REPORT OF THE
JOINT COMMISSION ON HEALTH CARE

ANALYSIS OF SECTION 125 PLANS AND VIRGINIA HEALTH INSURANCE EXCHANGE

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

REPORT DOCUMENT NO. 129

COMMONWEALTH OF VIRGINIA
RICHMOND
2012

Code of Virginia § 30-168.

The Joint Commission on Health Care (the Commission) is established in the legislative branch of state government. The purpose of the Commission is to study, report and make recommendations on all areas of health care provision, regulation, insurance, liability, licensing, and delivery of services. In so doing, the Commission shall endeavor to ensure that the Commonwealth as provider, financier, and regulator adopts the most cost-effective and efficacious means of delivery of health care services so that the greatest number of Virginians receive quality health care. Further, the Commission shall encourage the development of uniform policies and services to ensure the availability of quality, affordable and accessible health services and provide a forum for continuing the review and study of programs and services.

The Commission may make recommendations and coordinate the proposals and recommendations of all commissions and agencies as to legislation affecting the provision and delivery of health care.

For the purposes of this chapter, "health care" shall include behavioral health care.

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Preface

In 2006, Senate Joint Resolution 4 directed the Joint Commission on Health Care (JCHC) to study the derivative effects of increases in health care costs on health insurance premiums and ways the Commonwealth could reduce health care costs. Stemming from the findings of that study, JCHC members recommended that staff review the advisability of encouraging employer adoption of Section 125 plans and of establishing a Virginia health insurance exchange targeted for small businesses.

The JCHC review found that encouraging adoption of Section 125 plans would be useful as such plans typically reduce the "actual" health insurance costs for most employees and employers. However, establishing a Virginia health insurance exchange for small businesses was not likely to lower the cost of health insurance premiums significantly.

Section 125 Plans

A Section 125 or "cafeteria plan" allows employees to pay their health insurance premiums with pretax dollars which can result in savings of 25 to 40 percent for the employees. In addition, adopting a Section 125 Plan often reduces an employer's payroll taxes (assuming the employer already offered health insurance). Despite these savings, less than 35 percent of the small businesses that offer health insurance in Virginia have adopted a Section 125 Plan. By comparison, more than 90 percent of larger employers offering health insurance have Section 125 Plans. To encourage adoption of Section 125 Plans, JCHC members approved policy options designed to disseminate information about the requirements and benefits associated with Section 125 plans.

Health Insurance Exchanges

The basic idea of a health insurance exchange is to provide a clearinghouse for health insurance products. The exchange may be operated by a state or private entity and may address individual, small or large group insurance markets or a combination of all three markets. Health insurance exchanges generally attempt to: promote competition between health insurers; provide consumers a single access point for a wide variety of high-quality of health insurance products; and provide insurance product information in an understandable way. This review found that Virginia's insurance laws allow insurers to set premiums based on individual and group claims history which does not allow for standardization of rate quotes which is necessary for allow an effective health insurance exchange. Also, significant resources may be needed to create and operate an exchange. Consequently, it is unlikely that having an exchange would improve Virginia's health insurance market efficiency or lower the cost of premiums significantly.

Joint Commission members and staff would like to thank the numerous individuals who assisted in this study, including representatives of: America's Health Insurance Plans; Agency for Healthcare Research and Quality; Anthem; Asset Protection Group, Inc.; BB&T Insurance Services, Inc.; Benefit Solutions Inc.; Connecticut Business and Industry Association; Connecticut General Assembly Office of Legislative Research; Independent Insurance Agents of Virginia; Internal Revenue Service; Iowa Insurance Division; Joint Legislative Audit and Review Commission; local Commissioner of Revenue offices; Maryland Health Care Commission; Massachusetts Commonwealth Connector; Massachusetts Joint Committee on Health Care Financing; Minnesota Department of Health; Missouri Joint Committee on Legislative Research; National Conference of State Legislatures; National Federation of Independent Businesses; Office of the Secretary for Health and Human Resources; Rhode Island Office of the Health Insurance Commissioner; Riverside Health System; State Corporation Commission; Total Administrative Services Corporation; Virginia Association of Health Underwriters; Virginia Attorney General's Office; Virginia Association of Health Plans; Virginia Chamber of Commerce; Virginia Department of Business Assistance; Virginia Department of Human Resource Management; Virginia Department of Health; Virginia Department of Taxation; Virginia Employment Commission; Virginia Farm Bureau; Virginia Health Underwriters Association; and Your Benefits Partner.

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ATTACHMENT
SEPTEMBER 4, 2008 PRESENTATION

Analysis of Section 125 Plans and Virginia Health Insurance Exchange

In 2006, Senate Joint Resolution 4 directed the Joint Commission on Health Care (JCHC) to study the derivative effects of increases in health care costs on health insurance premiums and ways the Commonwealth could reduce health care costs. In 2007, JCHC members recommended continuing the study to review the advisability of:

i) establishing a Virginia health insurance exchange targeted for small businesses,
ii) increasing employer adoption of Section 125 plans, and
iii) addressing any other health insurance issues as deemed appropriate.

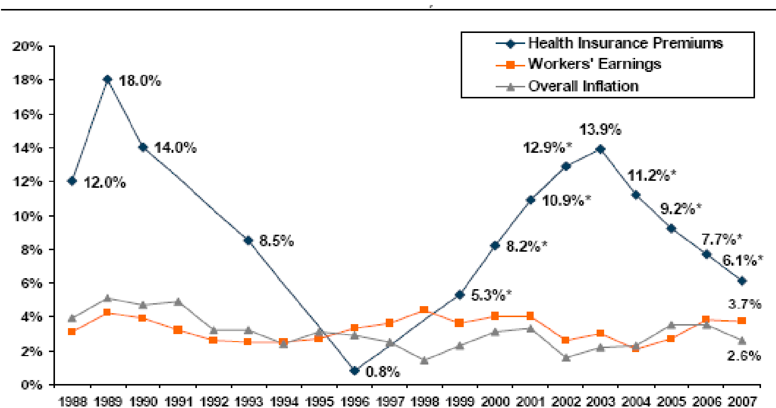
Health Insurance Costs and Accessibility

An estimated 9 to 15 percent of Virginia's population (632,000- 1,000,000) were uninsured in 2005.[1] The affordability of health insurance coverage is the primary barrier to obtaining health insurance. Health insurance premiums have increased significantly over the past 20 years; in fact, the increases in health insurance premiums exceeded the increases in workers' earnings for 16 of the 20 years. Consequently, health insurance costs took a larger share of workers' incomes year after year.

Figure 1 compares increases in health insurance premiums, workers' earnings and inflation over a 20-year period. As shown, health insurance premium increases fluctuated from 0.8 to 18 percent, with an increase of more than six percent for at least 12 years.

