Deutsche Bank AG

Managed Care
U.S. Health Care Equity Research

Health Care Reform and Impact on Employers

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Passion to Perform

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The Affordable Care Act (ACA) – aka Obamacare – Now the Law of the Land

Health care reform survived two major hurdles with the SCOTUS decision in June and the re-election of President Obama earlier this month. This means the market must now prepare for full reform implementation in 2014

- The health reform law will have a dramatic impact on the U.S. health care market in 2014. The law is expected to provide health care coverage to ~30m currently uninsured people but will also add significant new costs that will be largely passed on to employers and consumers.
- Some of the more significant changes for employers include the following:
  - Potential for premium "rate shock": to effectively price for new regulations such as guaranteed issue and community rating, health insurers have noted recently that premiums for small business and individual customers may need to rise 20-50% in 2014. Premiums will also rise for larger employers, possibly in the 10-15% range.
  - Individual (individual mandate) and employer ("pay-or-play") responsibility requirements are established. The law requires most citizens to have health insurance coverage.
  - Insurance carriers must provide guaranteed issue (no exclusions for pre-existing conditions) and premiums must be underwritten based on community rating (places restrictions on medical underwriting of individuals and small group employers). These regulatory changes will add to the average cost of health insurance products.
  - Health insurance exchanges are established with federal premium subsidies available based on income level. These exchanges will provide an alternative source of coverage in the market to the current employer-based system.

ACA Provisions Impacting Employers

The goal of the ACA is to increase access to health services by reducing the size of the uninsured population. Provisions that specifically impact employers include:

In 2014:

- New insurance regulations likely lead to “rate shock” in 2014, particularly for small employers and individual customers
- “Pay-or-play” – Employers with more than 50 employees that do not provide health coverage will generally be required to pay a penalty of $2,000/FTE.
- $185 billion in new taxes (over 10 yrs) on health insurance, medical devices, and prescription drugs will be passed on to employers and consumers
- Establishes “essential health benefits” (EHBs) that must be include in health insurance packages. This will likely require small employers to expand the level of benefits offered adding to the cost of their health insurance plans.

Beyond 2014:

- “Cadillac” tax (2018) – New excise tax will be imposed on employer-sponsored health plans with aggregate values of $10,200 for individual coverage and $27,500 for family coverage. The tax is equal to 40% of the value of the plan that exceeds the threshold amount.

Details on ACA Provisions Impacting Employers

Be prepared for the "Rate Shock" – Guaranteed issue, community rating, minimum essential health benefits and other new fees (industry tax, reinsurance assessments, etc.) are all expected to contribute higher premiums in 2014

- **Guaranteed Issue (GI):** Requires insurers to offer and renew coverage, without regard to health status, use of services, or pre-existing conditions. This requirement ensures that no one will be denied coverage for any reason.
- **Community Rating (CR):** A method for setting premium rates for health insurance plans under which all policy holders are charged the same premium for the same coverage. "Modified community rating" generally refers to a rating method under which health insuring organizations are permitted to vary premiums based on specified demographic characteristics, but not based on the health status or claims history of policy holders. Beginning in 2014, health plans will be required to adopt modified community rating. Variations in premiums will only be allowed for differences in geography, family structure, age (limited to a 3 to 1 ratio) and tobacco use (limited to a 1.5 to 1 ratio). Some estimates indicate that healthier individuals under 30 could see rates increase by 40%, while 30-45 year olds will also see increases and those over 50 will see rate reductions. With the median age of the U.S. workforce at 41 years, it is clear that blended rates will certainly increase due to CR.
- **Minimum essential health benefits (EHB):** A benchmark level of benefits created by the health reform law that is meant to ensure a health plan provides a comprehensive set of services. Plans both within and outside of the health insurance exchange will be required to offer at least this level of coverage. Cost-sharing will be limited to the current HSA limits ($5,950 for individuals and $11,900 for families). The Secretary of Health and Human Services will be required to define and annually update the benefit package. Many health plans offered by smaller employers to employees may not meet minimum EHBs, indicating that companies will need to offer more robust and therefore more expensive plans. AHIP (the health insurance trade group) estimates that average premium increases will range from 3-30% due to EHBs alone.
- **Other new fees:** These include the new insurer industry tax which insurers have indicated that they intend to pass through (amounts to ~2.5% average premium increase); the $25 bln reinsurance assessment; the medical device and Rx taxes which will likely be passed along in the form of higher premiums to some extent; etc.

