costs, as well as their impact on employees. We provide results for several scenarios that provide a wide range of financial outcomes for all stakeholders. Through our research, we examined five key industries — financial, manufacturing, pharmaceutical, retail, and university — and found that, across the board, there is no short- or long-term advantage to employers dropping group health plans in favor of carrying fines.

BACKGROUND

Despite vocalized objections and ongoing political posturing, U.S. health reform is close to becoming reality. Since President Obama signed the bill into law in early 2010, employers have been trying to digest the PPACA. The central concern among employers is what the "Pay or Play" and "Cadillac tax" provisions will mean for the long-term prospects of their healthcare programs.

Pay or Play

The PPACA will require employers to make a choice: either "pay" a penalty tax for dropping group health benefits to employees or "play" by continuing to offer such benefits. The Pay or Play employer mandate will affect employers with 50 or more full-time employees for health plans beginning on or after January 1, 2014. Under Pay or Play, employers are not required to provide group health insurance; however, employers providing coverage must meet minimum coverage levels or face penalties. These penalties, intended to help finance the cost of coverage expansion, are as follows:

> If an employer chooses not to provide group health coverage in 2014, and at least one full-time employee obtains federally subsidized coverage through a Health Information Exchange (HIX or Exchange), the employer pays a $2,000 "free rider" penalty for each full-time employee. An employer can exclude its first 30 employees from this calculation. The penalty is assessed on a monthly basis. This is the so-called Pay scenario.

If an employer continues to provide group health coverage in 2014 (Play), and at least one full-time employee obtains federally subsidized coverage through a HIX — which is a platform that allows those ineligible for Medicaid coverage to price shop and find a plan that best suits them — an employer will be assessed a monthly penalty. The federal subsidy (tax credit) is available to an employee if at least one of the following conditions is met:

- An employer offers employees the opportunity to enroll in a group health plan providing minimum essential coverage, and health plan premium costs for single coverage are greater than 9.5 percent of an employee's household income

OR

- An employer contributes less than 60 percent of actuarial plan value

The employer penalty is equal to the lesser of:

- $3,000 times the number of full-time employees receiving subsidized coverage in an Exchange

OR

- $2,000 times the number of full-time employees (excluding the first 30 full-time employees)

Understanding the Cadillac Tax

Beginning in 2018, PPACA requires employers to pay a 40 percent excise tax on the value of total healthcare premiums in excess of fixed threshold limits of $10,200 per employee per year (PEPY) for individual coverage and $27,500 for family coverage. Taxes will be assessed on a monthly basis. Benefits subject to the tax include employer and employee contributions to medical and pharmacy benefits, Flexible Spending Accounts (FSAs), employer contributions to Health Savings Accounts (HSAs) or Health Reimbursement Arrangements (HRAs), and benefits obtained at worksite clinics. Standalone dental and vision coverage is not subject to the tax.

There are a number of one-time adjustments applicable to the threshold limits, including:

- Higher premium threshold for retirees: $11,850 individual, $30,950 family
- Higher premium threshold if employees are in a "high-risk" profession (e.g., police, fire, paramedics): $11,850 individual, $30,950 family
- Adjustment in 2018 if the cost for Blue Cross/Blue Shield coverage under the federal employees' plan increases by more than 55 percent
- Employer-specific age/gender adjustment relative to the national average in 2018

Employers with self-funded plans are required to calculate annual premium equivalents for purposes of the Cadillac tax calculation in essentially the same way Consolidated Omnibus Budget Reconciliation Act (COBRA) rates are developed, using an accepted actuarial methodology. The Cadillac tax will be calculated directly on the premiums of insured options. Plans that are "grandfathered" under PPACA are not exempt from the Cadillac tax or the Pay or Play mandate.

Modeling Costs

In light of these looming federal requirements, employers are faced with a burning question: Continue to offer group health benefits despite the current trend of 6 percent annual insurance premium increases, or eliminate benefits altogether and take the penalty at $2,000 for each employee? As this paper will show, employers who choose to cut plans as a perceived cost-saving measure will not benefit as much as they might assume.