Figure 1

Increases in Health Insurance Premiums Compared to Other Indicators 1988-2007



Source: *Kaiser Family Foundation and HRET*

[1] Joint Legislative Audit and Review Commission, *Options for Extending Health Insurance to Uninsured Virginians*, House Document No. 19, 2007.

Employer-Based Health Insurance. Employers sponsoring health coverage for their employees and their families is the primary way that non-elderly individuals under age 65 obtain coverage in the United States. For Virginia's non-elderly insured, 80 percent are covered through employer-sponsored insurance.[2] However, the number of employers offering insurance is decreasing. In 2000, 69 percent of employers offered health insurance to their employees.[3] By 2006, that percentage had decreased to 60 percent.[4]

Businesses with more employees are more likely to offer health benefits. In 2006, 99 percent of firms with more than 200 employees offered health benefits, whereas only 45 percent of firms with three to nine employees offered such benefits.[5] The lack of employer-sponsored coverage often affects whether an individual acquires insurance. The number of individuals employed by smaller firms is sizeable; more than 1 million employees worked for employers with two to 99 employees in 2006.[6] Fifty percent of Virginia's working uninsured are employed by such businesses[7].

Making Health Insurance More Affordable

One way employer-sponsored health insurance can be made to be more affordable is to allow employees to pay their premiums with pretax dollars. According to the Agency for Healthcare Research and Quality, many of the over 400,000 Virginians offered employer-sponsored health insurance are not allowed to pay their premiums with pretax dollars. Section 125 Plans allow employees to pay their health insurance premiums with pretax dollars which can result in savings of 25 to 40 percent for the employees. Section 125 Plans often provided the added benefit of allowing employers to decrease their payroll tax liabilities.

Section 125 Plans. As noted, Section 125 Plans enable employees to purchase health insurance policies with pretax dollars and are commonly known as "cafeteria plans." These plans are documents in conformance with U.S. *Internal Revenue Code* Section 125 and apply to group health insurance plans.[8] Three versions of pretax plans are defined in Section 125. While all three plans allow for pretax treatment, this report addresses the simplest version, the Premium-Only Plan (POP). POPs allow for only pretax payment of health insurance premiums.

Section 125 provisions indicate that POPs must include and create limitations on who may participate; for the pretax payment of premiums, each POP must include:

- a description of the benefits that may be elected and eligibility rules;
- method, timing, and irrevocability of participant elections;
- manner of any employer contribution;
- maximum amount of employer and employee contributions; and
- date of the plan year.

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[2] *Id.*
[3] Kaiser Family Foundation and Health Research Educational Trust, *2007 Employer Health Benefits Survey.*
[4] *Id.*
[5] *Id.*
[6] United States Small Business Administration, *Employer Firms, Establishments, Employment, Annual Payroll and Receipts by Firm Size, and State*, 2006.
[7] *See supra*, note 1.
[8] The other two plan types are Flexible Spending Accounts and Full Flexible Benefit Plans with Benefits Credits. These plans are more complex to administer than POPs and may expose employers to potential financial liabilities.

Also, the employer is required to formally approve the plan. Not everyone employed by a business can take advantage of POP benefits as certain individuals are excluded from participating including: self-employed individuals, partners in a partnership, and directors and limited partners in a limited liability corporation. When pretax dollars are used, FICA (Social Security and Medicare payroll tax) and federal and state income tax liabilities are reduced. This decreases the cost of health insurance for the employee. Also POPs can allow employers to lower their Social Security tax obligations. Three examples of how these types of cost savings are shown below. Examples A and B highlight prospective employee savings while Example C highlights employer savings.

Example A: Individual Earning $50,000 Annually with Single Health Insurance Policy

	Rate	Amount	Total
VA Small Group avg. monthly premium (2006)			$ 246
Payroll deduction amount (through POP)			$ 246
Reduction in FICA tax →	7.65%	$ 19	
Reduction in federal tax liability →	18%	$ 44	
Reduction in VA state tax liability →	5.2%	$ 13	
Net premium cost to employee (including after tax-savings)			$ 170
Total Employee Monthly Tax Savings →	**31%**	**$ 76**	

Example B: Married Worker with Two Children Earning $70,000 Annually with Health Insurance Policy for Family of 4

	Rate	Amount	Total
VA Small Group avg. monthly premium (2006)			$ 645
Payroll deduction amount (through POP plan)			$ 645
Reduction in FICA tax →	7.65%	$ 49	
Reduction in federal tax liability →	15%	$ 97	
Reduction in VA state tax liability →	5.4%	$ 35	
Net premium cost to employee (including after tax-savings)			$ 464
Total Employee Monthly Tax Savings →	**39%**	**$ 181**	

Example C: Small Firm with 10 Employees with an Annual Payroll Cost of $500,000

	Without POP	With POP
Annual Payroll	$ 500,000	$ 500,000
Employee payroll deduction amounts (VA small group premium)	$ 0	$ 53,460
Taxable Payroll	$ 500,000	$ 446,540
Social Security Tax Rate → 7.65%	$ 38,250	$ 34,160
Employer Annual Tax Savings with a POP	**$4,090**	

In Example A, the employee saves 31 percent or $76 per month in taxes avoided that can be used toward the premium's cost. An average individual small group premium costs $246 a month. Without a POP, the employee's health insurance out-of-pocket payment is $246 per month. With a plan, the individual does not have to pay $19 in FICA taxes, $44 in federal income taxes, and $13 in Virginia income taxes. This would be $912 in taxes avoided per year. In Example B, a married employee with family coverage saves 39 percent of the premium cost, which is $181 per month or $2,172 annually.

POPs can also be used to avoid employer taxes. Example C highlights potential employer savings from adopting a plan. Employee premium contributions may be excluded from the employer's Social Security payroll tax obligations. To illustrate, the business in Example C has 10 employees and annual payroll costs of $500,000. All 10 employees have employer-covered health insurance and pay $53,400 in total toward premiums each year.[9] Without a POP, the employer would pay $38,250 in Social Security taxes for $500,000 in payroll expenses. With a POP, the employer can exclude from payroll $53,400 paid by employees for their health insurance premiums. This reduces the taxable payroll to $446,540, thereby decreasing the tax obligation to $34,160 instead of $38,250. The POP decreases the employer's taxes by $4,090.

