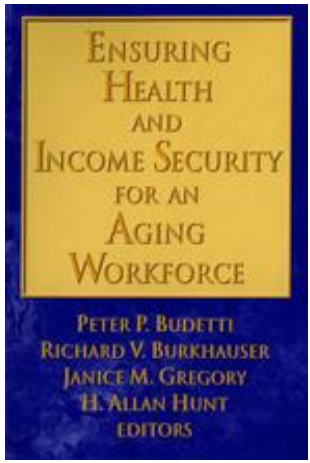
W.E. UPJOHN INSTITUTE
FOR EMPLOYMENT RESEARCH

Upjohn Institute Press

Commentary
[on Filling Gaps in Health Coverage]



Frank McArdle
Hewitt Associates

Chapter 24 (pp. 481-487) in:
Ensuring Health and Income Security for an Aging Workforce
Peter P. Budetti, Richard V. Burkhauser, Janice M. Gregory,
and H. Allan Hunt, eds.
Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2001
DOI: 10.17848/9780880994668.ch24

Commentary

Frank McArdle
Hewitt Associates

I've been asked to comment on this general issue from an "employer perspective," and I would like to remind everyone that we cannot easily generalize about the employer perspective because employers are such a diverse group. Employer reactions can vary very widely depending on their business, their locale, the size of their business, their labor costs, their margins, their competition, their employee relations, and even their individual company cultures.

When you step up from individual employers to larger groups of employers—the business groups and the employer trade groups—you will find that there is somewhat more consistency across employer groups, but even at that level there are very significant differences when you are talking about employer positions on public policy. So, there is a wide diversity among the employer group, and as I speak on the employer perspective, I urge you to remember that.

THE UNINSURED

Let me say by way of context that the problem of the uninsured is indeed viewed as an employer problem as well, in two ways. For one thing, employers intuitively realize that they are paying more for health care because the costs of uncompensated care are being reflected in what they pay providers. The second thing is that large employers also realize that they are covering more individuals than they would have to cover under their plan if other employers offered coverage. So the problem of the uninsured is recognized by most of the large employers that we at Hewitt Associates deal with, but (with some notable exceptions), employers generally don't feel, at least at the individual company level, that the problem of the uninsured is something they can do very much about.

I think that you will see some thought leadership emerging on this issue and more attention devoted to it. But you'll find that employers have not devoted a lot of thought to the uninsured in their daily operations. For example, I am meeting with a company tomorrow which has spent $1.4 billion on health care this year for retirees and active employees. When you are spending $1.4 billion, it is hard for you to relate to what is needed for the uninsured, because your population is so well insured and so well covered. And large employers generally insure their employees at a very high rate.

TAX CREDITS

Len and others have talked about tax credits and tax incentives. In my experience, the combination of individual tax credits for the uninsured combined with a subsidy—such as an ability to buy into Medicaid or state Children's Health Insurance Programs—employers would not lose a lot of sleep over that. If there were a direct and transparent tax increase on business associated with the subsidy, then I think you would get a different and stronger reaction. As the policy realm is evolving right now, it seems the individual tax credits would be most likely considered as a way of extending coverage for the uninsured and not as a way of replacing the current employer coverage or the current federal income tax exclusion, which would be potentially a major concern for employers.

From personal experience, I would like to add one administrative caution about tax credits. Len talked about the need to have refundable tax credits and to have the money paid up front. Well, I agree, but that is also a guaranteed formula for an overpayment. And as someone who has had to work with Supplemental Security Income beneficiaries and Social Security beneficiaries, attempting to take back money from a low-income group or a barely moderate-income group is not a politically pleasant exercise, let me assure you.

PROGRAM COORDINATION

Whenever public policy uses subsidies and tax credits and government programs in relationship to the private sector, there arises the question of coordination. It is an important question but often overlooked, particularly in the legislative developments that we see now. In my view, the idea of combining a government share of an insurance premium and an employer's share of the premium would not be well received by employers. A lot of companies that we deal with tend to want to avoid interactions with government agencies, especially when money is trading hands.

