Defined Contribution Health Plans

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Background

- Current health care offerings are much like defined benefit pensions – external forces dictate costs
- Employer
  - absorbs bulk of costs (premiums, health care pricing) over which it has little control
  - Heavily involved in plan design and selection
Structure of Defined Contribution Plans

Defined Contribution Plan Design

- Employer established Health Reimbursement Account
  - Employer contributions only
  - Allow employee to use contributions to purchase insurance (through public or private exchanges)
  - Possibly allow employee to also use HRA to pay for out-of-pocket health care costs
  - Perhaps differential contribution for opt outs (individuals who obtain health care elsewhere)
Defined Contribution Plan Design

- **Concerns**
  - Employee contributions are not allowed (need cafeteria plan for difference between contribution and plan costs)
  - Requires careful coordination if HSA/high deductible plan is utilized
  - Questionable availability after 2014 - annual limits prohibition
  - Question whether offsets for public subsidy will be allowed or differential contributions for opt outs
  - Rules/Limitations on carry over of account balances

Defined Contribution Plan Design

- **Employer established cafeteria plan**
  - Employee uses credits which are then used to make tax-free contributions to purchase of health plan coverage
  - Consider making this a premium-only cafeteria plan to avoid some non-discrimination rules
  - Allows pretax contributions for coverage (subject to public exchange restrictions) - including purchase of individual plans or coverage
Defined Contribution Plan Design

- Concerns - Cafeteria Plan
  - Credit use is constrained by employer size for public exchange
    - 2014 - 2017 employers less than 100 employees (some states less than 50)
    - 2017 states may authorize larger employers
  - Questionable offset for public subsidies
  - Requires careful coordination if HSA/high deductible plan is utilized

Defined Contribution Plan Design

- Exchange
  - Package of several health care and other benefit plan options - various levels of coverage
  - Employer not involved in plan design
Defined Contribution Plan Design - Public Exchanges

- In 2014 each state will have public exchange
  - Individuals without employer coverage or with unaffordable coverage may go into public exchange
  - Three levels of coverage

Defined Contribution Plan Design - Public Exchanges

- Individuals with income up to 400% of poverty level receive a cost sharing subsidy

<table>
<thead>
<tr>
<th>Income % of poverty level</th>
<th>Premium Cap as a % of Income</th>
<th>Income $ (family of 4)</th>
<th>Max OP Premium</th>
<th>Premium Savings</th>
<th>Subsidy</th>
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Defined Contribution Plan
Design - Private

- Contract with a private exchange* where employee chooses coverage
  - AON/Hewitt (1000+ employees)
  - Mercer (100+ employees)
  - BCBSM Glidepath (on Bloom engine)
  - Health Partners America
  - Humana
  - Several others including trade associations

- Currently, 4 - 7 choices of health coverage and various dental/vision options
  *not an endorsement

Health Care Reform Considerations

- Expanded Group of Employees
  - 2014 - coverage must be available to employees working 30 hours or more

- Determining full time status:
  - At hire, if full time
  - Part timers - essentially measure at three month intervals
  - Annual look back/stability period of 12 months then permitted
Health Care Reform Considerations

- Plan Entry
  - Can require 90-day wait
  - May exclude classifications (subject to penalties)
  - May set hours requirements for entry - potentially permitting part-timers to enter after completion of set number of hours of service

Defined Contribution Plan Design

- Penalties for Failures (2014)
  - Must offer all full-time employees health plan coverage or pay a penalty
    - Full-time = 30 or more hours per week
    - Penalty: $2000 per full-time employee (minus 30 employees)
  - Must offer minimum essential coverage to full time employees or pay a penalty
    - Employee contribution no more than 9.5% of employee's household income
    - plan must pay 60% of covered costs
    - Penalty: $3000 per employee who obtains subsidized coverage through exchange
Defined Contribution Plan Design