While POPs and Section 125 Plans can provide significant savings, they do not make insurance inexpensive. Individuals must have an adequate level of income to afford health insurance; a general rule of thumb is an individual's earnings must be more than 200 percent the federal poverty level (FPL) to consider the possibility of affording non-subsidized insurance. For reference, 200 percent of FPL was $21,660 for an individual and $44,100 for a family of four in 2009. In Virginia, 40 percent (400,000) of uninsured employees have incomes above 200 percent the federal poverty level.[10]

Section 125 Plans in Virginia. As illustrated, Section 125 Plans can result in significant cost-savings for employees and employers. Despite this fact, many businesses in Virginia, particularly smaller businesses, have not adopted a Plan.

- Sixty-eight percent of small businesses[11] (with fewer than 50 employees) that offer health insurance do not offer a Section 125 Plan. (These small businesses employ approximately 291,000.)
- Only eight percent of larger businesses (with 50 or more employees) that offer health insurance do not offer a Section 125 Plan. (These larger businesses employ approximately 139,000.)[12]

Virginia business groups, small business owners, health insurers, and health insurance brokers were interviewed about the low percentage of small businesses taking advantage of Section 125 Plan savings. There are a number of reasons that Section 125 Plans have not been adopted more broadly. There is a perception that establishing a Plan would result in a significant administrative burden, as well as questions regarding the cost and

[9] The figure $53,400 is the annual premium cost for five individual policies at $246/month and five family policies for four members at $645/month.
[10] *See supra,* note 1.
[11] For this comparison, smaller businesses are those with fewer than 50 employees and larger businesses have 50 or more employees.
[12] Agency for Healthcare Research and Quality, 2006 estimates of Virginia businesses offering health benefits that do not allow for pretax consideration. Unpublished data.

time it would take to understand and develop the Plan. Small business owners fulfill many roles and often do not have a dedicated person (other than the owner) to handle health-insurance matters. In addition, there are negative tax consequences if the Section 125 Plan is not set-up correctly and as noted previously, there are limitations on participation in a Plan. However, the primary reason that more employers indicated they had not adopted a Section 125 Plan was a lack of awareness and knowledge about such Plans. When Section 125 Plans are understood, the challenges associated in creating them are generally considered to be minor while the benefits are significant.

In summation, employers and employees can reduce out-of-pocket health insurance costs through tax advantages when employers offer health insurance and use a Section 125 plan. Employers can decrease their taxable payroll by the amount their employees pay towards their health insurance and employees can save 25 to 40 percent on their health insurance premiums.

Virginia Health Insurance Exchange

A health insurance exchange is a clearinghouse of multiple health insurance products from different companies. Exchanges allow for simpler insurance product comparisons and one-stop shopping for health insurance. Some exchanges go so far as to collect health insurance payments and can be structured to allow for pretax benefits. Exchanges work to lower premium costs through increasing competition and comparability between insurance products. Depending on the purpose, an exchange can improve the health insurance options for different groups such as: small businesses, small business employees, unemployed, temporary or seasonal employees.

Types of Exchanges. Exchanges can be state or private entities and can take many forms but all attempt to improve a health insurance market's functioning. The specific exchange type is driven mostly by the exchange's goals and the particular state's health insurance laws. Exchanges aim to improve market function by making insurance product information standardized and understandable, thus insurance options can be more readily compared. Some exchanges set minimum coverage standards for all offered policies such as specific conditions to be covered and out-of-pocket limits. Typical goals of an exchange are: lowering insurance prices, providing a single access point for a wide variety of high-quality products; and providing understandable insurance product information. Exchanges may apply to one or more of a state's insurance policy groupings whether individual, small, or large and may allow for portability of coverage.

Current Exchanges and State Insurance Law. In 2008, there were two operational statewide health insurance exchanges in the United States; the Connecticut Business and Industry Association Health Connections and the Massachusetts' Commonwealth Health Insurance Connector Authority (Connector). The Massachusetts' Connector began operating in 2006 with an initial appropriation of $25 million. The Connector's goal is to promote cost-effective high quality plans, to decrease the administrative health benefits burden on small business, and to make premiums less expensive through employer adoption of Section 125 plans.

Both the Connecticut and Massachusetts exchange operate by receiving health insurance benefits and premium price bids for the upcoming year from insurance companies. A

limited number of insurance products are offered on each exchange thereby providing incentives for insurers to make very competitive bids as they vie to have their insurance products included in the exchange. The exchanges then choose an assortment of the best insurance products to include in their offerings, after which each exchange creates simple and understandable price and benefit comparisons to assist customers in their decision making. Since the premium rates are known in advance, individual or group rates can be determined instantaneously on a website or over the phone.

An important legal facet in the states these exchanges operate is that neither state allows for an individual's past medical history to be factored into premium costs and few criteria may be used to determine an individual's rate. Both states' are considered "modified community rating" states in which an individual's premium is based on standardized rates calculated from a specific demographic group; the premium is not based on an individual's or business' previous health claims or status. Modified community rating allows for those with more expensive health conditions to find more affordable coverage than they would have had in an experience-rated state. For example, in Massachusetts sex, age, and region of the state are the only factors that can be used to determine a premium price. Insurers bid to have their insurance policies offered in the exchange by proposing set premium prices for different groups of individuals. Since the premium rate is standardized, this allows for premiums to be determined quickly as only four specific categories of personal information can be used. Therefore, immediate rate quotes are possible as an individual's unique medical history does not need to be reviewed. This is in contrast to Virginia, in which medical history can be reviewed which can be a lengthy process. Virginia's individual policy insurers routinely review an applicant's stated medical history, contact their previous medical providers, request medical records, and then review such records before determining whether to offer a policy and if so a premium rate.

Exchange Payment Collections and Other Services. Exchanges may collect health insurance payments from the insured and remit most back to the insurers, keeping a percentage of each premium to support the operation of the exchange. It is important to emphasize that exchanges are not a purchaser of insurance policies, but a policy clearinghouse and a collector and distributor of premiums.

As many smaller organizations have no dedicated human resource personnel, exchanges may provide limited health benefits administration. Providing this service lessens the administrative burden on employers providing health insurance and makes it more likely that employer-sponsored insurance will be offered. Also, exchanges can encourage employers to adopt Section 125 Plans. In Massachusetts, businesses are required to adopt a Section 125 Plan to be a part of the exchange and a booklet was created to assist the business owners in adopting such plans.[13]

General Exchange Considerations. In order to establish a health insurance exchange certain considerations must be addressed. Initial issues are determining the exchanges' goals and scope, procuring the initial operational investment needed, and determining

[13] Commonwealth Connector, *Helping Your Employers Connect to Good Health: Section 125 Plan Handbook for Employers,* 2007.

what organization would take the roles and responsibilities of the exchange. Even an exchange of limited scope would need a variety of tasks to be performed, including:

- Choosing insurance carriers allowed to offer products,
- Determining types of products offered,
- Determining product standards,
- Advertising the exchange,
- Communicating product-offerings to purchasers,
- Advising potential purchasers on insurance product specifications,
- Billing employers for insurance premiums, and
- Remitting policy premiums to insurers.