ACA Provisions Impacting Employers

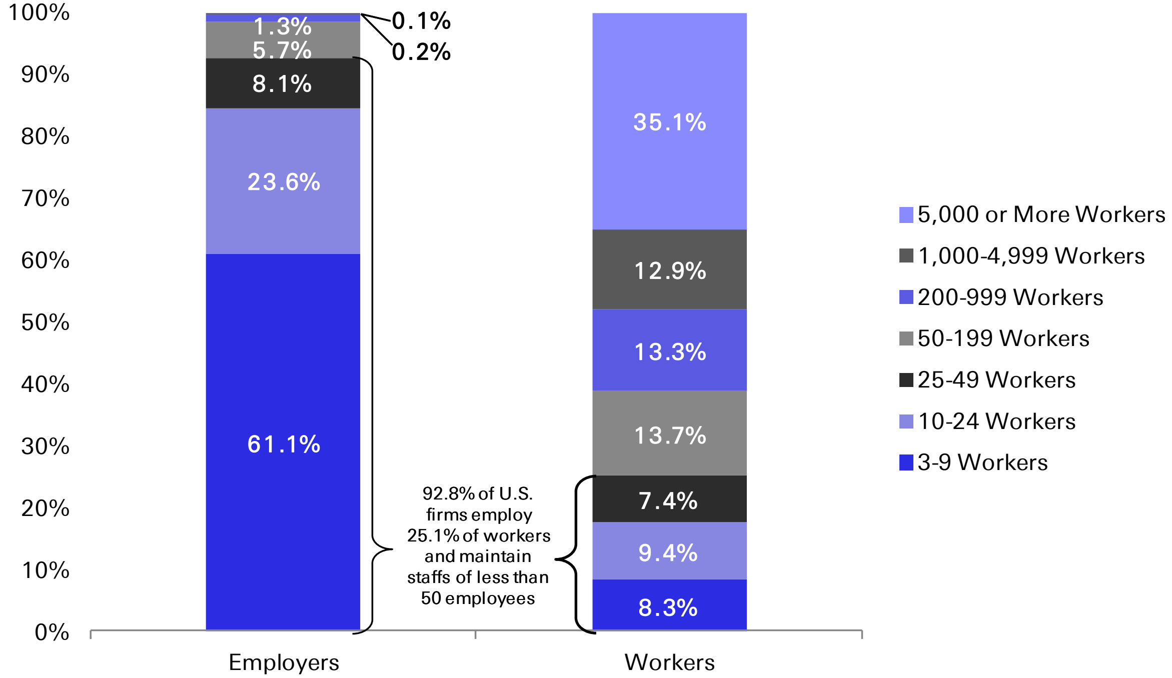
“Rate Shock” (continued)

- **Taken together, all of these new provisions, fees and taxes are expected to push HC premiums significantly higher in 2014. The CEOs of two national health insurers told us recently that small business and individual health insurance premium rates may need to rise on average by…**

+20-50% in 2014

- Guaranteed issue (GI) and community rating (CR) are the primary drivers of expected rate increases. These new provisions only apply to small employers (<50 employees), individuals, and exchanges – meaning those who obtain insurance in these segments will be the hardest hit.
- Larger employers will also likely see substantial rate increases; however, because most large employers already offer richer benefit packages (meeting EHB standards) and GI/CR will not apply, rate increases should be more in the10-15% range, in our view.

Employer and Worker Distribution by Firm Size, 2012



Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2012

ACA Provisions Impacting Employers

"Pay-or-play" – Many employers required to offer coverage

- The health care law will assess employers with more than 50 employees that do not offer coverage and have at least one full-time employee who receives a premium tax credit a fee of $2,000 per full-time employee, excluding the first 30 employees from the assessment. Employers with more than 50 employees that offer coverage but have at least one full-time employee receiving a premium tax credit, will pay the lesser of $3,000 for each employee receiving a premium credit or $2,000 for each full-time employee. (Effective January 1, 2014)
- Exempts employers with 50 or fewer employees from any of the above penalties.
- Require employers that offer coverage to their employees to provide a free choice voucher to employees with incomes less than 400% FPL whose share of the premium exceeds 8% but is less than 9.8% of their income and who choose to enroll in a plan in the Exchange. The voucher amount is equal to what the employer would have paid to provide coverage to the employee under the employer's plan and will be used to offset the premium costs for the plan in which the employee is enrolled. Employers providing free choice vouchers will not be subject to penalties for employees that receive premium credits in the Exchange. (Effective January 1, 2014)