METHODS

Using data, we examined 33 large employers with 933,000 employees in the university, pharmaceutical, retail, financial, and manufacturing industries. Our model uses granular, employee-level wage, demographic, and healthcare data to examine the direct benefit and tax cost of eliminating group health benefits as well as to project costs for 2014-2020 under a variety of scenarios.

The four benefit design scenarios we examined were:

- Eliminate Group Health and Make Employees "Whole": In this approach, employers eliminate group health coverage, but subsidize the full cost to employees of obtaining coverage through an Exchange
- Eliminate Group Health With Cost-Neutral Impact for Employers: This approach involves an employer dropping group health coverage and subsidizing Exchange coverage without spending any more PEPY than in their current group plan
- Eliminate Group Health and Provide Subsidy to Achieve 20 Percent Savings Target: In this scenario, an employer eliminates group health and provides sufficient additional compensation to reduce overall net employer healthcare costs by 20 percent
- Eliminate Group Health With No Subsidy for Employees to Purchase Healthcare Through an Exchange: In this case, an employer would eliminate group health and not provide any additional subsidy to employees to purchase their own healthcare

To establish the secular trend for annual cost increase for existing group health plans, we assumed a 6 percent annual employer group health plan trend rate for combined medical and pharmacy benefits based on a 5.8 percent MarketScan average annual trend rate data from 2007-2010. This rate reflects an employee-weighted average trend for a consistent group of 150 employers for 2007-2010.

For the purposes of modeling costs of benefits purchased through an Exchange, we used two sets of assumptions: the Congressional Budget Office (CBO) rates and adjusted MarketScan group health plan benefit and administration cost data.

We also examined the impact of the Cadillac tax upon its scheduled roll out in 2018. Note that we did not adjust assumed excise tax thresholds for size or type of plan, type of employer, or geographical differences under our analysis of the Cadillac tax.

FINDINGS

Summary of Findings

Our analysis revealed three key findings:

- There is no immediate or long-term cost advantage for employers to eliminate group health benefits.
- It will cost employers more to "make employees whole" when shifting their benefits to an Exchange than to continue existing group health plans.
- Should employers choose to eliminate group health, employees will suffer a significant reduction in overall compensation when they assume the incremental costs of benefits.

To arrive at these findings, we evaluated four different scenarios and calculated the cost an employer would incur if they chose to drop coverage for their employees.

Scenario 1: Eliminate Group Health and Make Employees Whole

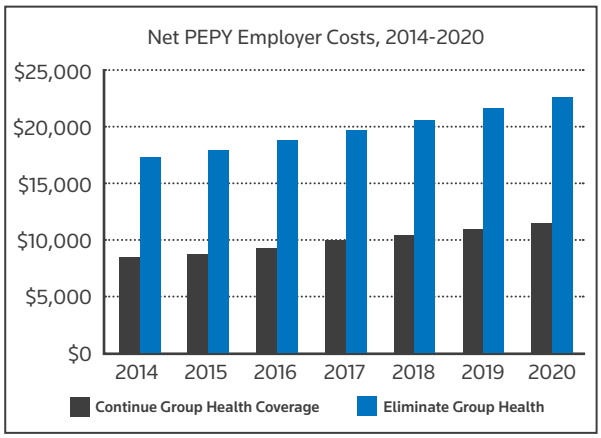
For employers choosing to eliminate group healthcare, we assume that "making employees whole" will entail providing additional compensation to cover the projected incremental cost for employees to purchase healthcare through an Exchange.