Virginia Health Insurance Laws

Virginia's large and small group and individual markets have different laws that apply to each and each operate indifferent fashions. For example, the amount of information requested for a premium quote is different for individual and small groups.[14] However, for all markets Virginia allows a modified experience rate structure. In this structure, insurers use the insured's current and previous health history in determining the premium that is offered. Consequently, an individual who has few ailments and health care costs will have a lower premium cost than if Virginia became a modified community rating state. As noted previously, the two states that operate health insurance exchanges now have modified community rating laws that allow insurance carriers to use only certain factors such as age and gender in determining premium rates. This allows individuals with high health costs to find more affordable premiums as the "community group" premium rate includes individuals with high and low health costs. In effect, modified community rating allows for premium subsidization for the more unhealthy by healthier individuals. A JCHC analysis determined that the premium costs in states that have modified community rating are 8 percent higher than experience rated states.[15]

Virginia Health Insurance Exchange. A state's insurance law framework may or may not allow for the typical advantages of a health insurance exchange. In Virginia, insurers use health status or previous claims history to assess the potential customer's risk of future claims in order to determine an appropriate premium for that risk. Premium cost determination is more time-consuming and complicated when health history can be used. Allowing the use of medical history to determine premium rates does not allow for instantaneous rate quotes and policy comparisons.[16] This limitation eliminates an

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[14] In the individual market to obtain an individual policy, insurers require a detailed questionnaire to be filled out and sometimes insurers review the individual's previous health care records. In the small group market, a less-detailed questionnaire is filled out by prospective insured with few medical record requests. The different requirements for small group policies occur for two main reasons. First as insured employees have an expectation of continual coverage and there is a disincentive for employers to drop health insurance or change plans yearly. Second, most insurers require at least 50 percent of the targeted workforce to be a part of the group plan; this allows for a more diversified risk pool compared to an individual policy and decreases the insurers risk.

[15] A JCHC analysis was conducted using American Health Insurance Plans "Small Group Health Insurance in 2006" report in conjunction with National Conference of State Legislatures "State Small Group Health Reform - A Brief History" highlights states with community ratings.

[16] Insurance markets that only use age, gender and location allow for standardized premiums and policies can allow an exchange to deliver quick, real-time comparisons of different insurance policies and cost options.

exchange's ability to drive competition through quick and easy insurance product comparisons.

Also in Virginia, most insurance companies do not have to offer health insurance to any individual that requests a premium quote. This means that an exchange may not promote competition for some individuals and groups if a sufficient number of insurers do not submit premium quotes. Virginia had the third most inexpensive small group policies in the nation in 2006,[17] which may be indicative of less efficiency to be gained by moving to an exchange under Virginia's current insurance laws.

Another aspect that must be raised is an exchange's cost of creation and operation. In Massachusetts an initial appropriation of $25 million was appropriated for the Connector's creation; continuing operating revenue comes from a percentage taken from insurance premiums collected. A Virginia exchange that is less comprehensive could be considerably less expensive; however, significant funding would still need to be provided.

This review of health insurance exchanges focused on decreasing Virginia's health insurance costs. With Virginia's modified experience rating laws, a health insurance exchange would not significantly decrease health insurance rates, if at all. An exchange's most significant benefits occur when a state has community rating laws.[18] Considering the uncertainty of insurance market efficiency gains, relatively low health-insurance premiums, and the resources that would be needed to create an exchange, the option of creating a Health Insurance Exchange is not advisable given Virginia's current market structure.

Other Issues. During study interviews, instances were described in which small business owners had been misinformed about the availability of insurers offering coverage in their areas. Currently there is no government or private resource that employers can consistently consult to find all of the health insurance options in their area. Employer-awareness of all viable insurance options can increase insurer competition and allow an employer to find an acceptable and affordable health insurance option. To address this market breakdown, a listing of health insurers and their contact information by locality could be added to the health insurance section of the Virginia Health Information website.

Policy Options and Public Comment

Ten policy options were presented for JCHC member consideration.

Keith D. Cheatham, Vice President of Government Affairs commented on behalf of the **Virginia Chamber of Commerce in support of Options 3 and 8**. Mr. Cheatham's letter indicated the following:

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[17] American Health Insurance Plans' Center for Policy and Research, *Small Group Health Insurance in 2006*, September 2006.

[18] If Virginia's insurance laws changed to require insurers to use community ratings then very likely the average individual and small group premium rate would increase.

"Section 125 Plans can make purchasing health care more affordable by providing considerable tax savings to employers and employees. Of the nine policy options you present, we would **support Options 3 and 8**…The Virginia Chamber, a small business itself, has offered a Section 125 Plan for years, so we are well aware of its benefits and costs. It has been a positive experience for us and our employees."

No additional public comments were received.

Option 1: Take no action.

Option 2: Amend the *Code of Virginia* to mandate that employers offer a Section 125 Plan if all of the following provisions are met:

- Full-time employees,
- Group health insurance is offered, and
- Employee pays some part of the health insurance premium

Note: No requirement for employers to provide health insurance or contribute to plan premiums.

Option 3: Request by letter of the Chairman that the Department of Human Resources Management (DHRM) in consultation with the Department of Business Assistance (VDBA) create a brief electronic document that highlights Section 125 benefits to post on the VDBA website and on Virginia's business portal website.

Option 4: Request by letter of the Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a detailed electronic document that highlights Section 125 benefits; requirements for adoption; and COBRA, ERISA and HIPPA implications for posting on the VDBA website and on Virginia's business portal website.

Option 5: Request by letter of the Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a detailed electronic document that highlights Section 125 benefits; requirements for adoption; COBRA, ERISA, and HIPPA implications; and a simple Section 125 plan form for posting on the VDBA website and on Virginia's business portal website.

Option 6: Amend the *Code of Virginia* to require that employers affirm on the Virginia Department of Taxation Form VA-6 that the employer has a Section 125 Plan, or the employer has read the State-created document regarding Section 125 Plans.

Option 7: Request by letter of the Chairman that the State Corporation Commission consider and report to JCHC on including Section 125 Plan information on both the Health and the Life & Annuity & Health insurance examinations.

Option 8: Request by letter of the Chairman that the Virginia Chamber of Commerce inform its membership of Section 125 Plans and associated benefits through its newsletter.

Option 9: Request by letter of the Chairman that the National Federation of Independent Businesses/Virginia include Section 125 Plans as part of the Federation's Area Action Council meetings with small businesses.

