EMPLOYERS WARY OF HEALTH REFORM COSTS AND HASSLES: AN ACTUARIAL ANALYSIS FROM LOCKTON

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PREPARED BY LOCKTON COMPANIES, LLC

EMPLOYERS WARY OF HEALTH REFORM COSTS AND HASSLES, LOCKTON DATA SHOWS

Insurance Broker Conducts Actuarial Analysis

(Kansas City, MO) 10 March 2011 – Actuarial modeling of more than 130 employee benefit plans by employee benefits consultant Lockton shows that last year's health reform law imposes additional costs on employers' health plans. The study also shows that the law will create a financial incentive for some employers to terminate health benefit plans in 2014 when new Insurance Exchanges take effect.

Lockton actuaries have modeled the impact of health reform for hundreds of its clients and aggregated results from 136 of those analyses into a report that examines the impact of the health reform law on middle-market health plan sponsors. The report includes a variety of industry segments, including construction, government, healthcare, manufacturing, professional services, transportation, and retail and entertainment. Summary charts of the research begin on page 5 of this report.

The modeling project assesses the additional costs for employers and employees in their current health plans due to changes imposed this year by the health reform law. It also evaluates the financial implications of options employers will have in 2014 when they are required to offer health coverage to full-time employees or risk penalties.

"Employers are burdened and frustrated by aspects of the health reform law that add costs to their health plans," said Mike Brewer, President of Lockton Benefit Group. "Some employers will eliminate group health coverage and full-time jobs in 2014 because of the law."

Brewer said, "Our clients understand that health reform is needed. They just wish that it was making their plans less expensive, not more expensive."

Key Finding—"Play or Pay" Mandate Creates Incentives to Terminate Coverage

The modeling examined the implications of choices the sponsor of a group health plan will face in 2014 under the health reform law's "Play or Pay" mandate.

Across all industry segments in Lockton's group of clients,[1] companies will have a significant financial incentive to terminate their group coverage once the Insurance Exchanges present employees with another subsidized health insurance option. The vast majority of our clients currently spend far more on health insurance per employee than the nondeductible penalty under the "Play or Pay" mandate. By 2014 this gap will be much larger still, the data shows.

As a result, were they to terminate their group coverage in 2014, companies would, on average, save **44 percent** of their projected 2014 health insurance costs. For clients whose health plans tend to be

[1] Except retail, hospitality, and entertainment employers, whose modeling results are addressed separately.

more expensive, savings are larger (84 percent for governmental clients, 60 percent for hospital clients in the study).

We also modeled the impact of plan termination on clients' *employees,* were they compelled to seek coverage in an Insurance Exchange. On average, our clients' employees can expect to pay between 101 percent and 155 percent more for Exchange-based coverage[2] equivalent to their employer's health plan (101 percent assuming the employee is the sole wage earner in the household, 155 percent assuming there is household income in addition to the employee's salary, thus reducing the size of the subsidy the employee receives in the Exchange).

This is because companies in the Lockton study typically subsidize a larger portion of employees' health insurance costs than the Exchanges will subsidize, and employees pay their portion of employer-based coverage with pre-tax dollars. Their portion of Exchange-based coverage will be paid with after-tax dollars.

The more highly paid the employer's workforce, the more significant the expense borne by the employee in the Insurance Exchange. For example, employees of the studied professional service firms can expect to pay 113-148 percent more than they would pay for equivalent employer-based coverage.

The modeling results for Lockton clients in the restaurant, retail, hotel, 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. Maintaining the status quo will trigger penalties.

Ironically, if the retail, hotel, or entertainment employer simply terminates its group plan it still pays 56.6 percent more than it would pay to continue its plan. These companies that employ a large number of full-time, relatively low-paid hourly workers who do not have 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.

By 2014, when the Insurance Exchanges open and present employees another, largely subsidized option for health insurance coverage, the burden of group health insurance costs on an employer's balance sheet will create tremendous tension within many clients between cost, profitability, and appropriate compensation and benefit structures.

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2 Estimates of Exchange coverage costs based on Kaiser Family Foundation data.

Additional Findings

The Lockton actuarial modeling study shows additional impacts.

