CHRT

ISSUE BRIEF

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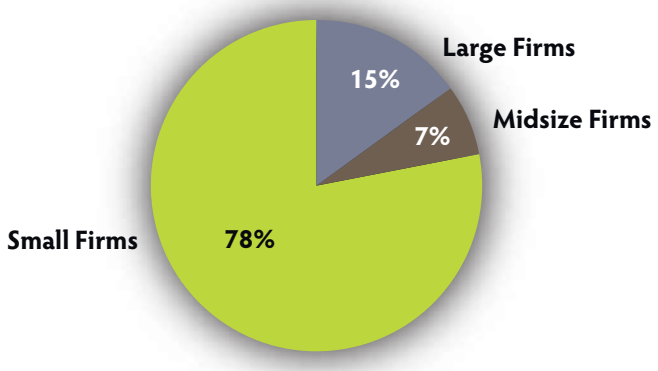
The Affordable Care Act and Its Effects on Small Employers

The Patient Protection and Affordable Care Act (ACA) is expected to increase access to affordable health insurance through a variety of provisions, many of which relate to employer-sponsored health coverage. A previous CHRT report details how the ACA impacts both midsize (100 to 1,000 employees) and large (more than1,000 employees) firms,[1] but certain provisions uniquely affect small firms (fewer than 100 employees).[2] In general, small firms will have to decide whether or not to offer health coverage, but this decision and its impact may not be so clear cut. Various incentives and penalties are built into the ACA to persuade more small businesses to offer coverage, but these levers are not applied uniformly across all small firms. Many of the provisions relevant to small firms depend on a number of variables, and small employers will have to first understand their own specific characteristics before understanding the impact of the ACA. For Michigan, understanding the true impact of ACA provisions on small employers is vital, as small firms represent the majority (78 percent) of private-sector firms in the state.[3] FIGURE 1

FIGURE: 1
Percentage of Private-Sector Firms in Michigan by Firm Size, 2011



Source: CHRT Analysis of 2011 MEPS-IC data

[1] J. Fangmeier and M. Udow-Phillips. 2011. *The Affordable Care Act and Its Effects on Midsize and Large Employers* (Ann Arbor, MI: CHRT). **http://www.chrt.org/assets/policy-briefs/CHRT-Policy-Brief-October-2011.pdf**.

[2] The federal government defines small businesses as those with fewer than 100 employees, but states will have the option to define small businesses as those with fewer than 50 employees from 2014 to 2016.

[3] Data from the AHRQ Medical Expenditure Panel Survey Insurance Component (MEPS-IC) measures firms with fewer than 10, 10 to 24, 25 to 99, and fewer than 50 employees. These figures were used to generate estimates for small firms with 100 employees or fewer. See **http://meps.ahrq.gov/mepsweb/survey_comp/Insurance.jsp** (accessed 5/1/13).

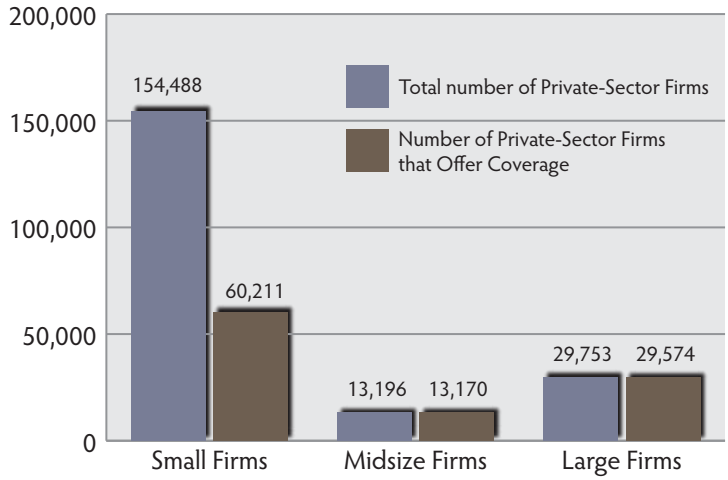
Small Firms in Michigan

On average, small businesses pay higher premiums than larger firms due to greater administrative costs, higher overhead, and reduced ability to spread risk across a large workforce. As a result, small businesses are also less likely to offer health coverage compared to larger employers. FIGURE 2

