Fine-Tuning the Impact of "Play or Pay" Strategies: Evaluating Compensation Adjustments

One of the options available to employers under the Affordable Care Act is to drop health care coverage, pay a penalty and provide some form of additional compensation to employees. This article describes a process for evaluating this option, including considerations for establishing the amount of compensation to be provided, if any. It identifies a number of complexities and provides hypothetical examples of how employers might apply this option to employees with different salaries, ages and family statuses.

by **Elliot N. Dinkin** | *Cowden Associates, Inc.*

Since the passage of the Affordable Care Act (ACA) in March 2010, companies have been trying to gauge the impact the new law will have. Part of that process has been trying to navigate strategies. One option is to drop health care coverage, pay a penalty and provide some form of additional compensation to employees.

This article describes a process for evaluating this option, including considerations for establishing the amount of compensation to be provided, if any. Setting the amount of additional compensation is a trying exercise given the disparities in public exchange rates that are tied to location and age. To evaluate the merits of this option, a company must establish a reasonable framework given a variety of factors including:

- Human resources and business strategies must be thoroughly reviewed as part of any analysis. This is one option out of many and should be considered along with other options and how this will impact co-pays and the ability to attract, retain and motivate.
- Will this additional compensation be classified simply as additional pay or tracked separately outside salary ranges?
- Evidence/case studies are not yet plentiful to provide meaningful insights of companies that have, in fact, used this approach. However, we would expect many issues, including unintended positive and negative consequences. What is certain is that massive employee communications and education will have to take place.

TABLE I

2015 Scenario: Cancel Health Insurance, Pay Penalty and Provide $500 Monthly Compensation Payment for Each Eligible Employee

Description	2015 Status Quo	2015 Exit Medical: Payment of $500 per Eligible Employee per Month
Estimated 2015 eligible employees	369	369
Annual Employer Costs:		
Employee contributions (25% of gross premiums)	($1,014,750)	
Company costs—net (excise penalty)	$3,044,250	$578,000
Company stipend payment	$0	$2,214,000
Total company costs	$3,044,250	$2,792,000
Monthly Employee Costs:		
Required premiums—employee only	$170	($670)
(Amount in "2015 Exit Medical" is the difference between the 2015 required premiums ($170) and stipends received ($500)		
Net-after-tax funds available (assumes 30% tax effect)		($469)
Monthly premium for silver plan (see Table A in appendix)		
Aged 24		$216
Aged 29		$242
Aged 40		$276
Aged 50		$386
Required Premiums—Other Than Single:	$350	($850)
(Amount in "2015 Exit Medical" is the difference between the 2015 required premiums ($350) and stipends received ($500)		
Net-after-tax funds available (assumes 30% tax effect)		($595)
Monthly premium for silver plan (see Table A in appendix)		
Aged 24		$432
Aged 29		$469
Aged 40		$546
Aged 50		$740

- This compensation adjustment will have to be reviewed annually to determine potential adjustments or consider alternate approaches.

Scenario: Eliminate Group Health and Make Employees Whole

Under this scenario, for employers choosing to eliminate group health care, "making employees whole" likely will entail providing additional compensation to cover an estimated cost for employees to purchase coverage through a public exchange. An employer wants to evaluate this option in order to consider the potential net employer cost (reduction in health care costs, increase in employer penalty and payment of additional compensation) and the potential net employee cost (reduction in premium contributions, cost of public exchange and net cost differentials for deductibles, coinsurance, copayments and a potential tax subsidy).

