



EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION

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May 26, 2009

Via Email

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Grassley:

The Employers Council on Flexible Compensation (ECFC) appreciates the opportunity to submit comments on the Senate Finance Committee options presented in the May 20th document “Financing Comprehensive Health Care Reform: Proposed Health System Savings and Revenue Options.” ECFC’s more than 100 member companies include employers who sponsor employee benefit plans as well as insurance, accounting, consulting, and actuarial companies that design or administer employee benefit plans that serve millions of Americans throughout the nation.

ECFC applauds the Finance Committee’s efforts to reform our nation’s health care system. Making health care coverage more affordable and accessible is long overdue. However, several of the financing options under consideration seemingly run counter to that objective. The employer-based system and the range of coverage options available have succeeded in extending coverage to millions of working Americans and their families. ECFC clearly agrees that expanding coverage is an imperative step in ensuring not only individuals’ health, but also the nation’s economic health. That said, ECFC implores the Committee to make sure that any changes to the health care system to expand coverage to individuals who currently are uninsured do not have detrimental outcomes for the many more millions of Americans who are satisfied with the health coverage they currently receive through their employer. The employer-based approach and current options can and should remain a fundamental component of a reformed health care system.

Option to Modify the Exclusion for Employer Provided Health Coverage

Current tax rules provide a preference for employer-provided health coverage, whether paid for directly by the employer or by the employee on a pre-tax basis through a cafeteria plan. This so-called “employer exclusion” is actually a tax benefit for working Americans and their families who receive (or elect to receive) part of their otherwise taxable compensation in the form of health coverage. The exclusion has succeeded in expanding health coverage to over 160 million employees, spouses, and dependents in large part due to its flexibility. The exclusion, when combined with individual account based plans such as flexible spending arrangements (FSAs), health reimbursement arrangements (HRAs), and health savings accounts (HSAs), encourage employees to make efficient use of their health care dollars because the money they spend is their own. ECFC believes that modifying the exclusion will have significant unintended consequences on the affordability and accessibility of health care for the following reasons:

- Reducing, capping or repealing this incentive will increase the cost of health coverage for working Americans and their families. Depending on an individual’s tax bracket, the effective tax increase for working Americans from repealing the employer exclusion could range from 7.65 percent (for those working Americans who pay no income tax) to over 40 percent of the cost of health coverage.
- While some debate exists with regard to the degree of impact, earlier studies have shown that for every 1 percent increase in the cost of health care, an additional 0.2 percent to 0.6 percent of individuals covered would lose health insurance coverage and become uninsured.¹ Using even the lower end of these studies would result in approximately 300,000 individuals losing coverage for every 1 percent real increase in the cost of coverage. The impact of such a provision on working Americans would be catastrophic.
- Reducing, capping or repealing the current tax exclusion for employer provided health care would increase an employer’s FICA taxes by up to 7.65 percent of the cost of employer paid health care (i.e., the employer’s share of FICA taxes on health insurance). This outcome will produce one of two negative results: (1) employers that are marginally able to provide health coverage will stop offering it or (2) employers will likely shift more health care costs to employees. Research has shown that the tax price of health coverage has a significant effect on employers’ coverage decisions. In fact, a 2002 study found that each percentage point in tax price – which results in higher costs to the employer – leads to a 0.63 percentage point increase in uninsurance.²

¹ J. Gruber and J. Poterba, "Tax Subsidies to Employer-provided Health Insurance," working paper no. 5147, National Bureau of Economic Research. June 1995; K.E. Thorpe. et al.. "Reducing the Number of Uninsured by Subsidizing Employment-based Health Insurance: Results from a Pilot Study," *Journal of the American Medical Association* (19 February 1992), 945-948; N.L. Barrand and W.D. Helms, "Testimony before the Subcommittee on Health, Committee on Ways and Means, United States House of Representatives," (Princeton. NJ): The Robert Wood Johnson Foundation. 1991).

² Gruber, J. (2002). The Impact of the Tax System on Health Insurance Coverage. *International Journal of Health Care Finance and Economics*, 1, 293-304.

- Employers have created and implemented some of the most successful innovations in health care that have lowered costs, and more importantly, improved quality and health outcomes including but not limited to: chronic care coordination programs, health and wellness programs, and consumer oriented health care through account based plans. A limit on the tax exclusion will likely crowd out such programs, resulting in less employer involvement and innovation. Less employer involvement results in a reduction in, or perhaps even an elimination of, the cost saving innovation provided by employers.
- Many of the individual protections that guarantee access to health coverage regardless of health status (HIPAA), disability (ADA), or age (ADEA) arise as a result of employer involvement. Elimination of the employer exclusion will result in less employer involvement and less protection of the interests of those least able to afford coverage.