Low rates of offering coverage are not uniform across all small firms. Indeed, the largest gap is among the smallest firms with fewer than 10 employees and, in 2011, these firms represented the majority (96 percent) of small firms in the state.[4]

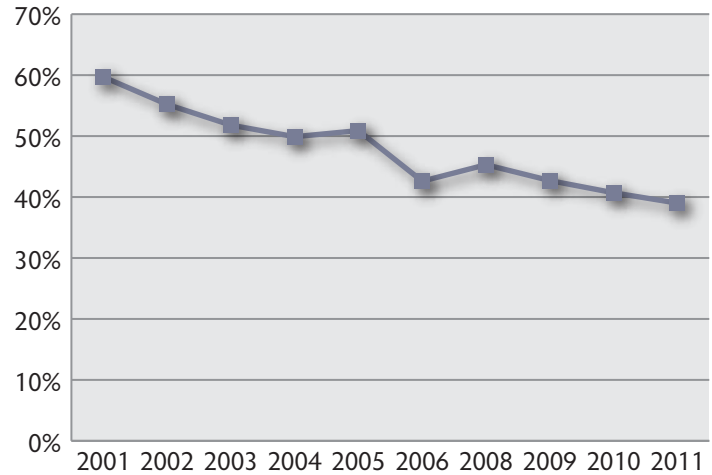
While it has generally been the case that small firms are less likely to offer health insurance coverage than midsize and larger firms, this low offer rate has worsened during the past decade. In Michigan in 2011, nearly 100 percent of midsize and large firms offered coverage to their employees, compared to less than 40 percent of small private-sector firms. Just 10 years earlier, in 2001, 60 percent of small firms in the state offered coverage. FIGURE 3

FIGURE:2
Number of Private-Sector Firms in Michigan Offering Coverage by Firm Size, 2011



Source: CHRT Analysis of 2011 MEPS-IC data

FIGURE:3
Percentage of Small Private-Sector Firms in Michigan Offering Coverage, 2001 to 2011



Source: CHRT Analysis of 2011 MEPS-IC data

[4] CHRT analysis of 2011 MEPS-IC Data.

The Effect of the Affordable Care Act on Small Firms

The effect of the ACA on small employers will depend on a number of variables, such as wages and workforce characteristics. If a small firm has a plan that is grandfathered[5] or if they choose to self-insure, certain provisions in the ACA will not apply to them. About 54 to 76 percent of small firms in 2011 had a grandfathered plan,[6] but given current trends, that percent will decline over time.[7] By 2016, it is projected that 88 percent of these small firms will have lost their grandfathered plan with most purchasing a plan elsewhere.[8] And, while there has been some discussion that the ACA may result in more small businesses becoming self-insured, only 11 percent of small firms that offered coverage in Michigan had a self-insured plan in 2011[9] and this percentage is expected to remain relatively stable.[10,11] Finally, there has been some speculation that small firms will adjust their payroll levels and/or workforce size to avoid some of the provisions of the ACA. While this may occur to some degree, these changes are likely to have only a small effect on coverage trends given the current size and coverage characteristics of small employers.

Overall projections on how coverage levels among small employers will change as a result of the ACA are mixed and range from estimates of a 10 percent drop in small employer-sponsored coverage to an 11 percent increase in employer-sponsored insurance.[12,13]

[5] Grandfathered plans must have been in effect prior to March 23, 2010, and have made relatively few changes in scope of coverage or cost sharing since that time.

[6] G. Claxton et al. 2011. *Employer Health Benefits 2011 Annual Survey* (Menlo Park, CA and Chicago, IL: Kaiser Family Foundation and Health Research & Educational Trust). **http://ehbs.kff.org/pdf/2011/8225.pdf** (accessed 3/12/13).

[7] C. Eibner et al. 2012. Small Firms' Actions in Two Areas, and Exchange Premium and Enrollment Impact. *Health Affairs*, 31(2): 324–331.