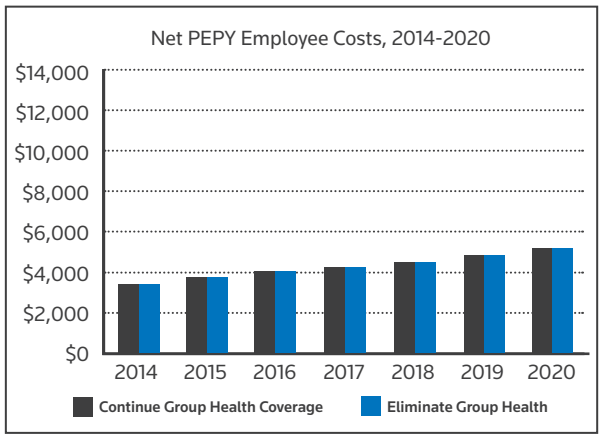
We have "grossed up" these compensation adjustments to reflect the impact of additional taxes on this income. In our model, costs for benefits purchased through an Exchange reflect two sets of assumptions: the CBO rates* and adjusted MarketScan group health plan benefit and administration cost data.

Note that the tables below reflect Exchange plan rates developed by the CBO. We found that results were directionally equivalent when we used Exchange plan rates based on 110 percent of the group health plan claims and administrative services only (ASO) fees for each of the industry groups included in the study. We assume in general that benefits purchased through an Exchange will be more expensive; therefore it will be less efficient for large employers to rely on Exchanges as a vehicle for delivering healthcare to their employees.

Employers who choose to eliminate group health and "make employees whole" may face significant employer net cost increases that could drive total healthcare costs as high as $17,269 PEPY in 2014, as seen in Figure 1a.

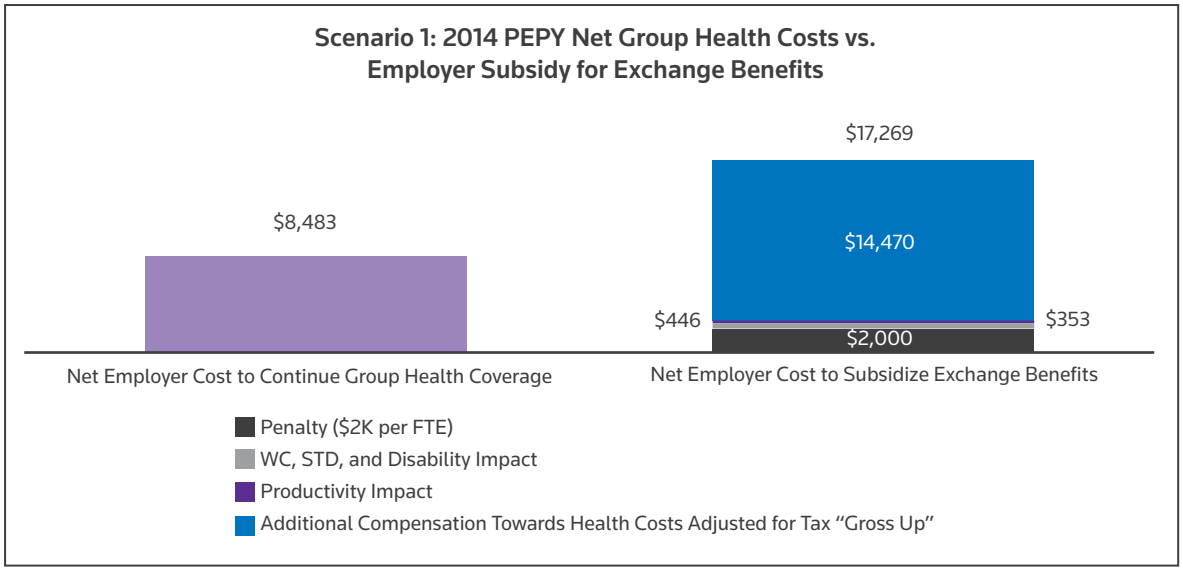
FIGURE 1A





As can be seen in Figure 1b, employers that continued traditional group coverage would spend $8,483 PEPY in 2014 while those dropping coverage and subsidizing employees in an Exchange would spend a total of more than $17,000, when you factor $14,470 in healthcare costs (including $1,403 in additional wages to offset payroll and income taxes), a $2,000 penalty per employee, and $799 for the anticipated impact on lost time benefits (i.e., short-term disability, long-term disability, workers' compensation, and incidental absence), and productivity.