Option 10: Include in the 2009 workplan, that the Joint Commission convene a workgroup to compile information needed for an informational website on health insurers to be hosted by Virginia Health Information (VHI) with appropriate linkages on other state websites and address other health insurance issues as appropriate. The workgroup to develop the website should include:

- National Federation of Independent Businesses
- Virginia Association of Health Plans
- Virginia Association of Health Underwriters
- Virginia Chamber of Commerce
- Virginia Department of Health
- Virginia Department of Business Assistance
- Virginia Health Information.

Subsequent Action by the Joint Commission on Health Care. Based on study findings, JCHC members voted in support of Options 5, 8, 9 and 10 to encourage dissemination of information about the requirements and potential benefits associated with Section 125 Plans.

JCHC Staff for this Report
Stephen W. Bowman
Senior Staff Attorney/Methodologist

ATTACHMENT

Presented to the:

Joint Commission on Health Care

September 4, 2008

Stephen W. Bowman
Senior Staff Attorney/Methodologist

- Study Background
- Section 125 Plans
- Health Insurance Exchange
- Other Issues
  - Access to Health Insurance Options
  - Update: Riverside Share Program
  - Update: Maryland Health Insurance Partnership
- Policy Options

2

Organizations Contacted

- Agency for Healthcare Research and Quality
- Anthem
- Asset Protection Group, Inc.
- BB&T Insurance Services, Inc.
- Benefit Solutions Inc.
- Connecticut Business and Industry Association
- Connecticut General Assembly Office of Legislative Research
- Independent Insurance Agents of Virginia
- Internal Revenue Service
- Iowa Insurance Division
- JLARC
- Maryland Health Care Commission
- Massachusetts Commonwealth Connector
- Massachusetts Joint Committee on Health Care Financing
- Minnesota Department of Health
- Missouri Joint Committee on Legislative Research
- National Conference of State Legislators
- National Federation of Independent Businesses
- Office of the Secretary for Health and Human Resources
- Rhode Island Office of the Health Insurance Commissioner
- Riverside Health System
- State Corporation Commission
- Total Administrative Services Corporation
- Virginia Association of Health Underwriters
- Virginia Attorney General's Office
- Virginia Commonwealth University
- Virginia Association of Health Plans
- Virginia Chamber of Commerce
- Virginia Department of Business Assistance
- Virginia Department of Health
- Virginia Department of Tax
- Virginia Employment Commission
- Virginia Farm Bureau
- Virginia Health Underwriters Association
- Virginia Local Commissioner's of Revenue
- Your Benefits Partner

3

Study Background

Health Insurance Affordability Is the Primary Barrier

- Estimates range from 9% - 15.5%
  - 632,000 – 1 million non-elderly Virginians
- "Affordability is the primary barrier to obtaining health insurance"
  - JLARC health insurance study finding

Source: *Options for Extending Health Insurance to Uninsured Virginians*, Slide 4 and 5, JLARC, December 11, 2006.

5

Employers Have Been a Primary Source of Working Non-Elderly Obtaining Health Insurance

60% of firms offered health insurance in 2006; down from 69% in 2000

- Approximately 77% of covered employees pay 0% - 50% of premium costs (2006)
- Virginia health insurers often require significant employer contribution for small group plans
  - frequently 50% of premium

# Employees	% Offering Health Benefits (2006)
3 to 9	45%
10 to 24	76%
25 to 49	83%
50 to 199	94%
200 or more	99%
All Firms	**60%**

Sources: KFF/HRET *2007 Employer Health Benefits Survey* and discussion with Virginia Association of Health Plans

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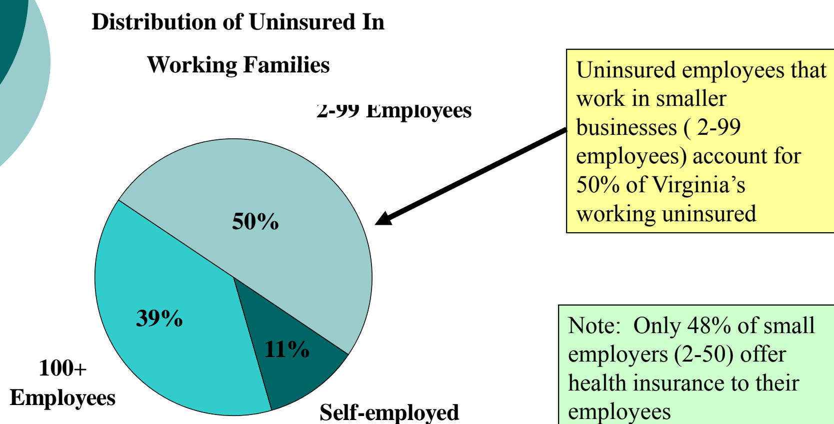
50% of the Working Uninsured Work for Smaller Employers

Distribution of Uninsured In Working Families



Uninsured employees that work in smaller businesses (2-99 employees) account for 50% of Virginia's working uninsured

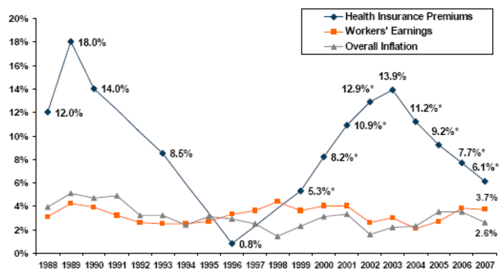
Note: Only 48% of small employers (2-50) offer health insurance to their employees

Source: *Options for Extending Health Insurance to Uninsured Virginians*, JLARC, December 11, 2006.

7

Health Insurance Premiums Continue to Increase

Exhibit 1: Increases in Health Insurance Premiums Compared to Other Indicators, 1988-2007



*Estimate is statistically different from estimate for the previous year shown (p<.05). No statistical tests are conducted for years prior to 1999.

Note: Data on premium increases reflect the cost of health insurance premiums for a family of four. The average premium increase is weighted by covered workers.

Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2007; KPMG Survey of Employer-Sponsored Health Benefits, 1993, 1996; The Health Insurance Association of America (HIAA), 1988, 1989, 1990; Bureau of Labor Statistics, Consumer Price Index, U.S. City Average of Annual Inflation (April to April), 1988-2007; Bureau of Labor Statistics, Seasonally Adjusted Data from the Current Employment Statistics Survey, 1988-2007 (April to April).

- Premiums are rising at a slowing rate
- Rate of increase is still greater than workers' earning increases

Sources: Kaiser Family Foundation and Health Research Educational Trust, *Employer Health Benefits* (2007)
Catlin, et al., *National Health Spending In 2005: The Slowdown Continues*, Health Affairs 26 (1): 142 (2007).

