LOCKTON COMPANIES, LLC TESTIMONY

HEARING ON

# "IMPACT OF OBAMACARE ON JOB CREATORS AND THEIR DECISION TO OFFER HEALTH INSURANCE"

SUBCOMMITTEE ON HEALTH CARE, ET AL.
OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES

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Chairman Gowdy, Ranking Member Davis, my name is J. Michael Brewer and I am the President of Lockton Benefit Group of Lockton Companies, LLC (Lockton). Lockton is headquartered in Kansas City, Missouri, and is the largest privately-held insurance brokerage and consulting firm in the world. Domestically, Lockton employs 2,300 associates in 24 offices nationwide who serve the insurance risk needs of approximately 9,000 employer clients from coast to coast. Lockton Benefit Group is the employee benefits consulting arm of Lockton Companies, LLC, and provides employee benefits consulting services to approximately 2,500 of those clients.

On behalf of Lockton I thank you for the opportunity to appear here today to share our observations and our clients' views regarding the impact of last year's health reform law on the group health plans they sponsor.

Lockton consults with clients on group medical plans, qualified and nonqualified retirement plans, group life and disability insurance programs, voluntary supplemental benefits, and dental and vision programs. Most of our 2,500 employee benefits clients employ us to assist in the design and administration of their group medical insurance programs.

Most Lockton clients are "middle market" employers, employing between 500 and 2,000 employees, although we also have some small-group and some "jumbo" clients. Our clients include private and governmental employers, and employers across many industry segments, including construction, healthcare, manufacturing, transportation, retail, professional services, local government, and the restaurant/retail/hospitality and amusement park industries.

More than half of Lockton's clients maintain self-insured group health plans. The others purchase group health insurance from licensed insurance companies.

## Overview

Mr. Chairman, the employer community is the single largest supplier of health insurance in America. Health insurance is the second most expensive element of employees' compensation, and in our experience the vast majority of employees appreciate, value and like the coverage they have.

The majority of our clients want to continue to supply health insurance, but they struggle mightily with the cost and with the federally-imposed complexity of plan administration. For example, under federal law and regulations today, a simple group health plan is required to supply up to an astonishing 52 separate notices, disclosures and reports to its enrollees and the federal government (many of those more than once). Virtually every aspect of plan administration, from enrollment to benefit summaries to specific eligibility and benefit requirements, to claim processing times and the timing, form and cost of post-employment coverage, are now under federal statutory or regulatory dictates.

Last year's healthcare reform law, the Patient Protection and Affordable Care Act (PPACA), poses significant challenges to our clients. It adds to, rather than subtracts from, the cost of their health insurance coverage, and adds so much more complexity to the process that a full ***80 percent*** of our clients said, in responding to a recent survey we conducted, that they were concerned or very concerned about the additional administrative complexity created by the PPACA.

This frustrates our clients immensely. They do not understand why, at a time when they struggle to supply this valuable fringe benefit, Congress would make the process more expensive and more complicated, rather than less so. They tell us the additional costs, complexity and uncertainty wrought by the PPACA affect their ability to hire additional workers, or to retain full-time employees.

In what we think is a remarkable demonstration of commitment to their employees, more than 80 percent of our survey respondents said they would like to continue to offer group insurance—primarily to attract and retain the talent they want—and at least today have no plans to consider otherwise when the insurance exchanges open in 2014. Yet nearly 20 percent of our clients said they'll consider terminating their group insurance plans in 2014, and they cite cost and complexity as the main reasons they will consider doing so.

If even half of that 20 percent—if merely 10 percent of our clients and health plan sponsors everywhere terminate coverage in 2014 or shortly thereafter—Congress will have substantially underestimated the number of Americans who will lose group insurance due to the PPACA, and thus will have substantially underestimated the cost of federal subsidies needed in the insurance exchanges, to help these individuals buy health insurance.

More significantly, if the 80 percent of our clients who today say they expect to remain engaged begin to see that they do not have to offer health insurance to attract and retain the talent they want—because their competitor or neighbor is not offering coverage—we are certain to see an even more substantial migration of employers out of the group insurance market.

## Lockton's Client Survey and Actuarial Modeling Results

In early 2009 Lockton formed a Health Reform Advisory Practice (HRAP) to shepherd our clients through the challenges posed by healthcare reform. HRAP is a multi-disciplinary consulting team comprised of attorneys, actuaries, data analysts, physicians, health risk managers, technology experts, compensation consultants, and others, all experts in one or more aspects of the federal healthcare reform legislation, the Patient Protection and Affordable Care Act (PPACA).