[8] Ibid.

[9] CHRT analysis of 2011 MEPS-IC data.

[10] K. Lucia, C. Monahan, and S. Corlette. April 2013. *Factors Affecting Self-Funding by Small Employers: Views from the Market* (Washington, D.C.: The Urban Institute). **http://www.rwjf.org/content/dam/farm/reports/issue_briefs/2013/rwjf405372** (accessed 4/10/13).

[11] Eibner et al. 2012.

[12] P.H. Keckley, E.L. Stanley, and K. Kenny. October 2012. *Impact of Health Care Reform on Insurance Coverage: Projection Scenarios Over 10 Years—Update 2012* (N.p.: Deloitte Center for Health Solutions). **http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_chs_2012InsuranceCoverageProjectionScenarios_09252012.pdf** (accessed 4/18/13).

[13] Eibner et al. 2012.

Employer-relevant ACA Provisions

While most elements of the ACA affecting employers take effect in 2014, some have already been implemented. Provisions already in effect for employers of any size that offer self-insured and fully-insured coverage include:

- Extension of dependent coverage for adult children up to age 26 (ACA, Section 2714)
- Prohibition of health plans from excluding children under age 19 from coverage due to a pre-existing condition (Section 2704)
- Requirement of health plans to cover preventive services without cost-sharing (Section 2713)
- Elimination of lifetime benefit limit and a phasing out of annual benefit limits (Section 2711)

Some provisions that take effect in or after 2014 also apply to employers of any size. A previous CHRT report[14] details these provisions, which include:

- Nondiscrimination rules and penalties for fully insured groups that offer richer benefits to only select employees (ACA Section 1001, PHSA Section 2716, Effective 2014)
- Excise tax on high cost self-insured and fully insured plans that exceed annually adjusted limits for individuals and families (Section 9001, Effective 2018)

[14] CHRT. 2011. *The Affordable Care Act and Its Effects on Midsize and Large Employers.* **http://www.chrt.org/assets/policy-briefs/CHRT-Policy-Brief-October-2011.pdf**.

Key Provisions in the ACA for Small Employers

The following summaries describe those ACA provisions that go into effect in 2014 and are most relevant to small firms.

"Play or Pay" Rules

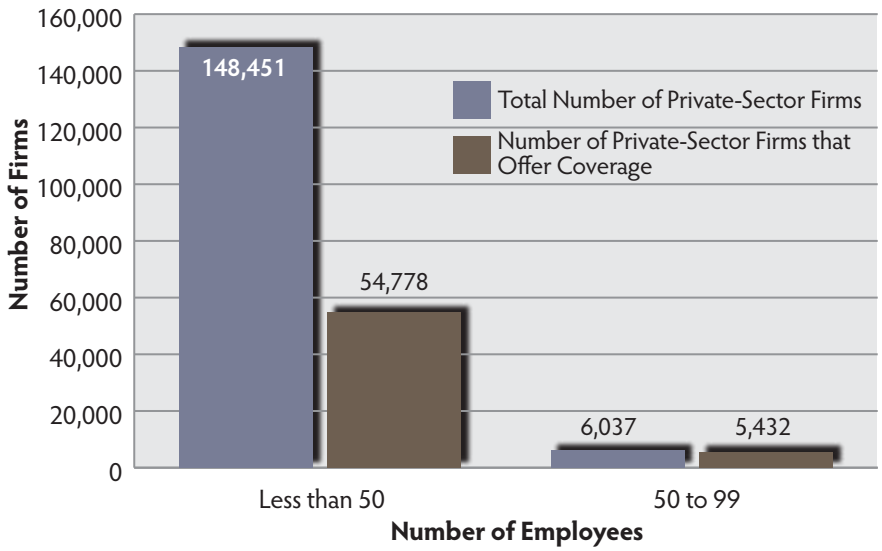
Section 1513

Beginning in 2014, some small firms will be required to either offer affordable health coverage ("play") or pay a penalty ("pay"). Small firms with 50 or greater full-time equivalents (FTEs) will be subject to this rule if they do not provide affordable insurance to at least 95 percent of their full-time employees. In 2014, the penalty will be $2,000 per full-time employee per year beyond the first 30 employees, not including part-time workers (those who work fewer than 30 hours per week) or seasonal workers (fewer than 120 days per year). The amount of the penalty will increase thereafter by the rate of premium inflation. Small firms with fewer than 50 FTEs are exempt from all penalties.[15]