FIGURE 1B

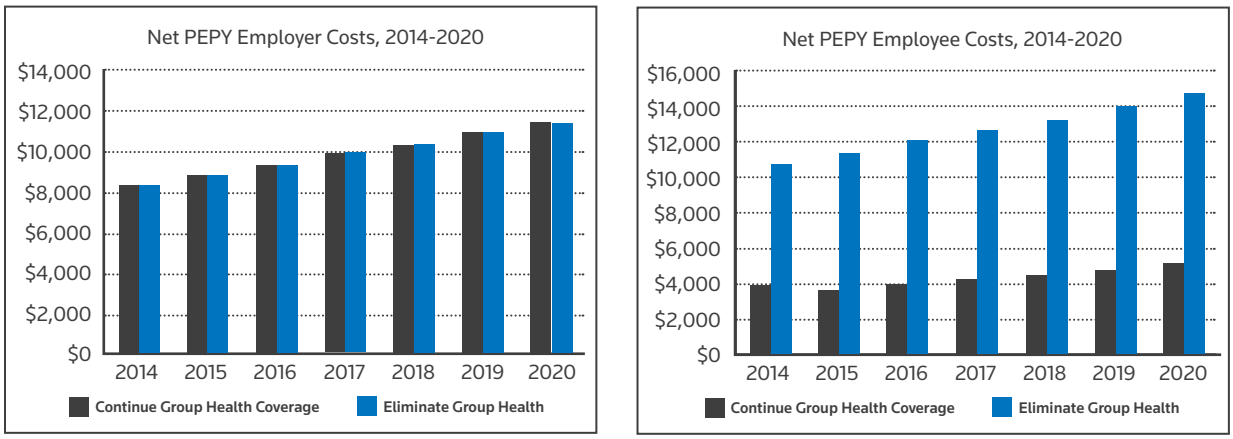


This spike in costs comes without a price break for the employees, as Figure 1a shows their expenses would stay the same. As a result, it makes scenario 1 counterproductive with a cost-cutting agenda.

Scenario 2: Eliminate Group Health With Cost-Neutral Impact for Employers

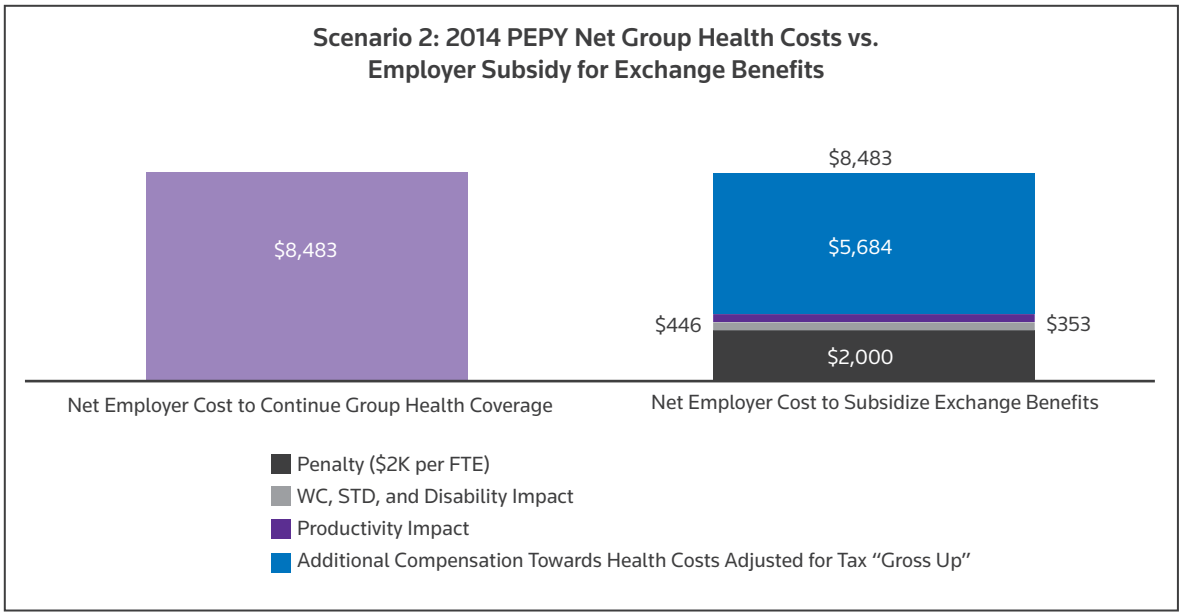
Employers who choose to eliminate group health benefits but provide additional compensation so that the move to Exchange-based benefits is cost-neutral to the employer will create significant cost shifts to employees, taking into account the benefit design, net premium, out-of-pocket, and tax differences. Under this scenario, PEPY 2014 employee net costs increase to more than $10,000 (Figure 2a).