Our HRAP team has been instrumental in educating our account teams and clients regarding the requirements of the PPACA and assessing the law's impact on our clients' employee benefit programs and budgets. In this regard we are uniquely positioned to

describe to you the PPACA's effect on employer-based health insurance plans, particularly in the middle market, and to relay to you the views about the PPACA as expressed to us by our clients.

Very soon after the law's passage in 2010 Lockton's attorneys, actuaries and select senior account managers developed a robust healthcare reform modeling tool that enables our account service teams and clients to model the cost implications of health reform with respect to their healthcare plans. Our account teams have performed hundreds of modeling analyses for our clients, and recently began aggregating those modeling results. We break out the aggregated results by industry (e.g., healthcare, transportation, government, restaurant/retail, etc.).

In addition, in May of this year Lockton conducted a survey of its 2,500 employee benefits clients, regarding the impact upon them of the PPACA. A remarkable 40 percent of our clients responded to the survey. We would like to share the aggregated modeling results, and the results of our survey, with the Subcommittee.

## *PPACA's Effect on Middle-Market Employers*

Our clients have expressed significant concerns about the additional cost the PPACA triggers for their healthcare plans, both with respect to several new (and immediately effective) benefit mandates, and with respect to the "play or pay" mandate upon employers in 2014. They are even more frustrated by the additional administrative complexity the PPACA places on their backs, and are concerned that the additional costs and headaches will limit corporate growth and in some cases cause a loss of full-time employment, or an outright reduction in jobs.

According to the survey, 63 percent of our respondents said they were concerned or very concerned about the cost implications of the PPACA's immediate benefit mandates, 71 percent said they were concerned or very concerned about the cost implication of "play or pay," and 60 percent about the cost implications of automatic enrollment. Their narrative comments underscore the survey responses:

- "This [the PPACA] will inevitably lead to three things: 1) Companies will offshore or near-shore more work. 2) Less companies will offer healthcare (they will just pay the fine instead). 3) Less full time employment will be offered (more part time)."
- "It is a job killer."
- "We operate our business on paper-thin margins and any additional government mandated costs will force us to either close the business or reduce the hours of our full-time employees."
- "The cost to smaller and independent employers will be substantial. It will likely cause a substantially number of employers to cease operation."

Immediate Benefit Mandates

Our actuarial modeling results justify our clients' concerns. The health reform law's immediate benefit mandates (coverage of adult children to age 26, elimination of lifetime dollar maximums, restrictions and ultimate elimination of annual dollar limits, etc.) on average add 2.5 percent to our clients' health insurance costs (on top of current health insurance inflation).

Firms that prior to the PPACA supplied benefits substantially more modest than the new mandates (e.g., firms that offered coverage to dependent children to age 22 and/or imposed $1 million or smaller lifetime maximums) see the largest percentage increases (3.7 percent).

The PPACA's prohibition on waiting periods longer than 90 days, and the requirement for larger firms to automatically enroll full-time employees, trigger additional costs increases.[1]

Our survey respondents' narrative comments again reflect their concerns:

- "Bad for business. The plan will hurt employees in the long run by forcing employers to cancel coverage due to cost increases."
- "What they are planning is only going to penalize the employers and the employees who actually are hard workers and who are trying to make a living for themselves and not relying on the government to take care of them."
- "I do not believe that they [Congress] considered the cost of this plan [the PPACA] to the employer in the short term. I think their only consideration was to the employees that do NOT currently have health coverage. Our rates went up an additional 7 - 9 percent in 2011 because of health reform."
- "This plan [PPACA] doesn't fix the healthcare problems but shifts the burden to employers to take care of the issue without any type of assistance on covering the increase in costs."

[1] A minority of our clients employ health insurance waiting periods longer than 90 days, but for those that do (on account of high turnover rates) the results are distressing. For example, a construction firm client with a six-month waiting period experiences an additional 3.9 percent cost increase, while another—with a 12-month waiting period—experiences an additional 39.3 percent cost increase. Our transportation firm clients with four-month waiting periods experience an additional 6.4 percent increase.

The PPACA's mandate on larger employers to automatically enroll full-time employees in coverage adds additional costs. On average, it stacks an additional 3.8 percent cost increase atop the increases described above, with our transportation industry clients seeing the largest additional average increase (10 percent). For one client, a large hospital, our actuaries expect the automatic enrollment feature to add more than $1 million annually to the client's health insurance cost.