- Choices
  - 2013 - Private Exchanges - Cafeteria Plan
  - 2014 - 2017
    - Potential bifurcation for small employers - using cafeteria plan
      - Less than 400% Poverty - Public Exchange offsetting contribution for subsidy
      - All others private exchange may need to bring some middle management to private exchange for personnel reasons and nondiscrimination eligibility classification requirements
      - HRA may not be available
      - Large employers private exchange only
  - 2017 - with State Action Bifurcated Plan for employees of large employers

Pros and Cons of Defined Contribution Plans
Pros of Defined Contribution Health Plans

- Transforms an unlimited benefit promise to a fixed contribution amount with contribution and cost certainty
- Enables Michigan public employees certainty in meeting the cost/hard cap requirements
- $15,000 family, $11,000 double, $5,500 single coverage or, if elected, 80% of cost

Pros of Defined Contribution Health Plans

- Limits employer involvement in Plan Design details
- Greater employee choice of options
- Fiduciary liability minimized duty to prudently select exchange and monitor provider costs
- Eventual avoidance of Cadillac Plan Excise Tax
Cons of Defined Contribution Health Plans

- Will employees find them acceptable?
  - Will they be confused by choices?
  - Will rate increases become too burdensome?
- Will employees get the same value?
  - Are these just individual policies?
  - Are “group rates” comparable to rates when employer is the buyer or self-insurer?

Cons of Defined Contribution Health Plans

- Potential adverse selection?
  - Will healthy employee migrate to cheapest, least comprehensive options, making more comprehensive policies unaffordable?
- What if others in industry don’t make the same move?
  - Will it be a competitive advantage or disadvantage in the labor market?
Cons of Defined Contribution Health Plans

- Legal uncertainties
  - Is it deductible as a health plan or as salary?
  - Are the benefit programs subject to COBRA and other federal mandates that apply to employer health plans?
  - How do nondiscrimination rules apply?
- Some designs may expose you to Health Care Reform employer responsibility penalties.

ERISA and Tax Code Issues
How are Employer Contributions Treated?

- Do employer contributions and benefits qualify under Tax Code Sections 104, 105 and 106?

- Implications:
  - Exempt from FICA and FUTA withholding requirements?

How are Employee Contributions Treated?

- Is coverage purchased through an exchange a qualified expense under a cafeteria plan?

- Implications:
  - Can employees pay their share on a tax-free basis?
    - Answer depends on whether use private or state exchange!
What is the Health Plan?

- Is it just the HRA?
- Or does it include the health coverage selected by the individual with Employer Credits?

Implications:
- ERISA Plan/SPD requirements
- Health Care Reform requirements
- COBRA requirements
- HIPAA nondiscrimination requirements (prohibits variation in premiums based on health factors)
- Will Selection of particular private exchange be subject to ERISA fiduciary responsibility requirements?

Does It Satisfy the Employer Mandate?

- Does the coverage count as minimum essential coverage?
- Is the coverage affordable?
- Does the coverage provide minimum value?

Implications:
- Does it count as coverage at all, or will employer be subject to $2000 per employee penalty?
- Will some employees qualify for subsidized coverage on state exchange—resulting in $3000 penalty per subsidized employee?
Offsets for Subsidies?

- Is this a self-funded or an insured health plan?
- Employee contributions through a cafeteria plan?

Implications:
- Can you send some individuals to the state exchange?
- Can employer contributions vary?
- Do you need to maintain different plans for different groups of employees?
- Could multiple plans pass nondiscrimination tests?

Recommendations

- Treat HRA/§125 or combination with exchange coverage as the plan
- Contract with a private exchange for group coverage
  - COBRA
  - HIPAA
  - ERISA requirements
- Can use cafeteria plan for employee contributions with private exchange
  - Small employers can also use with state exchange
Recommendations

- Keep affordability requirements in mind when establishing employer contributions.
- Simplest to offer to all full-time employees
  - Nondiscrimination rules
  - Restrictions on cafeteria plan

Questions?

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