Small firms in Michigan are likely to remain largely unaffected by the "play or pay" rule as most have fewer than 50 employees. Moreover, most small firms with 50 to 99 employees already offer coverage, although their plan design may need to change to conform to the requirements of the ACA. Figure 4

Figure:4

Number of Small Private-Sector Firms in Michigan Offering Coverage, by Number of Employees 2011



Source: CHRT Analysis of 2011 MEPS-IC data

[15] Full-time equivalents equal the number of full-time workers (>30hrs/week) plus (total hours worked by part-time workers/2,080). Hours from seasonal workers are not included in this calculation.

SHOP Exchanges

Section 1311

In addition to individual exchanges, each state will have a Small Business Health Options Program, (SHOP) Exchange (administered either by the state, the federal government, or through a federal-state partnership). The SHOP Exchange is designed to facilitate affordable insurance for smaller businesses by spreading administrative cost, providing greater purchasing leverage, promoting employee choice, and pooling the risk across multiple firms. In the first year of operation, however, federally-facilitated exchanges will only allow firms to purchase a single plan to offer employees and these plans will not be required to aggregate premiums. Therefore, in 2014, small businesses that purchase plans on federal SHOP Exchanges will need to choose one plan for all their eligible employees, while in 2015 and onward, businesses will be able to choose a general coverage level, and employees will choose a plan on the exchange within that level.[16] State-run and federal-state partnership SHOP Exchanges have the option to impose these purchasing limitations through 2014.

To be eligible for the SHOP Exchange, a business must have fewer than 100 employees (part-time and full-time are counted equally and seasonal employees are counted proportionally to the time worked). A state may limit the exchanges to businesses with fewer than 50 employees until 2016, at which point they must open to businesses with up to 100 employees with the option to expand to larger firms.[17] In both federally-facilitated and federal-state partnership exchanges, the U.S. Department of Health and Human Services will defer to the state's definition of their small group market. Based on the current definition of the small group market in Michigan, the SHOP Exchange will be limited to firms with fewer than 50 employees until 2016. Small firms may also purchase coverage outside of the exchanges but they will still be subject to all requirements of the ACA.

In 2006, Massachusetts created similar state-run health insurance exchanges. Their experience found that individuals made up the vast majority of exchange purchasers in 2011; small businesses only represented approximately 16 percent of the policies purchased on the exchange.[18,19] The percentage of small businesses offering coverage, however, remained stable at just over 70 percent.[20]

Affordability Tests

Section 1321

Health coverage under the ACA must be considered "affordable" by employees. There are two tests to make this determination. First, employee premium contributions for single coverage cannot exceed 9.5 percent of the employee's annual income. Second, the plan must cover at least 60 percent of healthcare expenses, otherwise known as having a "minimum actuarial value" of 60 percent. If both requirements are not met, the employee is eligible for subsidies to purchase insurance on the exchange, and the employer is subject to an annual $3,000 penalty for each employee receiving subsidies. The penalty for not providing affordable coverage cannot exceed the amount of their "play or pay" penalty. Therefore, a firm with 50 or more FTEs cannot reduce its *penalty costs* for an unaffordable plan by dropping employee coverage altogether. Firms with fewer than 50 FTEs are exempt from affordability requirements.

[16] U.S. Department of Health and Human Services. March 11, 2013. Patient Protection and Affordable Care Act; HHS Notice of Benefit and Payment Parameters for 2014. *Federal Register*, 78 (47): 15410–15541. **http://www.gpo.gov/fdsys/pkg/FR-2013-03-11/pdf/2013-04902.pdf** (accessed 3/11/13).

[17] U.S. Department of Health and Human Services. July 15, 2011. Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans: Proposed Rule. *Federal Register*, 76 (136): 41866–41927. **http://www.gpo.gov/fdsys/pkg/FR-2011-07-15/pdf/2011-17610.pdf** (accessed 4/22/13).