For example, in a recent study we did for the Henry J. Kaiser Family Foundation, Hewitt asked how many employers would accept the direct government subsidy under President Clinton's prescription drug proposal. About 25 percent said they would accept it, while many of the others don't want anything to do with it. There are lots of reasons for employers to do something different than accepting the subsidy, but one reason among several was their dread over docu-mentation, audits, etc., and the attendant bureaucracy when money crosses hands between the federal government and a private sector benefit sponsor.

Likewise, in the area of retiree health, whether it is extending Medicare coverage to pre-Medicare eligible retirees or reforming Medicare options for post-65 retirees, there are bigger issues of coordination because of the existence of Medicare.

COBRA

Len also mentioned that the extension of COBRA continuation coverage is an attractive policy option, but also an option that is not free. When you talk to large employers and employers of any size, there is a real disconnect between what they think are the costs of COBRA and what the legislators think are the costs of COBRA. For example, according to the latest survey that I've seen by Charles D. Spencer & Associates, the actual average claims cost of COBRA beneficiaries is 156 percent of the cost of active employees. Because the employer can only charge a 2 percent additional premium for that COBRA coverage, what you get, in effect, is another 54 percent or so that is coming from the individual's former employer and from the

employees at the individual's former company; there is that subsidy that passes back. So not only is COBRA not free, it is still subsidized to a significant degree by the individual's former employer.

Now when you talk about extending current COBRA eligibility periods(from the current 18 to 36 months available) up until age 65, you can see that the employer subsidy of COBRA would be much, much higher. Even allowing for the employer to charge 125 percent of the premium as some have proposed wouldn't come even close to covering those costs. So that proposed policy change is bound to generate opposition from employers on the matter of cost and also on a certain matter of equity for active employees.

Mandates

Mandates are a nonstarter for businesses. They are scary for employers, conjuring up images of high costs, limited flexibility, and stiff imposition of government rules. For better or for worse, those feelings are well established and in my opinion have not evolved since the 1993–1994 debate. I think we are still there. I would not expect mandated coverage to become feasible on a large scale for employers anywhere in the near term.

Retiree Health Coverage

On retiree health coverage, and in particular regarding pre-65 retirees, again citing the Hewitt report for the Henry J. Kaiser Family Foundation, we found a continuing decline in employer provision of retiree medical benefits. Most large companies with more than 1,000 employees are likely to provide retiree medical coverage. They are also more likely to provide coverage for pre-65 retirees than for post-65 retirees, because there is no Medicare available for pre-65 retirees. But even among this group, there has been a very significant decline. And based on questions that we asked employers about what kinds of changes they would consider over the next three to five years, we expect continued retrenchment in the employer-provider system. As many as 30 percent said they would "seriously consider" eliminating retiree health coverage on a prospective basis in the next three to five years, meaning

for new hires. Current retirees and near retirees are likely to be grandfathered under any situation.

I think the continuing decline in retiree coverage surprised some analysts who expected that after the accounting rules were adopted in the early 1990s—the FAS 106 rules, that forced such a big change among employers—a lot of people thought it was a one-time reaction to those accounting rules and that it would stabilize. Well, it hasn't, and our data shows it is not only continuing to decline, but has accelerated slightly.

I do think there are some options out there that could slow the erosion of employer-provided retiree coverage that wouldn't cost a great deal of new money and may even raise money in some ways. So, I would say in general that it is worth discussing policy measures that would slow the erosion of employer coverage. In doing so, we must also recognize that we have to be creative about how we would do that and also recognize that it may be an evolution toward a newer model—a model in which alongside the direct provision of a defined-benefit system there also might be room for a defined-contribution approach as well.

Here are some specific ideas.