Option to Modify or Repeal the Exclusion for Employer-Provided Reimbursement of Medical Expenses Under Flexible Spending Arrangements and Health Reimbursement Arrangements

Flexible Spending Arrangements (FSAs) and Health Reimbursement Arrangements (HRAs) allow employers to provide medical reimbursement to employees for expenses not covered by insurance. Health care needs vary by individuals, and these accounts offer one of the few health care delivery vehicles that truly enable employees to meet their personal health care need in a cost effective way. Health FSAs and HRAs also reduce costs because they encourage individuals to be a better consumer with respect to needed treatment. For example, an employee participating in a Health FSA funded with pre-tax salary reductions is much more apt to ask about generic medications if such medication will be reimbursed from the Health FSA so as to preserve the account balance for other health expenses. These types of arrangements also can be particularly important for individuals with a chronic condition, who can use these funds to obtain services and supplies necessary to maintain their health.

Through the current range of options and mechanisms, employees can choose cost-effective policies that work best for them and reject options that may be wasteful. Indeed, rather than curtailing the current tax benefits for FSAs and HRAs, such arrangements should be further encouraged by, for example, eliminating the current regulatory “use-or-lose” requirement for FSAs and allowing HRAs to co-exist along with HSA arrangements (discussed below).

Option to Modify Health Savings Accounts

At present, over 8 million Americans have chosen an HSA. Similar to FSAs and HRAs, HSAs enable employees to tailor the health benefits to meet their needs. HSAs also provide an important mechanism to help individuals effectively save for future health care expenses, including anticipated retiree health expenses. The options considered for HSAs could have several unintended consequences for the following reasons:

- HSA distributions are currently subject to the same substantiation requirements as other tax benefits, that is, the taxpayer is ultimately responsible for demonstrating that the HSA distribution was taken only for medical care expenses. Any additional substantiation and

reporting requirement for HSA distributions would increase HSA administrative and transaction costs, which will ultimately increase the cost to deliver health care for the millions of Americans who maintain HSAs.

- Limiting the HSA contribution amount to the deductible amount would result in many Americans exhausting their HSA balance each year and discourage individual savings for future health care expenses. Although Americans are encouraged to save for retirement through pension and 401(k) plans, they traditionally have not been encouraged to do the same for health care costs -- even though health care costs consume a significant portion of a retiree's income.
- Subjecting HSA contributions to any limit on employer-provided coverage would create a disincentive for employers to offer arrangements that provide desirable flexibility to employees and allow them to manage their own health care expenses.

Studies have shown that HSAs, combined with high deductible health plan (HDHP) coverage actually work to help control employer health care costs. Instead of curtailing HSA tax benefits HSAs should be further encouraged (and expanded) by, for example, clarifying when preventive care drugs can be covered on a tax free basis and allowing additional employer contributions (for example, for chronically ill employee HSA accountholders).

Option to Limit the Qualified Medical Expense Definition

A 2003 Internal Revenue Service (IRS) ruling clarified the eligibility of over-the-counter (OTC) medications for reimbursement under an FSA or HRA. As a result, many employees have opted for less expensive OTC drugs to treat some of the most common ailments (e.g., allergies, reflux). Indeed, the administration of OTC expenses through point of sale inventory information approval systems (IIAS) created in accordance with IRS guidance is one of the more cost effective methods of administering health care reimbursements. We believe that the proposed option to eliminate the tax exclusion for OTC drugs would result in an increase in health care costs because:

- If the OTC exclusion is reversed many employees will opt for much more expensive prescription drugs in lieu of their much less expensive OTC counterparts -- primarily because prescription drugs would be covered by their plan (oftentimes subject to only a nominal copayment).
- Traditional health plans would be unable to allow OTC substitution because they do not have the administrative infrastructure to provide taxable benefits. In other words, health plans are not equipped to track (and report) taxable benefits. Thus, in lieu of OTCs, more expensive prescription drug utilization would increase costs, without an increase in the quality of care.
- To the extent OTC drugs are not covered by the employer's plan, employees may forgo purchasing expensive prescription drugs, which will reduce the ability to effectively treat medical conditions and will thus will increase health care costs.

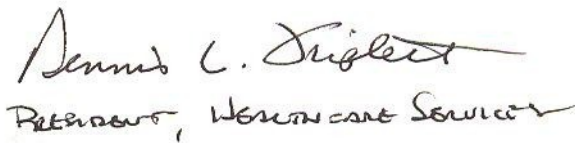
ECFC understands that the Committee is grappling with a very challenging and complex issue and that there are no easy answers. Our members appreciate that the Committee is holding such careful and open deliberations on the financing mechanisms. We hope, as those deliberations continue, that the Committee will strive to achieve greater affordability and accessibility without unnecessarily jeopardizing current policies that have enabled millions of employees and their dependents to receive dependable, quality health care coverage through their employers.

Thank you for considering ECFC's views on these matters. We would welcome the opportunity to discuss them in greater detail with you should you have any further questions.

Sincerely,

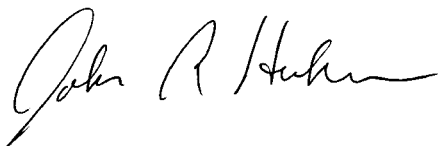


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cc: United States Senate Committee on Finance Members