- Immediate Benefit Mandates (in effect now)
  - Requirement to cover adult children to age 26, the elimination of lifetime dollar maximums, restrictions and ultimate elimination of annual dollar limits add 2.5 percent to our clients' health insurance costs.
- Waiting Periods Limited to 90 Days (2014)
  - This mandate has little cost implication for most of our clients because most do not currently maintain waiting periods in excess of 90 days. However, for those who do, the consequences can be more dramatic. For example, a construction firm client with a six-month waiting period experiences a 3.9 percent cost increase, while another construction firm with a 12-month waiting period sees a 39.3 percent cost increase.
- Automatic Enrollment Required (2014)
  - Automatic enrollment adds 3.8 percent to our clients' health insurance costs on average, assuming 25 percent of employees currently waiving coverage remain on the plan after auto enrollment.

So far, few clients have told us they definitely intend to terminate group coverage in 2014, when Exchange-based coverage becomes available. Similarly, few clients have told us they definitely intend to *maintain* their group coverage. The majority of our clients tell us they will wait and see.

"What they will do in 2014 depends on their health insurance costs and budget in 2014, and their perceived need to use a health plan to gain a competitive advantage for labor," said Brewer.

Lockton's actuaries are working to expand the existing study by incorporating additional modeling results into the analysis.

HEALTH REFORM ADVISORY PRACTICE

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Health Care Reform Model Compiled Data

February 2011

providing clear direction

Health Reform's Cost Impact – All Industries (except Retail, Restaurant, Hotels, Hospitality and Entertainment)

Reform Requirement	Description	Average Cost Adjustment	
2010/2011			
2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	2.5%	
2014			
Waiting Period (WP)	Waiting Period cannot be greater than 90 days	From current 180 day WP	3.9%
		From current 365 day WP	19.9%
Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	3.8%**	
Play or Pay		Plan	Employee
Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
Pay	Employer terminates plan	-44%	101% - 155% #
2018			
Excise Tax	If plan value exceeds limits, excess will be taxed.	1.9%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 136 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

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HEALTH REFORM ADVISORY PRACTICE

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Health Reform's Cost Impact – Construction Industry

Reform Requirement	Description	Average Cost Adjustment	
2010/2011			
2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	2.9%	
2014			
Waiting Period (WP)	Waiting Period cannot be greater than 90 days	From current 180 day WP	3.9%
		From current 365 day WP	39.3%
Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	3.2%**	
Play or Pay		**Plan**	**Employee**
Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
Pay	Employer terminates plan	-46%	129%- 164%#
2018			
Excise Tax	If plan value exceeds limits, excess will be taxed.	0.4%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low paid workforce where the ER did not highly subsidize coverage, the Ees' increase was 8% based on salary/80% based on est. household income. For a higher paid workforce with a high ER contribution, the impact to the Ee was 566% based on salary/877% based on household income.

Based on analysis of 12 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

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HEALTH REFORM ADVISORY PRACTICE

Health Reform's Cost Impact – Government Employers

Reform Requirement	Description	Average Cost Adjustment	
2010/2011			
2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	0.5%	
2014			
Waiting Period (WP)	Waiting Period cannot be greater than 90 days	0%	
Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	1.4%**	
Play or Pay		**Plan**	**Employee**
Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
Pay	Employer terminates plan	-84%	108%- 223%#
2018			
Excise Tax	If plan value exceeds limits, excess will be taxed.	4.3%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 3 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

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HEALTH REFORM ADVISORY PRACTICE

Health Reform's Cost Impact – Hospital Industry

	Reform Requirement	Description	Average Cost Adjustment	
2010/2011				
	2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	2.5%	
2014				
	Waiting Period (WP)	Waiting Period cannot be greater than 90 days	0%	
	Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	4.6%**	
Play or Pay			**Plan**	**Employee**
Play or Pay	Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
Play or Pay	Pay	Employer terminates plan	-60%	67%-159%#
2018				
	Excise Tax	If plan value exceeds limits, excess will be taxed.	2.5%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 16 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

Health Reform's Cost Impact – Manufacturing Industry

	Reform Requirement	Description	Average Cost Adjustment	
2010/2011				
	2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	3.3%	
2014				
	Waiting Period (WP)	Waiting Period cannot be greater than 90 days	From current 120 day WP	1.2%
	Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	2.7%**	
Play or Pay			**Plan**	**Employee**
Play or Pay	Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
Play or Pay	Pay	Employer terminates plan	-43%	91%- 153%#
2018				
	Excise Tax	If plan value exceeds limits, excess will be taxed.	1.0%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 31 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