Note that in assessing the automatic enrollment mandate, we assumed that 75 percent of employees who are eligible for coverage but have not affirmatively enrolled, and who are automatically enrolled by the employer, will opt out of coverage. Note also that these modeling results do not reflect the impact of the automatic enrollment feature on our retail, restaurant, hotel and entertainment industry clients. The modeling results for these clients are described separately because of the unique challenges the PPACA poses to these clients.

- So far, reform has done nothing to reduce costs to employers (and in turn employees). In fact, it has made it significantly more expensive."
- "In an effort to make healthcare more affordable for every American citizen, they [Congress] are actually driving up the costs."
- "Congress needs to be concerned with the REALITY of how businesses are going to be able to pay for all these healthcare decisions. How are HCR [healthcare reform] added costs going to be absorbed by businesses and how many businesses will not be able to?"

"Play or Pay" Mandate

The employer "play or pay" mandate (also known as the employer's "shared responsibility" requirement) poses significant issues for employers. Because the majority of our clients currently spend $8,000 to $12,000 (sometimes more) per employee per year on health insurance, and the PPACA's penalty for offering no insurance is $2,000 (nondeductible) per full-time employee per year, the majority of our clients have a significant financial incentive to exit the group insurance market in 2014 when the insurance exchanges give employees other, federally-subsidized options.

On average, our clients would save 44 percent off their current healthcare budget by terminating their group plans.[2] Where health plans tend to provide more generous coverage, savings are larger (84 percent for our governmental clients, 60 percent for our hospital clients). As a result, 16 percent of our survey respondents said the availability of the insurance exchanges is the most beneficial aspect of the PPACA, because it gives employers the opportunity to exit the group insurance market. Almost 19 percent of our survey respondents said they would consider doing just that in 2014.[3]

The "play or pay" mandate requires employers to offer qualifying and affordable coverage to all its full-time employees and their dependents, or risk penalties of $2,000 or $3,000 per year, per affected full-time employee. Coverage is "affordable" only if it does not require the employee to pay more than 9.5% of his or her household income for it. The PPACA is not entirely clear whether this affordability standard applies to employee-only coverage or to family coverage as well.[4]

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[2] Our restaurant/retail/hospitality/entertainment clients are considered separately because of the unique challenges the PPACA poses to them.

[3] Almost a fourth of our survey respondents (23%) said the aspect of reform they like best is the insurance exchanges because they give the employer an easier exit from providing pre-65 retiree coverage. Because relatively few of our clients offer retiree health coverage, this 23% of respondents represents the vast majority of those who do, portending a mass exodus of employers from the retiree health insurance market in 2014.

[4] The Joint Committee of Taxation's report on the healthcare reform law indicates the affordability standard applies to employee-only coverage, and our modeling tool assumes that this will be the case. However, we have read that the Administration may be contemplating a regulatory interpretation (of the PPACA's play or pay mandate provisions) that would require employers to make *dependent* coverage "affordable" if elected by the employee. Such a requirement would have a dramatic cost impact on a great many of our clients, as most of our clients currently subsidize a much smaller portion of dependent coverage than they do for employee-only coverage.

Under the PPACA, a "full-time employee" is one who averages at least 30 hours per week. Most of our clients currently require employees to work at least 35 or 36 hours per week to qualify for coverage. As a result of the "affordability" requirement and the requirement to provide an offer of coverage to employees working at least 30 hours per week, many clients expect significant cost increases in 2014. Again, the survey results bear this out.

A full 17 percent of our survey respondents said they would work to avoid "play or pay" penalties by substituting more part-time employees for full-time workers. 44 percent said they will reduce the employer's subsidy toward employee coverage (requiring the employee to pay more) and 43 percent said they will reduce the employer's subsidy toward *dependent* coverage.

*Restaurant/Retail/Hospitality/Entertainment Employers*

The modeling results for our clients in the restaurant, retail, hospitality and entertainment (e.g., amusement park) industries are more sobering. Most of these clients do not offer group health coverage to all their full-time employees because they cannot afford to do so. A restaurant chain, for example, will typically offer coverage to its corporate staff and restaurant managers. An amusement park will typically offer coverage to its year-round staff, but not to its extended seasonal workforce.

These employers are caught in a "damned if we do, damned if we don't" bind. On average, to comply with the "play or pay" mandate and offer qualifying and affordable coverage to *all* full-time employees, the employer's health insurance costs increase 150 percent, an increase they simply cannot absorb.

Maintaining the status quo—offering coverage to some employees, such as corporate staff, but not rank-and-file employees—can trigger excise tax penalties under the health reform law's nondiscrimination rule,[5] and in any event would trigger penalties under the employer "play or pay" mandate.

