Big decision ahead

Employers weigh costs of keeping, dropping health cover

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WASHINGTON—Employers viewing the enactment of health care reform legislation as an opportunity to drop health coverage and escape a huge financial burden may want to rethink that idea, experts say.

The hidden costs of dropping their health care plans could far outweigh the fine that employers would face for not offering health care coverage, they say.

At first blush, though, the financial advantages for an employer that terminates its health insurance plans are compelling.

Employers that take that route would have to pay a $2,000 per employee penalty to the federal government starting in 2014. But with health insurance costs averaging about $9,000 per employee, the savings from the elimination of coverage would dwarf the penalties paid.

"You don't have to be a health care actuary to know that $2,000 is a lot less than $9,000," said Linda Havlin, a partner with Mercer L.L.C. in Chicago.

Some employees also could benefit from health care plan terminations. Lower-paid employees would be entitled to federal health insurance premium subsidies to buy coverage through state insurance exchanges that the reform law authorized and are to be set up by 2014. Those subsidies could result in some employees paying less for coverage than they do under their employer's plan.

Those apparent advantages are why many employers are asking their consultants, brokers and agents whether a plan termination makes financial sense.

"The question comes up at almost every presentation I make," Mercer's Ms. Havlin said.

But the perception that every employer will come out ahead financially by dumping their health care plan differs from reality, experts say.

"When we have drawn up models, the vast majority of employers would pay more" compared with maintaining their plans, said Dave Osterndorf, senior health and group benefits actuary in the Milwaukee office of Towers Watson & Co.

"There may be scenarios where plan terminations may make economic sense, but they would be rare," said Marcia Benshoof, president of broker IMA of Colorado Inc. in Denver. "We are counseling against any knee-jerk reactions."

There are several reasons why a plan termination would not be cost-effective for employers, with the most significant being the cost that employers likely would incur by increasing salaries of employees not eligible for premium subsidies and those whose subsidies would be far less than their current share of the group premium.

Under the new law, employees with adjusted gross family incomes exceeding $88,000 would not be eligible for a federal subsidy and would have to pay the full premium. Since family premiums already often exceed $15,000 a year, upper middle-income and upper-income employees would effectively have a huge reduction in compensation if their employers terminated coverage and employees had to pay for their own coverage.

To make up for that huge loss of compensation, employers wishing to retain workers would have to bump up salaries, which would increase employers' share of FICA taxes.

Take the case of an employer plan that costs $15,000 for family coverage, with the employer paying $12,000 and the employee paying $3,000. For an employee who earns $50,000 and has a working spouse earning $50,000, no subsidy would be available.

The employer, though, would have to give the employee more than $12,000 to prevent a reduction in total compensation. That is because employees currently almost always pay their share of the total with pretax dollars through salary reductions, reducing their taxable incomes.

If the employer boosts employees' salaries, their taxable income would increase. In addition, Social Security and Medicare payroll taxes, paid by both the employer and employees, also would increase.

In addition, the employer would have to pay the $2,000 per employee penalty for not offering coverage.

There also could be other costs. Employers would lose their ability to influence employees' health through wellness programs, which could result in a less healthy, less productive workforce, said Andy Anderson, a partner with Morgan, Lewis & Bockius L.L.P. in Chicago.

Yet another concern, some say, is that if employers drop coverage, employees might not purchase coverage on their own. While employees would be hit with financial penalties for not buying health coverage, those penalties are relatively modest, which may lead to some employees deciding to pay the penalty rather than buying coverage.

If those employees then became ill or were injured and incurred large medical bills, the employees would face enormous financial stress that also could affect productivity.

There would, however, be situations in which employers, even after paying the $2,000 penalty, increasing salaries and incurring higher payroll taxes would come out ahead financially by terminating coverage. The most obvious situation is where employers have a large proportion of low-wage employees.

The economics will “depend on wage calculations,” said Thomas P. Miller, a resident fellow at the American Enterprise Institute in Washington.

Indeed, an employer could gain a competitive advantage by terminating coverage in some cases, said Michael Cannon, director of health policy studies at the Cato Institute in Washington.

Acknowledging that it might appear to be “counterintuitive,” such a financial advantage could happen during a strong economy when employers have difficulty in recruiting low-wage employees, Mr. Cannon said.

Those employees would only have to pay a small percentage—generally 2% to 4% of income—to buy coverage in insurance exchanges. As a result, any increase in employee salary to compensate for employees' additional health insurance costs would be modest. Employers then could give employees several thousand dollars in additional salary and still be far ahead financially, Mr. Cannon said.

There also could be cases where employers choose to terminate health care plans for the simplicity of just paying a fixed assessment to the government, said Grace-Marie Turner, president of the Galen Institute, an Alexandria, Va.-based free-market health policy organization.

“Some employers will say, "I'll write the check and I'm out of here,'” Ms. Turner said.

If large numbers of employers did that, the costs of providing coverage to the uninsured through the exchanges could explode, resulting in legislators having to find a lot more revenue than projected to pay the higher costs, Ms. Turner warned.