Health Reform's Cost Impact – Professional Firms

Reform Requirement		Description	Average Cost Adjustment	
2010/2011				
2010/2011 Mandated Benefits		• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	1.9%	
2014				
Waiting Period (WP)		Waiting Period cannot be greater than 90 days	From current 180 day WP	4.0%
			From current 365 day WP	0.5%
Auto Enroll *		Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	3.9%**	
Play or Pay			Plan	Employee
	Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
	Pay	Employer terminates plan	-41%	113%- 148%#
2018				
Excise Tax		If plan value exceeds limits, excess will be taxed.	2.9%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 68 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

Health Reform's Cost Impact – Transportation Industry

Reform Requirement		Description	Average Cost Adjustment	
2010/2011				
2010/2011 Mandated Benefits		• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	3.7%	
2014				
Waiting Period (WP)		Waiting Period cannot be greater than 90 days	From current 120 day WP	6.4%
Auto Enroll *		Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	10.0%**	
Play or Pay			Plan	Employee
	Play	Employer continues to offer coverage	~0% other than the cost impacts listed above.	
	Pay	Employer terminates plan	-33%	53%- 84%#
2018				
Excise Tax		If plan value exceeds limits, excess will be taxed.	0.0%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 2 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

Health Reform's Cost Impact – Retail, Restaurant, Hotels, Entertainment Industries

	Reform Requirement	Description	Average Cost Adjustment			
	2010/2011					
	2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	2.4%			
	2014					
	Waiting Period (WP)	Waiting Period cannot be greater than 90 days	From current 180 day Waiting Period		N/A	
			From current 365 day Waiting Period		N/A	
	Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	Groups **not** offering qualifying coverage to all 30+ Hour FTEs		Groups offering qualifying coverage to all 30+ Hour FTEs	
			16.6%**		5.7%**	
Play or Pay			**Plan**	**Employee**	**Plan**	**Employee**
	Play	Employer continues to offer coverage	150%		14.3%	
	Pay	Employer terminates plan	56.6%	-4.6-9.5%#	-27.1%	6%-51%#
	2018					
	Excise Tax	If plan value exceeds limits, excess will be taxed.		3.4%		

Note: Assumes Limited Medical Plans get waiver of annual dollar maximum requirement.

The impact to the EE varied significantly based on salary levels.

For example, one client's salaried employees would see a 73% increase to purchase through the Exchange where the hourly employees would see a 40% decrease because of the governmental subsidies.

Based on analysis of 16 clients; Summary of Findings - February 2011 .
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date. ** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

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Health Reform's Cost Impact – Other Industries

	Reform Requirement	Description	Average Cost Adjustment	
	2010/2011			
	2010/2011 Mandated Benefits	• Remove pre-ex cond'n restriction to 19 • Remove lifetime dollar maximums on EHB's • Minimum annual dollar maximums on EHB's • Cover children to age 26	2.8%	
	2014			
	Waiting Period (WP)	Waiting Period cannot be greater than 90 days	0%	
	Auto Enroll *	Plans must automatically enroll newly eligible FT EEs and re-enroll existing EEs	2.2%**	
Play or Pay			**Plan**	**Employee**
	Play	Employer continues to offer coverage	~0% other than the cost impacts listed above	
	Pay	Employer terminates plan	-41%	255%- 417%#
	2018			
	Excise Tax	If plan value exceeds limits, excess will be taxed.	0.5%	

The impact to the EE varied based on salary levels and the ER's contribution.

For example, for a low-paid workforce where the ER does not contribute a significant portion of premium, the Ees' increase is much smaller than a higher-paid workforce with a substantial ER contribution.

Based on analysis of 4 clients; Summary of Findings – February 2011
* Statute did not clearly indicate effective date; regulators leaning toward 2014 effective date.
** Employees can opt out, so the impact will depend on how many new employees remain on the plan, for how long, and the size of the ER's subsidy.
# First number based on employee's salary; second based on estimate of the EE's household income, on which Exchange subsidies will be based.

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