Considerations for determining the "make-whole" amount are:

- **Choosing an exchange metal level:** For purposes of evaluating an employee's gross cost for purchasing coverage and then setting a compensation payment, a

TABLE I Continued

2015 Scenario: Cancel Health Insurance, Pay Penalty and Provide $500 Monthly Compensation Payment for Each Eligible Employee

Impact of change: Employer perspective

- Savings of expense/cash (pretax) of $252,250
- Payments for medical/Rx and payments for stipend are deductible for federal income tax purposes.
  —Loss of health care deduction (for-profit organizations)
  —Gain of additional deduction for increased payroll costs
- Excise penalty of $578,000 is nondeductible.
- Payments of stipends are included in the payroll tax basis, which increases employer costs by 7.65% for each subsidy paid to those employees under the applicable payroll tax base and 1.45% for each subsidy paid to those employees above the applicable payroll tax base.
- Handling employee issues for those who are married (especially those over the age of 40) with children as combination of stipend and elimination of required premium contributions will not be sufficient to cover premium costs for employee and spouse (without regard to dependent coverage).

Impact of change: Employee perspective

- Payments for medical/Rx are not included as income for federal income tax purposes while payments for stipends are included as income for federal income tax purposes.
- Payments of stipends are included in the payroll tax basis, which increases employee costs by 7.65% for each subsidy received by employees under the applicable payroll tax base and 1.45% for each subsidy received by employees above the applicable payroll tax base.
- Paying 100% of dependent coverage after the change compared with company-provided assistance
- Greater flexibility in choosing plans than status quo
- Receipt of stipend will increase income, thereby decreasing or potentially eliminating the amount of government subsidy otherwise available to offset cost of coverage.
- From a gross premium perspective, single employees are better off (generally) enrolling in the silver plan or a lower metal option compared with the current company plan (in this illustration) and will have funds available to be used for other health care out-of-pocket expenses, if applicable.

company may want to consider a target plan level under a public exchange. This provides a rationale for a starting point.

—For example, a company may want to choose a silver-level plan as this is the metal level used by the federal government to target the value of a subsidy.[1] (See tables in the appendix.)

- **Choosing a region:** Companies may operate in multiple locations. Exchange rates will differ based on the demographics of each employee. The company could consider various states where it operates and tie the level of potential compensation payment to that state or county location. This may also increase the complexity. A "cost-of-living" factor could be applied to a base rate to reflect geographic differences in rates.
- **Choosing a target age level:** For purposes of setting a compensation payment, once a target level of exchange coverage is chosen, the next issue is the age of the individual. The exchange pricing established is tied to age bands. Companies may want to set reimbursement levels tied to age, even though this would create complexities. Setting compensation levels tied to age, where older employees receive a higher amount than younger employees, may create other compensation issues if employers attempt to "correct" this situation in making other compensation adjustments. Setting an average reimbursement rate would result in "overpaying" some groups and "underpaying" others. A point system tied to age and service may be the best option, as it recognizes service and age and would be perceived by employees as a fair method.
- **Should the target compensation payment reflect a**

TABLE II

Typical Scenario of What Plan Designs Look Like on an Exchange

PPO	Company	Bronze	Silver	Gold
Deductibles (per year):				
Medical deductible (family total)	$4,000	$12,000	$5,500	$1,400
Medical deductible (per individual)	$2,000	$6,000	$2,750	$700
Prescription drug deductible (family total)	$0	$0	Included with medical	$0
Prescription drug deductible (per individual)	$0	$0	Included with medical	$0
Out-of-pocket maximum (per year):				
Out-of-pocket maximum (family total)	$6,000	$12,700	$12,700	$11,000
Out-of-pocket maximum (per individual)	$3,000	$6,350	$6,350	$5,500
Health care out-of-pocket maximum (family total)	$6,000	$12,700	$12,700	$11,000
Health care out-of-pocket maximum (per individual)	$3,000	$6,350	$6,350	$5,500
Prescription drug out-of-pocket maximum (family total)	Included with medical	Included with medical	Included with medical	Included with medical
Prescription drug out-of-pocket maximum (per individual)	Included with medical	Included with medical	Included with medical	Included with medical
Copayments/Coinsurance:				
Primary doctor	$25 copay	$35 copay and 30% coinsurance after deductible	$30 copay	100% covered
Specialist doctor	$25 copay	$35 copay and 30% coinsurance after deductible	$60 copay	$50 copay
In-patient doctor	100% covered	30% coinsurance after deductible	20% coinsurance after deductible	20% coinsurance after deductible
In-patient facility	100% covered	30% coinsurance after deductible	20% coinsurance after deductible	20% coinsurance after deductible
Emergency room	$75 copay	30% coinsurance after deductible	20% coinsurance after deductible	$500 copay
Generic prescription	$15 copay	$25 copay	$4 copay	$5 copay
Preferred brand prescription	$25 copay	$60 copay	$45 copay	$35 copay
Non-preferred brand prescription	$40 copay	$120 copay	50% coinsurance after deductible	$75 copay
Specialty prescription	20% coinsurance	50% coinsurance	40% coinsurance after deductible	20% coinsurance