[18] Kaiser Family Foundation. January 22, 2013. State Exchange Profiles: Massachusetts. *Health Reform Source*. **http://healthreform.kff.org/state-exchange-profiles/massachusetts.aspx** (accessed 4/4/13).

[19] A. G. Raymond. November 2011. *Massachusetts Health Reform: A Five-Year Progress Report* (N.p.:The Blue Cross Blue Shield Foundation). **https://www.mahealthconnector.org/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/Health%2520Care%2520Reform/Overview/BlueCrossFoundation5YearRpt.pdf** (accessed 4/16/13).

[20] S. K. Long and K. Stockley. 2009. Massachusetts Health Reform: Employer Coverage from Employees' Perspective. *Health Affairs* 28(6): w1079–w1087. **http://content.healthaffairs.org/content/28/6/w1079.full.pdf+html** (accessed 4/1/13).

Community Rating Rules

Section 2701

For insurance plans sold to individuals and small groups inside and outside the exchanges, community rating rules limit the factors that can be used by insurers to adjust premiums. Under the ACA, insurers will only be allowed to vary premium costs for family size, age, geographic location, and tobacco use. Community rating provisions prohibit the use of previous healthcare claims or health status as a factor in premium determination, and premiums for older Americans can be no more than three times that for younger Americans. Firms purchasing insurance that have fewer than 100 employees will be subject to community rating rules. However, from 2014 to 2016, if a state limits their SHOP Exchange to small firms with fewer than 50 employees, then community rating rules will not apply to small firms with 50 to 100 employees during that time (this would also be true for any states that participate in the federally-facilitated Exchanges). Firms that self-insure are exempt from this provision.

Essential Health Benefits Tests

Section 1302[21]

The ACA will establish benefit guidelines to standardize health plans offered to individuals and fully insured small groups inside and outside the exchanges. Specifically, health plans must limit annual cost-sharing in high-deductible health plans and provide the "Essential Health Benefit" package. These benefits must cover ambulatory patient services, emergency services, hospitalization, maternity and newborn care, prescription drugs, rehabilitative services, laboratory services, pediatric services, preventive services, and mental health and substance abuse disorders services. In 2014, cost-sharing in high-deductible health plans cannot exceed $5,950 for individuals and $11,900 for families.

Small Business Tax Credit

Section 1421

Small businesses with fewer than 25 FTEs may be eligible for a tax credit if they contribute at least 50 percent toward employee health insurance premiums. This tax credit has been available since 2010, but will undergo changes in 2014.

From 2010 through 2013: A qualified small firm can obtain a maximum credit of 35 percent of the employer's contribution to employee premiums. In order to obtain the maximum, a business must have 10 or fewer FTEs and average taxable wages of $25,000 or less. As a small business increases from 10 to 25 FTEs and the average taxable wages increase from $25,000 to $50,000, the maximum available tax credit is phased-out.

Beginning in 2014: Only small businesses that purchase insurance on the SHOP Exchange with fewer than 25 FTEs and an average taxable salary less than $50,000 will be eligible for a maximum tax credit of 50 percent of the employer's contribution to employee premiums. The credit phase-out continues to apply. Eligible firms can only receive this tax credit for two consecutive years after 2014.

Workplace Wellness Programs

Section 10408 and 399MM

The ACA appropriated $200 million for FY 2011 to 2015 in competitive grants for businesses that wish to develop and implement a comprehensive worksite wellness program. Firms that did not have a worksite wellness program in place prior to March 2010 and have fewer than 100 employees that work 25 hours or more per week will be eligible for these grants.