8

Background: Health Care Costs Study

- JCHC recommended in 2008 JCHC study the advisability of:
  - i) establishing a Virginia health insurance exchange targeted for small businesses,
  - ii) increasing employer adoption of Section 125 plans, and
  - iii) any other health insurance issues as deemed appropriate.

9

Section 125 Plans

Section 125 Plans Defined

- Enables employees to purchase health insurance policies with pre-tax dollars
  - Refer to Section 125 of the U.S. Internal Revenue Code
  - Group Plans (with or without employer contribution)
- Employee savings can be 25%-40% per dollar contributed towards health insurance
  - FICA (Social Security and Medicare payroll tax), federal and state income taxes
- Employers can decrease tax liability by decreasing their payroll taxes, if employees contribute to their health care premiums

Source: States use 'Cafeteria plans' to expand health insurance coverage, Cauchi NCSL Health Program, September 2008.

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About Section 125 Plans

- Employers which do not offer health insurance are not benefited as there would be no reduction in payroll taxes paid
- Not all entities and individuals can participate including:
  - Self-employed individuals
  - Partners in a partnership
  - Outside directors, limited partners and members in an Limited Liability Corporations (LLCs)

Source: Section 125 Flexible Benefit Plans, Benefit Solutions.

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Section 125 Plans Are Not Helpful When …..

- Low-income employees do not make enough to afford health insurance
  - Less than 200% of the Federal Poverty Guideline
- Employers that pay 100% of the employees' premiums are not benefited by setting up a plan
  - No payroll tax for employers or employees to deduct from wages or salary

Sources: Interviews with representatives from Independent Insurance Agents of Virginia and Virginia Health Insurance Underwriters, August 2008.

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Types of Section 125 Plans

- Section 125 plans can address
  - Premium Only Plans
  - Flexible Spending Accounts (FSA)
    - Medical Expenses
    - Dependent Care Expenses
  - Full Flexible Benefit Plan with Benefit Credits

Focus of the Presentation is increasing employer adoption of Section 125 - Premium Only Plans

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Section 125 Plan Requirements

- Plan must delineate:
  - Description of the benefits that may be elected
  - Eligibility rules
  - Method, timing and irrevocability of participant elections
  - Manner of any employer contribution
  - Maximum amount of employer and employee contributions under the plan
  - The Plan Year
- Plan must be adopted by employer

Source: Helping Your Employees Connect to Good Health: Section 125 Plan Handbook for Employers, Massachusetts Commonwealth Connector, Version 2.0 (July 1, 2007).

15

Section 125 Effect on Premium Cost: Employee Illustration # 1

Individual earning $50,000 Annually (~$24/hour) = 409% of Federal Poverty Guidelines

		Single
VA Small Group avg. monthly premium (2006)		$ 246
Payroll deduction amount (through 125 plan)		$ 246
Reduction in FICA tax →	7.65%	$ 19
Reduction in federal tax liability →	18%	$ 44
Reduction in VA state tax liability →	5.2%	$ 13
Net premium cost to employee (including after tax-savings)		$ 170
Total Monthly Tax Savings →	**31%**	**$ 76**

Sources: Internal Revenue Service and Virginia Department of Taxation.

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Section 125 Effect on Premium Cost: Employee Illustration # 2

Married Worker with Two Children earning $70,000 Annually (~$33.65/hour) = 339% of Federal Poverty Guidelines

		Family of 4
VA Small Group avg. monthly premium (2006)		$ 645
Payroll deduction amount (through 125 plan)		$ 645
Reduction in FICA tax →	7.65%	$ 49
Reduction in federal tax liability →	15%	$ 97
Reduction in VA state tax liability →	5.4%	$ 35
Net premium cost to employee (including after tax-savings)		$ 464
Total Monthly Tax Savings →	**39%**	**$ 181**

Sources: Internal Revenue Service and Virginia Department of Taxation.

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Section 125 Effect on Premium Cost: Employee Illustration # 3

Married Worker with Two Children earning $50,000 Annually (~$25/hour) = 235% of Federal Poverty Guidelines

		Family of 4
VA Small Group avg. monthly premium (2006)		$ 645
Payroll deduction amount (through 125 plan)		$ 645
Reduction in FICA tax →	7.65%	$ 49
Reduction in federal tax liability →	13%	$ 87
Reduction in VA state tax liability →	5.2%	$ 33
Net premium cost to employee (including after tax-savings)		$ 476
Total Monthly Tax Savings →	**39%**	**$ 169**

Sources: Internal Revenue Service and Virginia Department of Taxation.

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Section 125 Effect on Premium Cost: Employer Illustration # 1

Small firm with 10 employees has an annual payroll cost of $500,000

	§ 125 Plan w/o POP	§ 125 Plan w/ POP
Annual Payroll	$ 500,000	$ 500,000
Employee payroll deduction amounts (VA small group premium average (2006) – 5 single and 5 families of 4)	$ 0	$ 53,460
Taxable Payroll →	$ 500,000	$ 446,540
Annual Social Security Tax Rate 7.65%		
Annual Social Security Tax →	$ 38,250	$ 34,160

Employer Annual Tax Savings with Section 125 Plan $ 4,090

Source: Internal Revenue Service.

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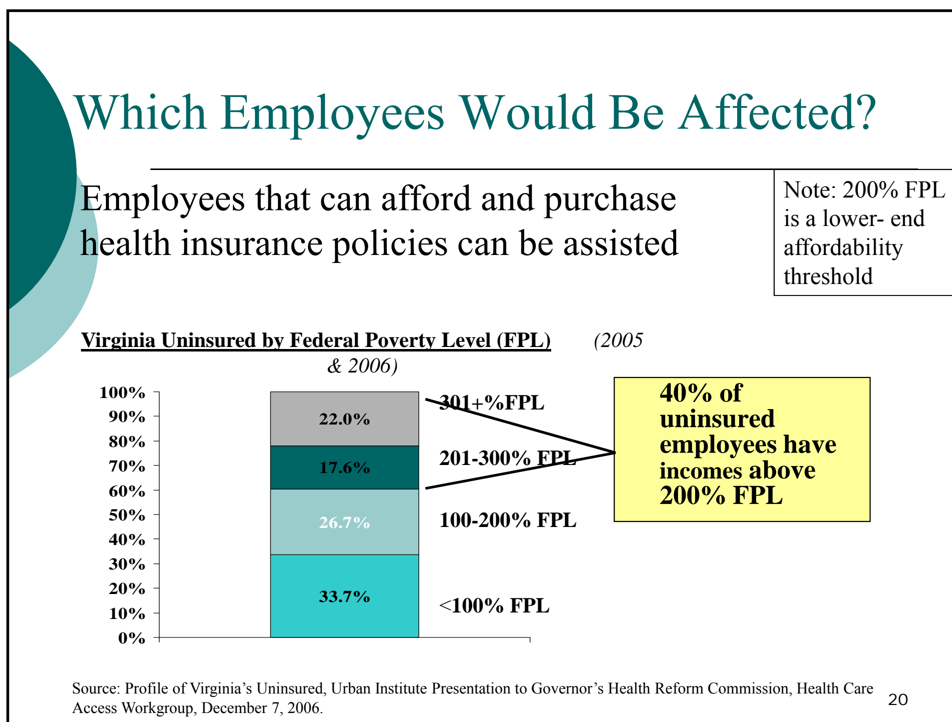
Which Employees Would Be Affected?

