Practical Law™

Expert Q&A on the Effects of Health Care Reform on Retirement Plans

PRACTICAL LAW EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

An expert Q&A with Marcia S. Wagner of The Wagner Law Group on the effects of health care reform on retirement plans.

At first glance, health care reform (the Patient Protection and Affordable Care Act (PPACA) as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA)), does not seem to affect qualified plans, since health care reform regulates health care and not retirement plans. However, a closer examination of health care reform reveals that it could make a significant difference for retirement plans for employees, employers and the retirement community generally.

HOW COULD HEALTH CARE REFORM AFFECT EMPLOYEES OF EMPLOYERS THAT OFFER RETIREMENT PLANS?

Health care reform currently requires most employees to maintain health care, generally through their employer or a state or federal health insurance marketplace called an exchange (see *Practice Note, Health Insurance Exchange and Related Requirements under Health Care Reform (www.practicallaw.com/4-507-2259)*).

If employees do not have their health care tied to their employers, they may have less of an incentive to stay at their current jobs in order to maintain health care coverage, as many employees do. Higher paid employees may take advantage of the ability to obtain insurance through the exchanges and start their own businesses or retire early. This could result in earlier retirement plan distributions than were previously anticipated and could require different criteria when establishing investment and liquidity strategies.

Additionally, employees who leave the workforce need to be replaced. While older employees tend to be fully vested in their retirement benefits, new employees (whether older or younger in age) have several years ahead of them before they become vested in their retirement benefits. This could save employers money because not all newly hired employees work the required number of years to fully vest in their retirement benefits. Employees who terminate employment before being fully vested may forfeit some or all of their retirement benefits (see *Practice Note, Requirements for Qualified Retirement Plans: Vesting Requirements (www.practicallaw.com/3-506-6895)*).

New employees tend to have less experience than the employees they replace, which means that employers could pay lower salaries. Lower salaries could result in reduced employer pension plan contributions and smaller 401(k) plan employer matching contributions. However, for certain positions and industries, the opposite could be true as some employers may be forced to increase salaries and benefits to attract the desired employees.

Under health care reform, most lower salaried employees must obtain health care coverage and may be unable to afford to pay for health care and also make 401(k) plan contributions. Since there is a penalty for failing to obtain health care insurance beginning in 2014 (see *Practice Note, Health Care Reform: Overview: Individual Mandate (www.practicallaw.com/7-502-3192*), these employees may choose to purchase health insurance or contribute to their employer's health care plans, but forego contributions to their retirement plans.

A reduction in the overall participation and contribution rate of the lower-paid employees could change the demographics of plan participation and lead to average deferral percentage and average contribution percentage issues during 401(k) plan discrimination testing (see *Practice Note, Requirements for Qualified Retirement Plans: Nondiscrimination Rules (www.practicallaw.com/3-506-6895)*).

HOW COULD HEALTH CARE REFORM AFFECT EMPLOYERS THAT OFFER RETIREMENT PLANS?

Under health care reform, beginning in 2015 (but subject to Internal Revenue Service (IRS) transition relief), employers must provide a certain level of health care benefits or pay penalties (see *Practice Notes, Employer Mandate under Health Care Reform: Overview (www.practicallaw.com/0-523-4715), Employer Mandate under Health Care Reform: Determining Full-time Employees for Employer Payments (www.practicallaw.com/9-524-2565)*, and *Transition*

THOMSON REUTERS™

Relief for the Employer Mandate under Health Care Reform (www.practicallaw.com/4-558-8106)). Some employers who have already established the overall amount they wish to contribute for employee benefits may react to this new requirement by cutting back on their 401(k) matching contributions, which could result in less incentive for employees to make 401(k) plan contributions. While this might seem like a neutral transfer of employer assets from one form of benefits to another, it could ultimately result in problems with discrimination testing for employers.

One of the employer penalties under health care reform applies in situations where coverage offered by an employer is considered unaffordable (see *Practice Note, Employer Mandate under Health Care Reform: Overview: Two Types of Employer Mandate Payments (www.practicallaw.com/0-523-4715)*). In these situations, the employer must pay an annual penalty of $3,000 for each full-time employee who enrolls in an exchange and receives a health care premium tax credit. Coverage under an employer-sponsored plan is considered unaffordable if the employee's share of the premium for self-only coverage is more than 9.5% of his annual household income for the year. However, employers generally do not know their employees' household incomes.

As a safe harbor, the IRS provides that if the employee's contribution for self-only coverage under the employer's lowest cost health plan option does not exceed 9.5% of the employee's Box 1 pay on the Form W-2 for that year, the affordability test is satisfied (see *Practice Note, Employer Mandate under Health Care Reform: Overview: Affordability Requirement and Safe Harbors (www.practicallaw.com/0-523-4715)*). However, Box 1 on the Form W-2 does not include any salary deferrals made by an employee to a 401(k) plan.

Health care reform could have the inadvertent effect of discouraging employers from establishing or maintaining 401(k) plans, since any reduction in Box 1 salary due to employee 401(k) plan contributions could make it more likely that the employer's group health plan does not pass the affordability test for that employee.

Beginning in 2014, health care reform prohibits group health plans from applying a waiting period of more than 90 days (see *Practice Note, Ninety-day Limit on Waiting Periods under Health Care Reform (www.practicallaw.com/0-525-3558)*). A waiting period is generally the time that must pass before coverage for an individual who is "otherwise eligible" to enroll under the plan becomes effective. For administrative purposes, many employers prefer to have newly-hired employee become eligible for all employee benefit plans at the same time. For employers who provide the opportunity to enroll at the time of hire and do not impose a waiting period, there would not be a violation of the 90-day waiting period limit. However, employers who apply a 401(k) plan eligibility waiting period of more than 90 days might have to reconsider their plans' provisions or change to a policy that permits eligibility for different plans at different times.

HOW COULD HEALTH CARE REFORM AFFECT THE RETIREMENT PLAN INDUSTRY GENERALLY?

Health care reform may also affect the retirement plan community generally if health care brokers find that their commissions are diminishing due to heavy participation in the newly created federal and state health care marketplaces and therefore many brokers switch over or start to focus on 401(k) plans. While this may result in reduced administrative costs due to increased competition, employers should be wary of professionals who hastily switch their area of expertise.

The success of the state and federal marketplaces could also lead to a radically different approach to retirement planning. Senator Tom Harkin (D-Iowa) has proposed the creation of the USA Retirement Fund, which would be similar to the health care marketplaces in that individuals could contribute to this fund, with or without employer participation, to establish their own retirement coverage. At this point, it remains to be seen whether the concept of this type of retirement fund will gain acceptance.

For the links to the documents referenced in this note, please visit our online version at **http://us.practicallaw.com/7-502-3192**

05-14