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Fixed Income Commentary Unintended Consequences of Health Care Reform

After Congress passed the sweeping health care bill in March, many health care companies voiced their concerns on getting “accidentally” hurt by reform. Managed care, medical device, pharmaceutical and health care providers all equally feared unintended consequences. Recent disclosures by large corporations also suggest that U.S. taxpayers might ultimately absorb a higher burden of health care costs.

Recently disclosed internal documents discussed corporate health care costs in details. Those documents were originally requested by the Congress after a number of large companies including AT&T, Verizon and Caterpillar recorded significant non-cash charges driven by the elimination of the drug coverage tax benefit subsidy for their retirees. Recall that these companies warned Congress that their costs for providing health care for employees would rise significantly with reform. Caterpillar estimated their costs would rise by at least 20% or more than \$100 million in just the first year of the health care overhaul program.

Internal documents from all three companies show that each has been reviewing an option of paying penalties instead of providing health care coverage for their employees. AT&T spent \$4.7 billion in 2009 on health care coverage for their active employees and retirees. The new bill imposes a \$2,000 penalty per

employee to large employers who choose to not provide health care for their employees. For AT&T that translates into a rather paltry \$600 million dollars.

Relying on Employer-Sponsored Coverage

The current U.S. health care system heavily relies on employers to provide coverage. According to the U.S. Census Bureau, approximately 85% of Americans have health insurance. Nearly 60% of those who are insured obtain it through their employer (150 million) while about 9% purchase it directly with the rest being provided by various government agencies. Since 1999, health insurance premiums for families have risen 131% according the report from the Kaiser Family Foundation and the Health Research & Education Trust survey. By comparison, the rate of inflation was just 28% over the same period. Due to the skyrocketing costs, many employers have chosen to shift burdens to their employees in the last few years through higher co-pays and deductibles. As a result, many health care providers

Average Cost for Health Insurance Policy in the U.S.		
Year	Single	Family
2000	\$2,471	\$6,438
2001	2,689	7,061
2002	3,083	8,003
2003	3,383	9,068
2004	3,695	9,950
2005	4,024	10,880
2006	4,242	11,480
2007	4,479	12,106
2008	4,704	12,680
2009	4,824	13,375

Source: Kaiser Family Foundation, Health Research and Educational Trust

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Medical Costs vs. No Coverage Penalty

2009 Medical Costs		Penalty for Coverage	
Active Employees	\$2.4B	Employee	283K
Retirees	2.3B	Annual Penalty	\$2K
Total Cost	\$4.7B	Total Annual Penalty	\$0.6B

Source: AT&T

have recorded higher bad debt expense as their patients were unable to pay for their share of deductibles and co-pays. With health care reform signed into law, many large employers are worried that they will face higher costs on two fronts: bearing the cost of reform through higher taxes while continuing to pay for health coverage costs that may continue to rise due to the shifting of increased taxes and fees from providers and insurers to consumers.

A document from AT&T outlines estimated additional costs in relation to health care reform of up to \$460 million in ten years (see Key Impacts table below). A Verizon document reportedly presented by consulting firm Hewitt Associates shows that employers are recommended to consider exiting the employer health market and sending their employees to the exchanges. When asked by Fortune magazine, however, Verizon said it is not, “considering or even contemplating” the plans laid out in the report. But the truth is if employers were to offer some type of incentives such as a salary increase to their employees in exchange for health care coverage, many employees would likely qualify for government subsidies to purchase their own health insurance. The bill allows households with incomes between 133% and 400% of the Federal poverty level (for family of three, the threshold is family income from \$24,000 to \$73,000) to receive tax credits for health care insurance purchases. According to Fortune, policies for a family making \$66,000 would cost them just \$5,300 a year with the government picking up the rest, up to \$10,000.

Key Impacts of Health Care Reform		
Provision	Costs to AT&T	Effective Date
Taxation of Medicare Part D Subsidy	\$1.0B one time charge	2013 (immediate tax impact)
Medicare Reform	\$10-\$200MM	Various
Excise Tax	<\$30MM	2018
Pay or Play	\$90-\$130MM	2014
Dependents (to 26)	\$50-\$100MM	2011

Source: AT&T

“Free Rider” Assessment

- Companies that do not offer coverage to their employees or that offer coverage considered unaffordable, would be required to pay an assessment
- Even though the proposed assessments are material, they are modest when compared to the average cost of healthcare
- To avoid additional costs and regulations, employers may consider exiting the employer health market and send employees to the Exchanges

Verizon Impact

- Potential assessment for approximately 3,000 employees at \$2,000 per employee would be \$6MM

Source: Verizon, prepared by Hewitt Associates

Dropped Coverage Could Mean Higher Costs

Within the CBO’s initial cost estimates of health care reform, one of the assumptions was that those people who are currently insured through their employers would stay insured by employers. The CBO had estimated fewer than 25 million will be receiving the subsidies by 2020 and that reform will reduce the federal deficit by \$138 billion in ten years based on that assumption. However, if employers start dropping coverage for their employees in exchange for higher salary, each person dropped from the employer’s plans would cost the government an estimated \$2,100 after deducting the extra taxes collected on their additional pay. If 50% of people are dropped by their employers then federal health care costs will increase by exorbitant \$160 billion a year come 2016, in addition to the \$93 billion in subsidies already forecast by the CBO.

The reform bill itself was built around the current health care system of employer-sponsored health care coverage, and President Obama has emphasized over and over that, “If you like your health care plan, you can keep your health care plan,” while campaigning for the bill. While it is unlikely that these large corporations will drop coverage for their employees anytime soon, it is fair to say that option is available to them. Certainly, one of the unintended consequences of the sweeping health care reform may be the decline of the employer-sponsored health care system. In theory, this may be accretive to corporate earnings while increasing the federal government’s fiscal challenges.

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