FIGURE 2A



We project that employers will have to provide an additional $5,684, or 67 percent of current health plan costs, in salary to compensate for eliminating group health plans in 2014 (Figure 2b). This would still leave employees woefully short of their annual $10,000+ healthcare cost burden. This scenario is unlikely to be a practical solution for many employers, as the market will likely not allow the large unilateral reduction in compensation and benefits that this represents.

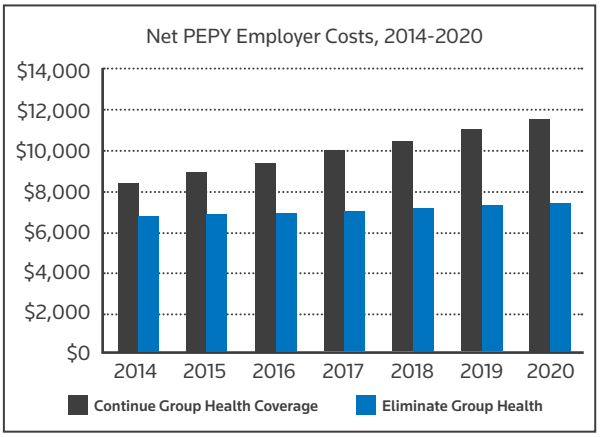
FIGURE 2B

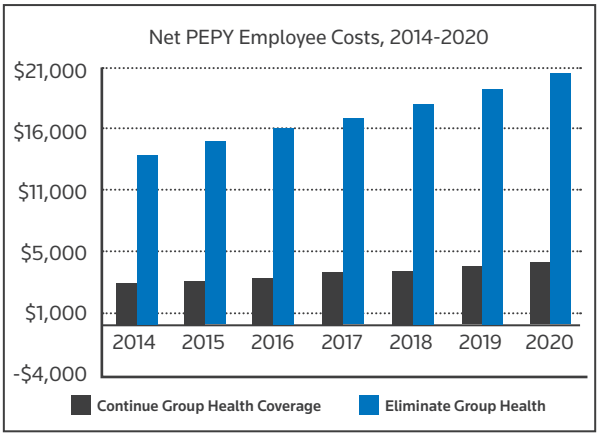


Scenario 3: Eliminate Group Health and Provide Subsidy to Achieve 20 Percent Savings Target

We also examined the level of additional compensation an employer would need to provide should they eliminate group health and seek to obtain a 20 percent PEPY savings in 2014 relative to net health costs. We chose the 20 percent amount as a "straw man" representing a potentially attractive financial target for an employer considering elimination of group health. As Figure 3a shows, employees would again bear a significant cost shift, paying $10,454 PEPY more than their traditional plan copay in 2014 if their employer were to eliminate coverage and pursue a 20 percent cost reduction.