Ironically, if the employer simply terminates its group plan it still pays 56.6 percent more than it would pay to continue its plan. Although the employer saves a portion of its health insurance expense (it loses the tax deduction on those dollars, and the FICA/FUTA savings on employee pre-tax contributions), it pays a $2,000 per year, nondeductible penalty on *each* of its full-time employees, even those employees on whose behalf the employer is not otherwise now incurring a health plan expense.

[5] It is possible, depending on how federal regulators flesh out the requirements of the nondiscrimination rule, that these employers will simply have to terminate their existing group coverage. However, the nondiscrimination rule has yet to be interpreted by the regulatory agencies and we intend to continue to urge that as they do so, regulators develop guidance that will minimize disruption to current coverage and provide employers the flexibility they need to provide health benefits to the wide range of employees' needs and circumstances.

These clients, and clients like them who employ a large number of full-time, relatively low paid hourly workers who are not receiving an offer of robust health coverage today, tell us they have but one option: ***eliminate large numbers of full-time positions.*** By making full-time employees part-time, the employees are removed from the penalty equation.

For some employers, particularly seasonal employers, recent indications from the IRS are encouraging. The Service suggested in May of this year that it may consider allowing employers to average an employee's hours over a "measurement period" of up to 12 months, to determine if the employee qualifies as "full-time." If this methodology is adopted in regulations, it will ease the potential financial implications for seasonal employers.

It appears to do little, however, to ease the financial implications for non-seasonal employers unless they have extremely high turnover rates. For example, our actuaries performed a case study illustrating that with an annual turnover rate of 75 percent and a 12-month look-back "measurement period," an employer with 200 salaried and 800 hourly employees would still suffer more than a 20 percent cost increase (over its current health insurance budget) by terminating group coverage and paying penalties. This is better than the 56 percent increase it would suffer otherwise, but significant nevertheless.

Our survey respondents' comments again reflect their frustration with legislation that they see as compromising their ability to remain profitable in already challenging economic times, much less to expand:

- "We operate our business on paper-thin margins and any additional government mandated costs will force us to either close the business or reduce the hours of our full-time employees."
- "The cost to smaller and independent employers will be substantial. It will likely cause a substantially number of employers to cease operation."
- "Having to provide insurance benefits in our retail operations where high turnover is simply the nature of that business, and will place a significant cost burden on those operations as well."
- "Healthcare reform as written will cripple my industry (restaurant). It is impossible to fund coverage for restaurant workers earning $2.13 in hourly [non-tip] wages. It also will stunt further growth -- franchisees already have indicated that they will not build additional restaurants because they cannot afford to pay [health] insurance. This will result in fewer jobs, which will not help improve our economy."

<u>Administrative Complexity and Burdens</u>

Our survey respondents achieved the greatest consensus in their disdain for the PPACA's additional administrative burdens. Additional, PPACA-imposed administrative

duties on plan sponsors include a variety of new notices to employees, additional plan summaries, and new reports to federal authorities, including W-2 reporting of health plan values and detailed reporting to the insurance exchanges. A full 80 percent of our survey respondents said they were concerned or very concerned with the additional administrative burdens.

Their narrative summaries underscore their angst:

- "The reporting requirements are extremely cumbersome and will add administrative burden and cost to our operations."
- "It [the PPACA] has created an excessive amount of additional administrative work; and increased costs are going to make it increasingly difficult for us to provide the same level of benefits -- we will be forced to reduce benefits and/or increase the proportion of cost to the employee."
- "The overhead for a small school district with no HR department is overwhelming. It will eventually drive us to a point where we will consider eliminating healthcare coverage for our employees and let them use the exchanges."

## Conclusion

Lockton greatly appreciates the opportunity to appear before you today. In assessing the impact of the health reform legislation, we urge you to place yourselves not only in the shoes of those Americans who need access to affordable insurance, but in the shoes of the employers who supply valued coverage to 160 million of us.

Employers are burdened and frustrated by aspects of the health reform law that add costs and complexity to their health plans, and may lead some of them to eliminate group coverage and full-time jobs. They are bewildered at the cost and other burdens thrust upon them in the midst of an economic recession. The view of many of our clients is summarized by the narrative comment that one of them included in its survey response:

> "The Congress and health reform have created an environment of uncertainty, confusion, inability to forecast cost of medical programs, fear among employees that their employer will cut benefits, and confirmed that Congressional leaders have no sense of what the American people want in healthcare."

Again, we thank the Committee, and welcome the opportunity to work with you to mitigate these burdens on the employer community.