Employees that can afford and purchase health insurance policies can be assisted

Note: 200% FPL is a lower- end affordability threshold



Source: Profile of Virginia's Uninsured, Urban Institute Presentation to Governor's Health Reform Commission, Health Care Access Workgroup, December 7, 2006.

20

Virginia Small Businesses Are Much Less Likely to Offer Pretax Savings

Employers Offering Health Coverage w/o Pretax Savings	# of Employees Less than 50	50+
% of Employers	68%	8%
% of Employees Enrolled	52%	5%
	291,000 employees	139,000 employees

Note: If employer pays 100% of health insurance cost then there is no need for a Section 125 plan

Source: Unpublished estimates for Virginia provided by the Agency for Healthcare Research and Quality.

21

Why Haven't More Businesses Adopted Section 125 Plans

- Employer lack of knowledge
- Perception of:
  - Significant increased administrative burden
  - Cost
  - Time it takes to learn and develop plans
- Not all business owners can receive pretax benefits toward <u>their</u> premiums
- Tax consequences if plan not correctly set-up

Sources: Interviews with representatives from Independent Insurance Agents of Virginia, Virginia Association of Health Plans, and Virginia Health Insurance Underwriters, August 2008.

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Potential Benefits of 125 Plans

- Section 125 plans can be set up for as little as $100
- Profits can increase for employers that offer health insurance
- Employee health insurance costs can be reduced
- Increased health insurance adoption can improve health of employer's workforce
- Many parties can assist in creation of plans:
  - Health insurance brokers
  - Health insurers
  - Third-party administrators
  - CPAs
  - Attorneys

Sources: Interviews with representatives from Independent Insurance Agents of Virginia, Virginia Association of Health Plans, and Virginia Health Insurance Underwriters, August 2008.

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Initiatives in Other States

- Massachusetts – requires employers with 11 or more employees to offer at least a "premium only" Section 125 plan
  - Tax consequence if the employer does not contribute a portion to employee health insurance
  - State created document detailing how to set up plan with sample form
- Rhode Island – requires use of Section 125 plans for employers with 25 or more employees
  - No requirement for employers to contribute to the plans

Source: States use "cafeteria plans" to expand health insurance coverage, Cauchi NCSL Health Program, September 2008.

24

Initiatives in Other States

- Minnesota –employers affirm that they have read about Section 125 Plans or have a Section 125 Plan in place
- Iowa – Commissioner of Insurance required to assist small employers with implementing and administering Section 125 plans through information on website

Source: States use 'Cafeteria plans' to expand health insurance coverage, Cauchi NCSL Health Program, September 2008.

25

Possible Avenues to Encourage Section 125 Plan Adoption

- Websites
  - Virginia Business Portal
  - Business One-Stop - Virginia Department of Business Assistance
  - Virginia Health Information (VHI)
  - InsureMoreVirginians - Department of Health
  - Bureau of Insurance – State Corporation Commission
- Agencies that can assist small businesses regarding health insurance
  - Department of Business Assistance
  - Bureau of Insurance
  - Department of Health
- Professionals that serve small businesses
  - Brokers
  - Insurers
  - Third-party administrators
  - CPAs
  - Attorneys

Sources: Interviews with representatives from Independent Insurance Agents of Virginia, Virginia Association of Health Plans, and Virginia Health Insurance Underwriters, August 2008.

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Methods to Increase the Adoption of Section 125 Plans

- Amend the *Code of Virginia* to mandate that employers offer a Section 125 Plan if all of the following provisions are met:
  - 11 or more full-time employees,
  - Group health insurance is offered, and
  - Employee pays some part of the health insurance premium
  - *(Option 2)*
- Provide Section 125 Plan information to employers on state website, information may include:
  - Brief document highlighting Section 125 Plan benefits
  - Detailed document with Section 125 Plan requirements and adoption details
  - Detailed document with Section 125 Plan requirements and adoption details with sample Section 125 Plan adoption forms
  - *(Options 3, 4 and 5)*

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Methods to Increase the Adoption of Section 125 Plans (Continued)

- Amend the *Code of Virginia* to require employers with 11 or more full-time employees to affirm either:
  - Employer has read the state-created document regarding Section 125 Plans, or
  - Employer has a Section 125 Plan
  - *(Option 6)*
- Consider including Section 125 plan information on the State's health insurance broker examination.
  - (Option 7)

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- Work to increase adoption through awareness of Section 125 Plans through public-private partnership with:
  - Virginia Chamber of Commerce Newsletter
  - National Federation of Independent Businesses – Area Action Council meetings
  - *(Options 7 and 8)*

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Health Insurance Exchange Benefits and Types

- **BENEFITS:** Exchanges' goals are:
  - Promote competition
  - Provide consumers a single access point for:
    - A wide variety of high-quality of health insurance products
    - Understandable and complete information of products
- **TYPES:** Exchanges may:
  - Be a state or private entity
  - Be of large or small scope
  - Apply to either the individual or small group insurance market, or both
- Other state insurance reforms have occurred in concert with the creation of a health insurance exchange to further its ability to execute its role

Source: Health Insurance Exchange Study, Minnesota Department of Health, February 2008.

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Functions of a Health Insurance Exchange

- Single point of:
  - access to multiple insurance products
  - payment to multiple health insurers
- Exchange Does Not purchase policies
- Employees are allowed to choose best health insurance product for their situation, if other reforms are in place

Source: Health Insurance Exchange Study, Minnesota Department of Health, February 2008.

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Functions of a Health Insurance Exchange (Continued)

- Limited health benefits administration provided for employers
- Exchange may allow for:
  - Decreased premium cost by increasing competition between insurers
  - Individuals with multiple employers combine employer contributions toward health insurance

Source: Health Insurance Exchange Study, Minnesota Department of Health, February 2008.