1. A recent report from an ERISA Advisory Council work group suggests that it is a good idea to use pension surplus assets to fund and prefund retiree medical expenses for this same group of employees in the pension plan and with guaranteed protections for those employees in the pension plan. There is a huge wealth of surplus pension assets, particularly as a result of the recent stock market performance, and applying those assets to stabilize retiree medical is probably not a bad idea.

2. There are also some relatively small changes in the tax code that would help, such as allowing employers to take future inflation into account when prefunding retiree medical benefits through what's called a Voluntary Employee Beneficiary Association (VEBA); that's another positive change.

3. A third idea is talking about development of some kind of individual account that would allow employees and employers to save for retiree health expenses. The key to the tax treatment here

would be that the accumulated funds would be usable by the retiree for health care expenses only and without incurring taxable income for the purchase of coverage, which is not available to a broad extent in the tax treatment of 401(k) plan withdrawals right now.

So, creation of a dedicated account where employers and employees could contribute could be a meaningful contribution to meeting retiree health care expenses later on. And, it would also facilitate coordination with Medicare, in the sense that the retirees could then allocate the money to a plan of their choice for supplemental or high-option coverage that they wanted or for out-of-pocket expenses associated with that plan, without incurring taxable income.

In this sense, it really is something very compatible with what Len has talked about, but in a different setting. Len says there are two key dimensions to expand coverage policies for the near elderly: the subsidy mechanism and the range of market opportunities the beneficiary will have in which to use that subsidy. I think you could substitute for subsidy the employer and the employee contributions and the tax benefits conferred thereon. In essence, what you need is money and a place where you can buy coverage at an affordable price. We don't always need to think of employer coverage as a specific comprehensive benefit plan, and I think we should broaden our horizons to think of a combination of both defined-benefit and defined-contribution approaches, not just one traditional approach.

Speaking of saving for retiree medical expenses, I don't think that this issue gets enough publicity on the retirement side of the equation in terms of underscoring that individuals do need to factor into their target replacement ratios future retiree medical expenses. Nor do I think Social Security in its replacement ratios gets credit for the Medicare coverage that is also provided with the additional FICA payroll taxes. In other words, a 40–50 percent average replacement ratio is a lot more when the lifetime Medicare coverage is added on.

A couple of years ago, we did some very rough estimates, rough calculations that we did internally. For example, for someone without employer retiree health coverage who is age 40 and earning $25,000, we estimated that individual would need to save between 7 and 13 per-

cent of pay at age 40 for retiree health expenses if they were to retire at age 62. Naturally the amount required as a percentage of pay goes down with income, but it rises with age. At age 50, a worker making $25,000 would have to save between 15 and 25 percent of pay if he/she had no employer retiree health coverage.

CLOSING

I would like to close with a couple of comments. Len talked about his preferred option of creating a new group purchasing entity to facilitate group market conditions, and Deborah has commented on that too. I have to tell you that from an employer perspective, "Avalon" sounds like the 1993–1994 HIPCs (health insurance purchasing cooperatives). It conjures up this image that, if it is government-initiated, it is going to be unwieldy, expansive, and bureaucratic, and employers are going to be nervous about it as a group.

I also think we may be at the beginning of a stage where we are going to see some new intermediaries emerge in the marketplace who may be able to create some of these markets on their own. For example, with the use of the Internet, some of the relatively big administrative loads that Len and also Deborah talked about, there is a potential for those administrative costs to come way down in a highly electronic Internet environment. We can also foresee the development of new intermediaries that would create a virtual marketplace where the money could be applied and also reduce administrative costs substantially by using the Internet and other means, such as standardization of health plan offerings to increase efficiencies and lower costs.

Finally, in Len's simulations, the cost of the insurance premium modeled reflects a premium for fairly comprehensive health care coverage. Comprehensive coverage has traditionally been the standard of coverage advocated by most policy analysts, and it certainly remains a viable policy option for the future.