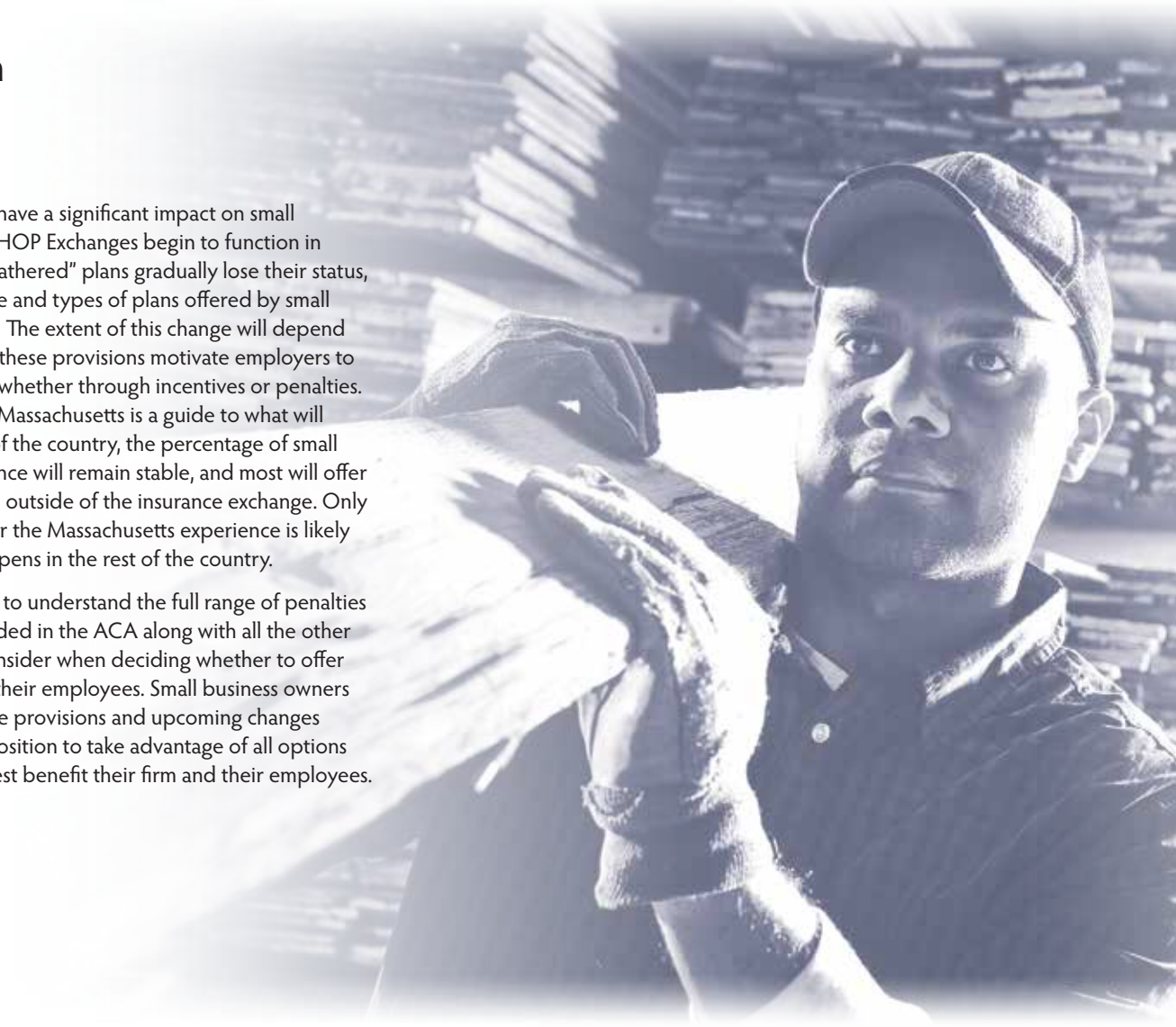
[21] The Department of Health and Human Services released its final rule for essential benefits on February 25, 2013. See *Federal Register*, 78(37): 12834–12872. **http://www.gpo.gov/fdsys/pkg/FR-2013-02-25/pdf/2013-04084.pdf** (accessed 5/1/13).

Illustrative Examples of the Impact of ACA Provisions

The effects on small employers vary depending on workforce and insurance coverage characteristics. The majority of small firms with 50 to 99 employees currently offer coverage. Conversely, the majority of smaller firms with fewer than 50 employees do not currently offer coverage nor will they incur penalties for not offering coverage. The following examples illustrate how relevant provisions apply to different small employers. Employers should consult a professional benefits advisor to obtain a tailored analysis for their particular firms.

