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

At first glance, the Patient Protection and Affordable Care Act (PPACA), as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA) (collectively, health care reform), does not seem to affect retirement plans, since health care reform regulates health care and not qualified retirement plans. However, a closer examination of health care reform reveals that it could make a significant difference for employee retirement plans, employers that offer retirement plans and the retirement plan industry generally. Practical Law asked Marcia Wagner of The Wagner Law Group, P.C. to discuss the implications of health care reform for retirement plans.

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**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. If employees do not have their health care tied to their employers, employees may have less of an incentive to stay at their current jobs in order to maintain health care coverage. 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 younger or older 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.

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, 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 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.

Search Health Care Reform: Overview for more on the individual mandate.

Search Health Insurance Exchange and Related Requirements under Health Care Reform for more on the health insurance exchange.

### 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. 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. 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 the affordability test is satisfied 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. 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. 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 a 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.

Search Ninety-day Limit on Waiting Periods under Health Care Reform for more on the 90-day waiting period limit.

Search Employer Mandate Toolkit or see page 38 in this issue for information on complying with the employer mandate.

### How could health care reform affect the retirement plan industry 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, many brokers may switch over to 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 health care 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.

### What are the next steps for employees?

The majority of employees will continue to work at their current jobs and participate in their employer's group health plan and retirement plans. However, depending on their individual circumstances employees may wish to examine:

- Their long-term goals and whether a second job or employment of a spouse is still needed, since adequate health care coverage is not dependent on employment.
- Their rights under the new health care marketplaces, including eligibility, enrollment and potential government subsidies.
- Whether to start their own business. An employee that wishes to start a business may have to plan for health care coverage once he terminates employment.

- For those who have longer term plans to start a business, whether to increase their 401(k) plan contributions to take full advantage of their employer's matching program or to assure the existence of sufficient savings for start-up costs for the new business.

### What are the next steps for employers?

Employers should carefully examine their current situation, as well as their own employee benefits objectives, in order to create a long-term response to the changes brought by health care reform. Employers should:

- Examine the demographics of their workforce to determine if there are a significant number of employees who may be able to terminate employment or retire early.
- Determine if they may be subject to the pay-or-play penalty and, if so, whether the use of the W-2 safe harbor may create penalties that could be avoided by using a more exact method of determining health care affordability.
- Review the previous years' retirement plan discrimination testing to determine if relatively small variances in employee participation and contribution rates could negatively affect test results.
- Not allow health care reform's complexity to cause the benefits staff to overlook retirement plan compliance. Often small to medium-sized employers use the same personnel for all benefits administration. With new health care reform rules and regulations constantly being issued, these personnel could neglect the retirement side of the equation.
- Reassess employee benefits objectives as a whole to determine, among other things, whether, in view of the new health care reform requirements, the amounts paid for employee benefits are achieving their intended purpose.