tax subsidy? The net incremental cost for an individual who buys coverage on a public exchange reflects the value of a federal tax subsidy that is tied to earnings. Attempting to calculate this amount will be difficult, at best, and not practical.

- **Single vs. nonsingle status:** Is it practical and permissible to vary the amount of additional compensation based on marital status and/or number of family members?
  —From a simplistic standpoint, it would not be prudent to provide varying amounts tied to marital status. There may be a variety of employee relations issues involved in establishing reimbursement rates tied to marital status.
  —Establishing a set reimbursement rate with a "kicker" amount for additional dependents could be an option. Under this scenario, the monthly payment could be $500 (for example) for a single person, with an increase of up to an additional $50 for each family member up to a cap.
  —A public exchange may not cover dependents and may steer families to the Children's Health Insurance Program (CHIP). Trying to determine dependent costs for exchange coverage should therefore result in avoiding consideration of dependents.
  —A company's philosophy on this approach is similar to establishing a cost-sharing arrangement that companies use today in establishing cost sharing for health coverage.
- **Should the target compensation payment include a "tax gross-up" amount?** The cost of employer-provided health care is tax-free to individuals. A compensation payment will be taxable for all federal, state and local income and payroll tax purposes. As such, for purposes of setting a target compensation payment, should the payment include a tax gross-up amount (which is also taxable) so the net-after-tax amount is at the target level?
  —An individual's federal income tax level varies based on total income and marital status. Establishing a fair and reasonable gross-up amount will be a challenge. In addition, different state and local tax rules will complicate this issue.
  —Payroll taxes will also vary based on income.
- **Compliance with Department of Labor and other regulatory requirements:** If an hourly employee receives a monthly compensation payment, how will this be treated for purposes of overtime pay and other related issues? Like any other similar arrangement (e.g., profit sharing), care in design must be considered to avoid any unintended consequences. If it is desirable to track this payment separately from other compensation, it should not be treated or classified in any way as a reimbursement plan or other company-provided health benefit plan. Target compensation will be treated as compensation for all other benefit plans (wages for 401(k) purposes, life insurance, etc.) unless specifically carved out of those definitions. If a company does not want these amounts treated as earnings for benefit plan purposes, it may have to complete various testing to determine if this is permissible.
- **Estimates for future-year increases in exchange rates:** A new set of rating rules, a competitive environment and ambiguity around enrollee populations have created tremendous uncertainty about establishing rates. Although three programs were established as part of ACA (risk adjustment, risk corridors and reinsurance) to address some of the uncertainty, two of the programs will expire after 2016. As such, the end of the risk corridors and reinsurance programs, coupled with growing health care utilization and higher costs due to the increasing annual nondeductible fee on health plans, could make significant premium increases the norm for the future. Absent any type of crystal ball, companies should understand that the public exchanges will certainly impact their approach on setting future compensation increases. Conservatively, estimating an annual increase in public exchange rates at less than 10% would not be prudent.

What It All Means

To emerge strong and retain their best people, employers need a total compensation approach designed to attract, retain and motivate employees. To accomplish this goal, employers need to understand not only their current workforce, but how the workforce and the needs of individuals and households will change because of technology and demographics.