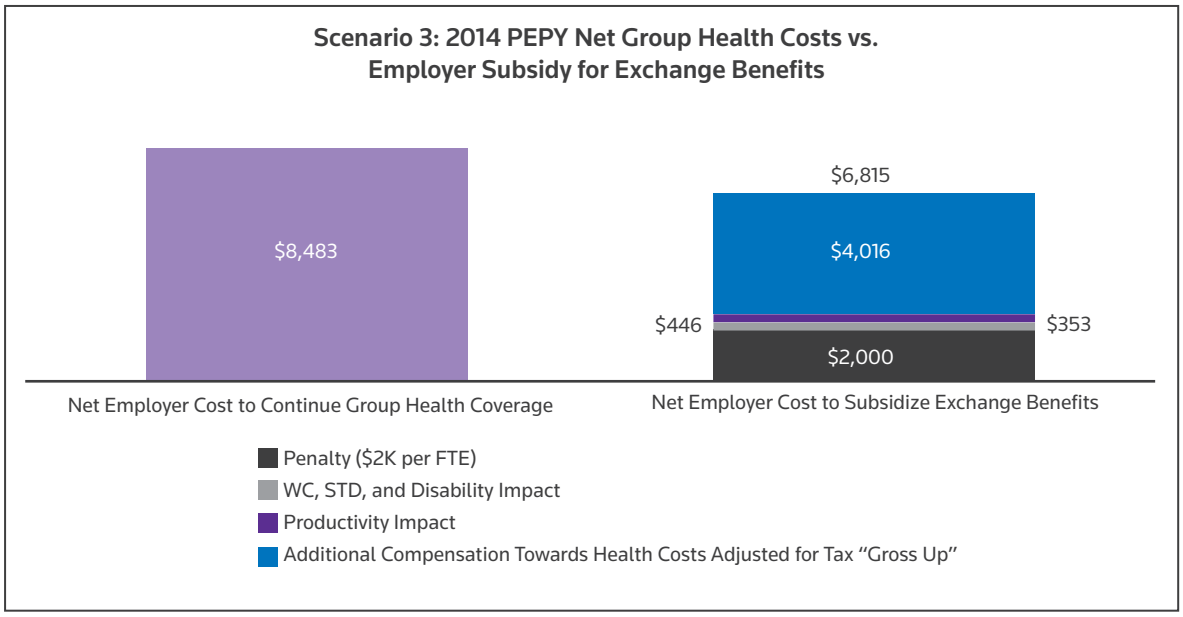
FIGURE 3A





While the 20 percent savings would be substantial to employers, it would not come without sacrificing employee relationships. Figure 3b shows that employers would get significant savings even after incurring fines, in this scenario, but it is critical to note that the remaining costs would land squarely on the shoulders of employees.