Examples of Small Employers	Most Relevant ACA Provisions	Why Provision is Relevant
1. Firm with fewer than 50 employees (therefore also fewer than 50 FTEs) that does not offer coverage to any of its employees	"Play or Pay" Rules	Since the firm has fewer than 50 FTEs it will be exempt from penalties for not offering coverage.
	SHOP Exchange	If the firm decides to offer coverage, it can purchase qualified health plans through the SHOP Exchange to decrease otherwise high administrative costs, pool their firm's risk with other small firms, and increase their own purchasing power.
2. Firm with 90 employees and more than 50 FTE that does not offer coverage to any of its employees	"Play or Pay" Rules	Since the firm does not offer any coverage, it will pay a penalty of $2,000 for each full-time employee beyond the first 30 full-time employees.
	SHOP Exchange	If the firm decides to offer coverage it can purchase qualified health plans through the SHOP Exchange. If the state in which the firm resides decides to limit the SHOP Exchange to only firms with less than 50 employees, then the firm will need to purchase a health plan outside of the SHOP Exchange until 2016.
	Affordability Tests	If the firm begins offering coverage and an employee's premiums cost 9.5% or more of their income or the health plan does not cover 60% of costs, then the employee is eligible for exchange subsidies and the firm is penalized $3,000 per worker receiving a subsidy.
3. Firm that is fully insured and has 15 FTEs	SHOP Exchange	If this firm decides to expand its plan offerings to employees it can purchase qualified health plans through the SHOP Exchange.
	Affordability Tests	Since the firm has fewer than 50 FTEs it will be exempt from affordability test penalties. An employee at this firm, however, may still be eligible for exchange subsidies if the employee's premiums cost 9.5% or more of their income or the health plan does not cover 60% of costs.
	Employer Tax Credits	If this firm continues to offer adequate health insurance, it may be eligible for a tax credit of up 50% of the employer contribution to employee premiums.
4. Firm that is fully insured with fewer than 100 employees	SHOP Exchange	If this firm decides to expand its plan offerings to employees it can purchase qualified health plans through the SHOP Exchange beginning in 2016 or earlier if the state in which it operates does not limit participation to firms with less than 50 employees.
	Affordability Tests	If an employee's premiums cost 9.5% or more of their income or the health plan does not cover 60% of costs, then the employee is eligible for exchange subsidies and the firm is penalized $3,000 per worker receiving a subsidy. However, if the current plan offering is a grandfathered plan, then these affordability tests will not apply.
	Community Rating Rules	If the health plan offered to employees is based on the healthcare claims of these workers, premiums may either increase or decrease when claims can no longer be used to adjust premiums. Under community rating, only family size, age, geographic location, and tobacco use may be used to adjust premiums.
5. Firm that is self-insured with fewer than 100 employees	Affordability Tests	If an employee's premiums cost 9.5% or more of their income or the health plan does not cover 60% of costs, then the employee is eligible for exchange subsidies and the firm is penalized $3,000 per worker receiving a subsidy.
	Community Rating Rules	Since the firm is self-insured it is not subject to community rating rules.

Conclusion



The ACA is likely to have a significant impact on small employers. As the SHOP Exchanges begin to function in 2014 and as "grandfathered" plans gradually lose their status, the rates of coverage and types of plans offered by small businesses will vary. The extent of this change will depend greatly on how well these provisions motivate employers to purchase coverage, whether through incentives or penalties. If the experience in Massachusetts is a guide to what will happen in the rest of the country, the percentage of small firms offering insurance will remain stable, and most will offer products purchased outside of the insurance exchange. Only time will tell whether the Massachusetts experience is likely to predict what happens in the rest of the country.

Small firms will want to understand the full range of penalties and incentives included in the ACA along with all the other factors that firms consider when deciding whether to offer health insurance to their employees. Small business owners who are aware of the provisions and upcoming changes will be in the best position to take advantage of all options available that can best benefit their firm and their employees.

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