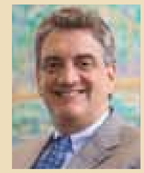
In conjunction with new legislation, employers have a unique opportunity to take a fresh, strategically based total compensation approach to planning. Consider a framework that accomplishes objectives including: (1) cost containment related to compensation and benefit programs including health and retirement, (2) flexibility to meet diverse employee needs, (3) minimal additional administration and compliance and (4) creation of a competitive-advantage total compensation program that aids in retention and attraction.

Table I illustrates one such scenario—canceling health insurance, paying the penalty and providing a $500 compensation payment for each eligible employee—and its impact on the employer and employees. The table shows hypothetical exchange rates and plan comparisons, including comparisons of current plan design with various exchange plans. Data for the plan shown in Table I comes from Table A-I in the appendix. The appendix includes additional tables showing monthly employee costs for various ages, levels of income and single or family coverage. Table II illustrates what a typical plan design for differing metals would look like on an exchange.

Endnote

1. Subsidies reflected in this article are based on certain facts, and the amount of subsidy that a person is eligible for may be very different than the amounts indicated. This is why the author suggests using a gross "metal cost" vs. an after-subsidy approach. If an employee gets a subsidy, it will then help him or her—keeping in mind that this additional compensation will have to be counted as income for purposes of evaluating the subsidy.

AUTHOR



Elliot N. Dinkin is the president and CEO of Cowden Associates, Inc., consultants and actuaries in Pittsburgh, Pennsylvania. He founded and previously served as president of Elliot Dinkin and Associates. Dinkin has worked in the actuarial, compensation and employee benefits fields for more than 25 years. He earned a B.A. degree in economics from Dickinson College and an M.B.A. degree in finance and accounting from the University of Pittsburgh.

TABLE A-I

Full-Time Employee
Single Coverage—Non-Tobacco User
Annual Salary: $33,000
Age: Adult, 24

	2015 premiums per employee*				
	Company plan	**Bronze PPO**	**Silver PPO**	**Gold PPO**	**Platinum PPO**
Total monthly employee cost**	$135	$182	$216	$262	$312
Total annual employee cost**	$1,616	$2,184	$2,592	$3,144	$3,744
Less premium tax credit*	N/A	$0	$0	$0	$0
Net employee cost—annual	$1,616	$2,184	$2,592	$3,144	$3,744
Net employee cost—monthly	$135	$182	$216	$262	$312
Net difference from current—monthly	N/A	$47	$81	$127	$177
Net difference from current—annual	N/A	$568	$976	$1,528	$2,128

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.

TABLE A-II

Full-Time Employee
Single Coverage—Non-Tobacco User
Annual Salary: $49,000
Age: Adult, 29

	2015 premiums per employee*				
	Company plan	Bronze PPO	Silver PPO	Gold PPO	Platinum PPO
Total monthly employee cost**	$135	$204	$242	$293	$349
Total annual employee cost**	$1,616	$2,448	$2,904	$3,516	$4,188
Less premium tax credit*	N/A	$0	$0	$0	$0
Net employee cost—annual	$1,616	$2,448	$2,904	$3,516	$4,188
Net employee cost—monthly	$135	$204	$242	$293	$349
Net difference from current—monthly	N/A	$69	$107	$158	$214
Net difference from current—annual	N/A	$832	$1,288	$1,900	$2,572

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.

TABLE A-III

Full-Time Employee
Family Coverage (4 Members)—Non-Tobacco Users
Annual Salary: $49,000
Ages: Adults, 29 and 27; Children, 5 and 7

	2015 premiums per employee*				
	Company plan	Bronze PPO	Silver PPO	Gold PPO	Platinum PPO
Total monthly employee cost**	$399	$395	$469	$567	$675
Total annual employee cost**	$4,784	$4,740	$5,628	$6,804	$8,100
Less premium tax credit*	N/A	($306)	($306)	($306)	($306)
Net employee cost—annual	$4,784	$4,434	$5,322	$6,498	$7,794
Net employee cost—monthly	$399	$369	$443	$541	$649
Net difference from current—monthly	N/A	($29)	$45	$143	$251
Net difference from current—annual	N/A	($350)	$538	$1,714	$3,010

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.