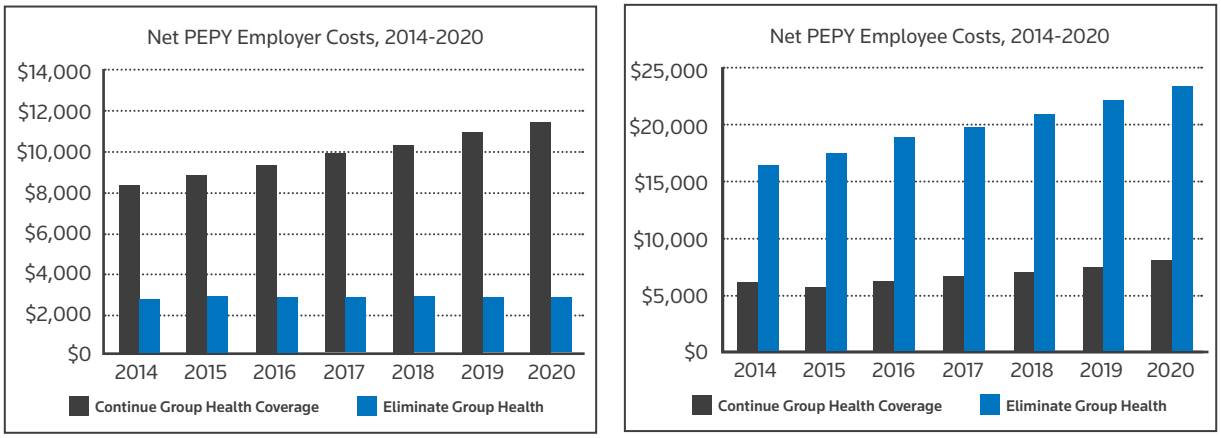
FIGURE 3B



Scenario 4: Eliminate Group Health With No Subsidy for Employees

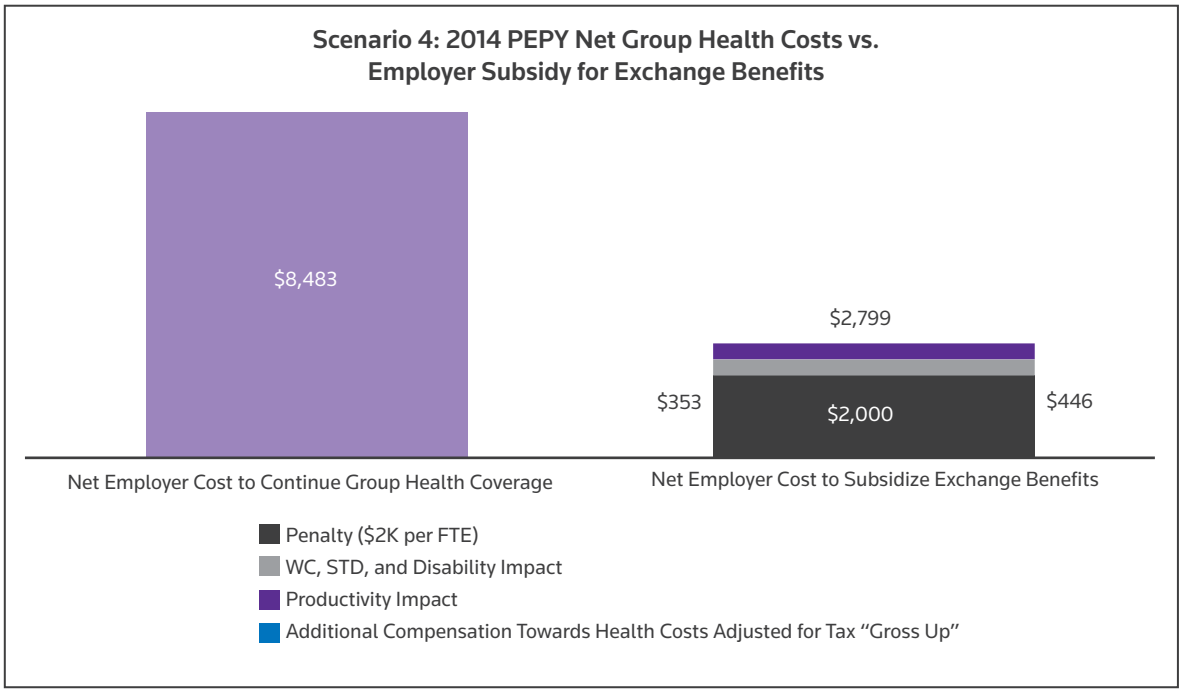
The last scenario in the study assumes the elimination of group health with no additional subsidy provided to employees to purchase healthcare through an Exchange. It should come as little surprise that, as Figure 4a indicates, employer costs fall considerably while employees bear the brunt of $16,551 in annual healthcare costs.

FIGURE 4A



Under this scenario, employers would succeed in reducing annual healthcare costs to the penalty amount of $2,000 PEPY plus an anticipated $799 PEPY impact on lost time and productivity benefits (Figure 4b), but employees will pay the full cost of purchasing benefits through an Exchange, or $12,881 more than they would pay in a continued group coverage scenario.