ACA Provisions Impacting Employers

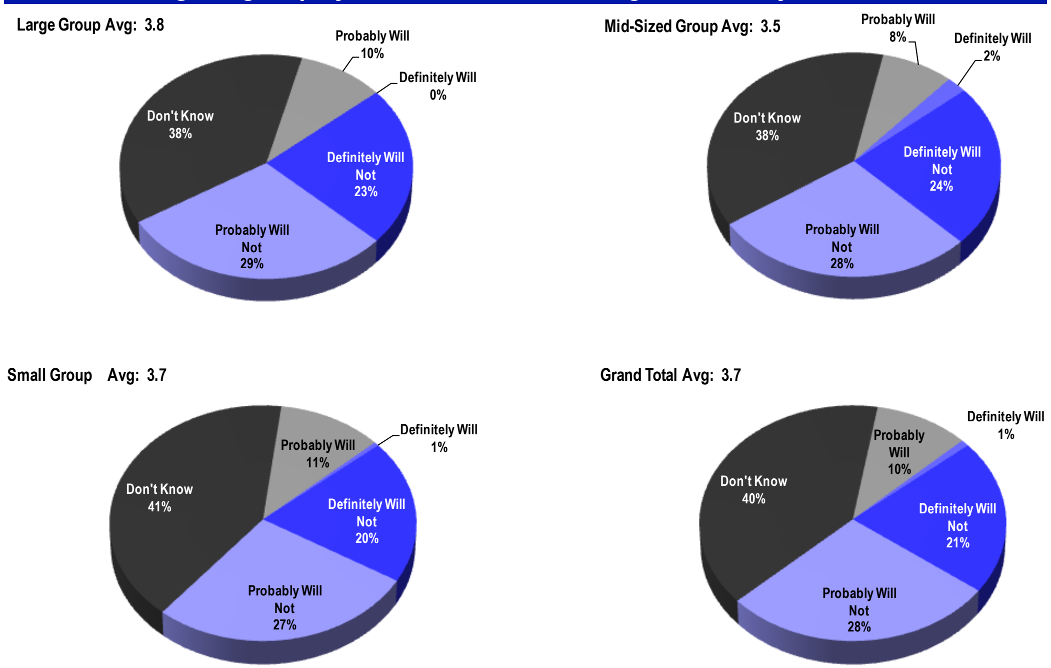
“Pay-or-play” – Employers required to offer coverage (continued)

- According to our 6th Annual Employer Health Benefits Survey (published in Dec 2011) 11% of employers were actively considering migrating employees into Exchanges in 2014.
- We think the relatively low interest in the Exchanges likely reflects the generally disorganized state of affairs around Exchange planning at both the state and federal levels, which has created significant uncertainty around the path to implementation of the Exchanges in 2014.
- However, as employers learn more about the potential “rate shock” in 2014, more of them may consider dropping coverage, paying the penalty, and “dumping” their employees into the new Exchanges.

Migrating Employees into the new Exchanges in 2014 by Plan Size

	Definitely Will Not	Probably Will Not	Don't Know	Probably Will	Definitely Will	Avg.
Small Group	38	53	79	22	1	3.7
Mid-Sized Group	20	24	32	7	2	3.5
Large Group	14	18	23	6	0	3.8
Grand Total	72	95	134	35	3	3.7

Migrating Employees into the new Exchanges in 2014 by Plan Size



ACA Provisions Impacting Employers

Transitional Reinsurance Program: An often overlooked potential new cost for Employers

- A three year program beginning in 2014 that will be funded by a $25 bln fee on insurers that sell risk based products ($12 bln assessed in 2014).
- Intended to ease the initial risks in the exchanges from the guaranteed issue and community rating provisions. These new insurance provisions could result in adverse selection in the exchanges early on that would potentially make the exchanges unsustainable from a cost perspective before they even get off the ground.
- Industry experts have estimated that the cost of the reinsurance program will be ~$60-100 per covered life which amounts to an incremental cost of 1-2% based on an average annual single coverage premium of $5,615[1] in 2012. While this is not as significant as other provisions, it is another cost of health reform that has been largely overlooked by employers.
- Employers that are self insured will also be assessed the fee to fund the reinsurance program which means this will be an incremental cost for larger employers.
- Employers that are fully insured will likely see the assessment passed through via higher rates.
- The bulk of the assessment ($20 bln) will flow back to insurers based on risk adjusted exchange membership but large self-funded employers will not see any direct benefit.

[1] Source: Kaiser Employer Health Benefits 2012 Annual Survey

Appendix 1
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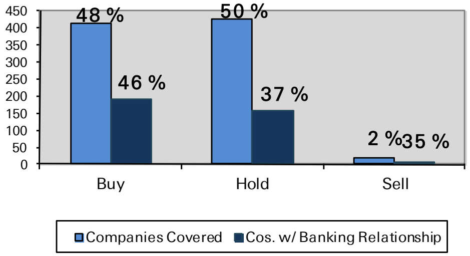

North American Universe

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