Note: The family coverage example above reflects only two covered members (adults). Healthcare.gov assumes the child dependents would be eligible for coverage through CHIP and thus would not be covered through the public exchange.

TABLE A-IV

Full-Time Employee
Single Coverage—Non-Tobacco User
Annual Salary: $76,000
Age: Adult, 40

	2015 premiums per employee*				
	Company plan	Bronze PPO	Silver PPO	Gold PPO	Platinum PPO
Total monthly employee cost**	$135	$233	$276	$334	$398
Total annual employee cost**	$1,616	$2,796	$3,312	$4,008	$4,776
Less premium tax credit*	N/A	$0	$0	$0	$0
Net employee cost—annual	$1,616	$2,796	$3,312	$4,008	$4,776
Net employee cost—monthly	$135	$233	$276	$334	$398
Net difference from current—monthly	N/A	$98	$141	$199	$263
Net difference from current—annual	N/A	$1,180	$1,696	$2,392	$3,160

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.

TABLE A-V

Full-Time Employee
Family Coverage (4 Members)—Non-Tobacco Users
Annual Salary: $76,000
Ages: Adults, 40 and 38; Children, 10 and 12

	2015 premiums per employee*				
	Company plan	Bronze PPO	Silver PPO	Gold PPO	Platinum PPO
Total monthly employee cost**	$399	$460	$546	$660	$786
Total annual employee cost**	$4,784	$5,520	$6,552	$7,920	$9,432
Less premium tax credit*	N/A	$0	$0	$0	$0
Net employee cost—annual	$4,784	$5,520	$6,552	$7,920	$9,432
Net employee cost—monthly	$399	$460	$546	$660	$786
Net difference from current—monthly	N/A	$61	$147	$261	$387
Net difference from current—annual	N/A	$736	$1,768	$3,136	$4,648

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.

Note: The family coverage example above reflects only two covered members (adults). Healthcare.gov assumes the child dependents would be eligible for coverage through CHIP and thus would not be covered through the public exchange.

TABLE A-VI

Full-Time Employee
Single Coverage—Non-Tobacco User
Annual Salary: $68,000
Age: Adult, 50

	2015 premiums per employee*				
	Company plan	Bronze PPO	Silver PPO	Gold PPO	Platinum PPO
Total monthly employee cost**	$135	$325	$386	$467	$556
Total annual employee cost**	$1,616	$3,900	$4,632	$5,604	$6,672
Less premium tax credit*	N/A	$0	$0	$0	$0
Net employee cost—annual	$1,616	$3,900	$4,632	$5,604	$6,672
Net employee cost—monthly	$135	$325	$386	$467	$556
Net difference from current—monthly	N/A	$190	$251	$332	$421
Net difference from current—annual	N/A	$2,284	$3,016	$3,988	$5,056

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.

TABLE A-VII

Full-Time Employee
Family Coverage (4 Members)—Non-Tobacco Users
Annual Salary: $68,000
Ages: Adults, 50 and 48; Children, 10 and 12

	2015 premiums per employee*				
	Company plan	Bronze PPO	Silver PPO	Gold PPO	Platinum PPO
Total monthly employee cost**	$399	$623	$740	$895	$1,066
Total annual employee cost**	$4,784	$7,476	$8,880	$10,740	$12,792
Less premium tax credit*	N/A	$0	$0	$0	$0
Net employee cost—annual	$4,784	$7,476	$8,880	$10,740	$12,792
Net employee cost—monthly	$399	$623	$740	$895	$1,066
Net difference from current—monthly	N/A	$224	$341	$496	$667
Net difference from current—annual	N/A	$2,692	$4,096	$5,956	$8,008

*Illustrative only. Employee premium costs and premium tax credits reflect 2015 information from www.healthcare.gov.

**Premiums reflect the highest cost options; each plan level includes various options of deductibles and copayments.
Note: The family coverage example above reflects only two covered members (adults). Healthcare.gov assumes the child dependents would be eligible for coverage through CHIP and thus would not be covered through the public exchange.