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Current Health Insurance Exchanges

States with Exchanges:

Connecticut, Massachusetts, Washington

Massachusetts Role for Its Exchange

- Promote cost-effective high quality plan
- Decrease administrative health benefits burden for smaller business
- Facilitate pretax premium purchases through Section 125 plans

Sources: State Coverage Initiatives website at statecoverage.net and an interview with Sara Nolan, Senior Researcher, *Massachusetts Joint Committee on Health Care Financing*, August 2008.

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Establishing a Health Insurance Exchange is a Significant Investment

- An organization (public or private) would need to take on the administrative role of:
  - Deciding which insurers may offer products
  - Deciding types and standards of product offerings
  - Advising employers and employees on health products offered
  - Monthly billing to employers for insurance premiums
  - Payment of policy premiums to insurers

Initial Operational Cost of Massachusetts Exchange $25 Million (2006)

Sources: Health Insurance Exchange Study, Minnesota Department of Health, February 2008, and an Interview with Sara Nolan, Senior Researcher, *Massachusetts Joint Committee on Health Care Financing*, August 2008.

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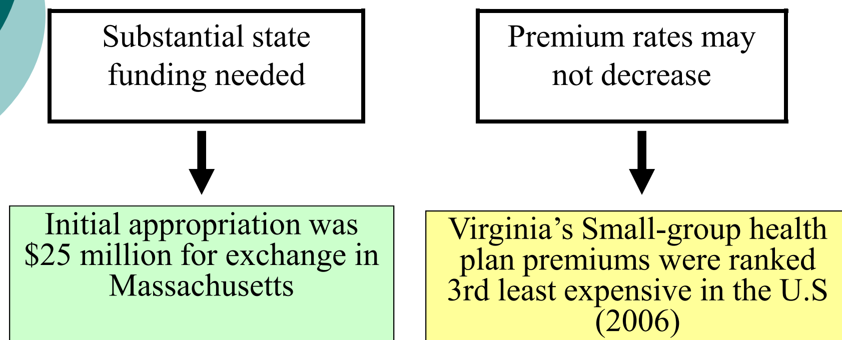
Health Insurance Exchanges Are Costly and May Not Decrease Premium Costs

Implications for Creating an Exchange in Virginia



Source: American Health Insurance Plans' Center for Policy and Research, *Small Group Health Insurance in 2006*, September 2006.

36

Other Issues

Finding All Health Insurance Options

- There is no place employers can go to consistently find all of the health insurance options in their area
- Market Breakdown: Some employers are not aware/misinformed of health insurance options

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Enhancing Consumer Avenues to Virginia's Health Insurance Options

Remedy: Establish website listing of health insurers that offer coverage by locality with contact information

- Workgroup to develop website:
  - National Federation of Independent Businesses
  - Virginia Association of Health Plans
  - Virginia Association of Health Underwriters
  - Virginia Chamber of Commerce
  - Virginia Department of Health
  - Virginia Department of Business Assistance
  - Virginia Health Information (VHI)
  - *(Option 10)*

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Riverside Share Program for the Working Uninsured

- Riverside Health System Foundation donated $1 million over two years
  - $100 per individual per month
  - Can serve 500 individuals
  - Working with Anthem to include HMO products
- Plan Specifics
  - Employee pays 1/3 of health insurance cost
  - Employer could not have offered insurance in the last 6 months
  - Employee's income is ≤ 200% FPL
  - Open to employee and spouse
    - Children can be enrolled in FAMIS

Source: Interview with Sally Hartman, Vice President, Riverside Heath System, August 2008.

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Maryland Health Insurance Partnership

Partnership Facts

- Employer assistance:
  - up to 50% of the premium cost
- Expected enrollment
  - 1500 employers
- Year 1 appropriation
  - $15 million
- Enrollment starts September 9th
- Coverage begins October 1st

Employer Requirements

- 2-9 employees
- Did not offer insurance in previous 12 months
- Average employee wage
  - under $50,000
- Must have Section 125 Plan

Source: Interview with Nicole Stallings, Maryland Health Care Commission, August 2008.

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Policy Options

Policy Options

Option 1: Take no action

Option 2: Amend the *Code of Virginia* to mandate that employers offer a Section 125 Plan if all of the following provisions are met:

- 11 or more full-time employees,
- Group health insurance is offered, and
- Employee pays some part of the health insurance premium

Note: No requirement for employers to provide health insurance or contribute to plan premiums.

Policy Options

Option 3: Request by letter of the Chairman that the Department of Human Resources Management (DHRM) in consultation with the Department of Business Assistance (VDBA) create a:

- Brief electronic document that highlights Section 125 benefits to post on the VDBA website and on Virginia's business portal website.

Option 4: Request by letter of the Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a:

- Detailed electronic document that highlights Section 125 benefits; requirements for adoption; and COBRA, ERISA and HIPPA implications for posting on the VDBA website and on Virginia's business portal website.

Policy Options

Option 5: Request by letter of the Chairman that the Department of Human Resources Management in consultation with the Department of Business Assistance (VDBA) create a:

- Detailed electronic document that highlights Section 125 benefits; requirements for adoption; COBRA, ERISA, and HIPPA implications; and a simple Section 125 plan form for posting on the VDBA website and on Virginia's business portal website.

Option 6: Amend the *Code of Virginia* to require that employers affirm on the Virginia Department of Taxation Form VA-6 that:

- Employer has a Section 125 Plan, or
- Employer has read the State-created document regarding Section 125 Plans.

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Policy Options

Option 7: Request by letter of the Chairman that the State Corporation Commission consider and report to JCHC on including Section 125 Plan information on both the Health and the Life & Annuity & Health insurance examinations.

Option 8: Request by letter of the Chairman that the Virginia Chamber of Commerce inform its membership of Section 125 Plans and associated benefits through its newsletter.

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Policy Options

Option 9: Request by letter of the Chairman that the National Federation of Independent Businesses/Virginia include Section 125 Plans as part of the Federation's Area Action Council meetings with small businesses.

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Policy Options

Option 10: Include in the 2009 workplan, that the Joint Commission convene a workgroup to compile information needed for an informational website on health insurers to be hosted by Virginia Health Information (VHI) with appropriate linkages on other state websites.

- The workgroup to develop the website should include:
  - National Federation of Independent Businesses
  - Virginia Association of Health Plans
  - Virginia Association of Health Underwriters
  - Virginia Chamber of Commerce
  - Virginia Department of Health
  - Virginia Department of Business Assistance
  - Virginia Health Information.

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Public Comments

- Written public comments on the proposed options may be submitted to JCHC by close of business on October 6, 2008.
- Comments may be submitted via:
  - E-mail: sareid@leg.state.va.us
  - Fax: 804-786-5538
  - Mail: Joint Commission on Health Care
P.O. Box 1322
Richmond, Virginia 23218
- Comments will be summarized and presented to JCHC during its October 23rd meeting.

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