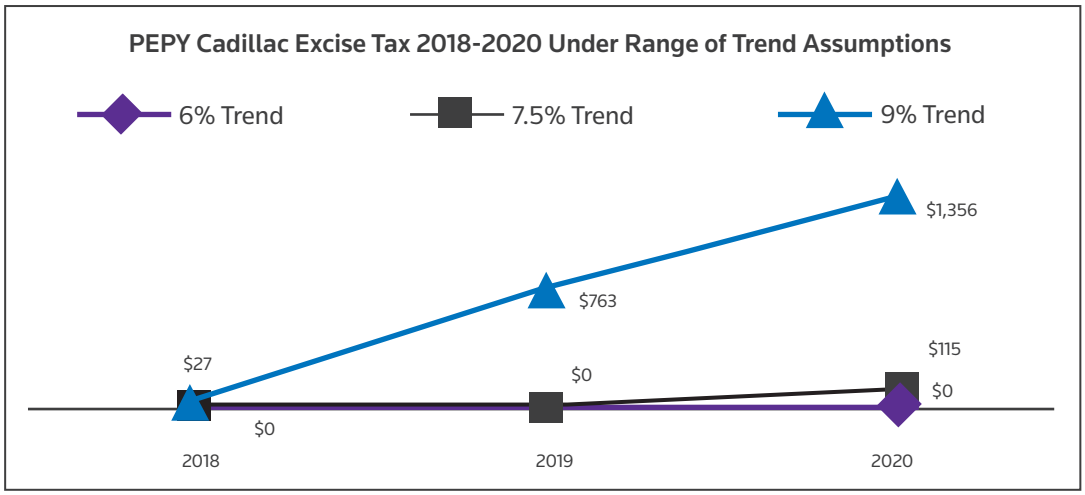
FIGURE 4B



Cadillac Tax

Under the 6 percent annual group plan cost trend assumption, employers in the study will not hit the Cadillac tax thresholds for active employees in 2018-2020. However, if trend rates increase by 9 percent annually from 2010 onward, we estimate the study group will be subject to Cadillac excise taxes beginning in 2018 ($27 PEPY in 2018, $763 PEPY in 2019, and $1,356 PEPY in 2020). Figure 5 depicts projected PEPY Cadillac excise tax for 2018-2020 under three trend scenarios.

FIGURE 5



CONCLUSIONS

In this analysis using the MarketScan Research Databases, we found that there is no cost advantage, neither immediate nor long-term, for employers to eliminate group health benefits. Employers must provide market value — in benefits and compensation — to retain skilled workers and will not be able to unilaterally cut benefits and expect employees to absorb the projected inefficiency of Exchanged-based coverage. The potential penalties for dropping group plans, as well as the net gain most employees would need to receive in their compensation packages to make up for not receiving health benefits, should be enough to discourage most companies from discontinuing such services to their workers.

Future research should be conducted to determine whether the patterns we observed persist after the healthcare reform bill takes effect in 2014. In particular, the economics of Pay or Play for midsized and large employers will be greatly dependent upon how the market for Exchange-based plans develops and whether Exchanges can offer plans that are as efficient or more efficient than existing group health plans. There may also be opportunities for an employer to selectively Pay or Play on a group-by-group basis. We have not reflected this more nuanced approach within this study.

What is clear is that employers should not see the existence of an option not to cover their employees as a "slam dunk" cost-saving measure. An employer's cost calculations to Pay or Play are much more complex than simply balancing their current group health costs against the nominal penalties under PPACA. Whether the true cost is felt by the employer or the employee, the impact is the same. Not only is eliminating group health coverage not cost efficient, it may potentially have a large impact on an employer's competitive market position for retaining and recruiting talent.

TRUVEN HEALTH ANALYTICS℠ PAY OR PLAY MODELING TEAM

Christopher Justice – Senior Director, Practice Leadership, and Team Lead
Gary Pickens, PhD – Chief Research Officer, Center for Healthcare Improvement
Bob Kelley – Vice President, Healthcare Analytics
Tami L. Mark, PhD, MBA – Director, Analytic Strategies
Jody Amodeo, RN, PAHM – Vice President, Practice Leadership
Dennis Dunn – Lead Scientist, Analytic Consulting and Research Services

MORE INFORMATION

For more information on the Truven Pay or Play model or other ways we help clients like you navigate the changes of healthcare reform, please contact your client services director or email us: *employer@truvenhealth.com*.

ENDNOTE

* Congressional Budget Office. An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act, p.28, table 2, November 30, 2009.

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