Sean White
Principal

1301 Fifth Avenue, Suite 1900
Seattle, WA 98101
+1 206 214 3705
sean.white@mercer.com
www.mercer.com

Trustees
Everett School Employee Benefit Trust

April 15, 2016

Subject: ACA Employer Shared Responsibility Liability Assessment Analysis

This letter summarizes the results of an analysis conducted by Mercer to assess the potential financial exposure of the Everett School District to assessments under the Employer Shared Responsibility provisions of the Affordable Care Act. The analysis conducted by Mercer is purely focused on potential assessments as imposed pursuant to Internal Revenue Code 4980(H)(b) for failing to offer Minimum Essential Coverage (MEC) that is not affordable. This analysis does not address potential exposure to assessments as imposed pursuant to Internal Revenue Code section 4980(H)(a) for failing to provide MEC to substantially all full time employees, nor does it address whether the plans offered meet MV requirements. Please see the Appendix for a very high level overview of these requirements.

As you know, Mercer is not a law firm and we cannot give legal advice. The rules are complex and we encourage you to seek legal counsel for a more detailed explanation of the rules as well as an analysis of the ACA's requirements that are not addressed in this letter.

Summary of Results

Mercer analyzed census data provided by the Everett School District on April 7, 2016. The analysis focused on full-time employees as indicated by the FTE status as reported in the census data. Note that we did not receive information on actual hours worked; to the extent that actual hours worked differs from the FTE status included with the census, the results of this analysis would be impacted.

An MV plan provides affordable coverage if employee contributions don't exceed a specified percentage of the employee's household income (9.66% for 2016). The affordability definition for purposes of employer-sponsored coverage is based on the following:

- Contribution for self-only coverage, regardless of the actual level of coverage selected.
- Contribution for the lowest MV plan option ***offered*** to an employee even if the employee chooses a higher cost option.

The assessment as imposed pursuant to Internal Revenue Code 4980(H)(b) applies to employers for failing to offer MEC that lacks MV or is not affordable. For 2016, this assessment is calculated for each month as the lesser of the 4980H(a) payment described in the Appendix (generally

$2,160 X # of full-time employees for 2016), or 1/12th of $3,240 times the number of full-time employees who meet both of the following conditions in a calendar month:

- The full-time employee either is not offered coverage at all or is offered employer-sponsored health coverage that is either unaffordable or doesn't meet the ACA's MV standards, or both; and
- The employee receives a premium tax credit to buy insurance on a public health exchange.

As noted, our analysis is focused purely on the affordability issue and assumes that all coverage offered meets MV requirements. To determine affordability, we calculated whether the contribution that applies for employee only coverage on the UHC HDHP option is greater than 9.66% of the employee's annual salary, as shown in the census data provided. For those for whom the cost for employee only coverage is more than 9.66% of annual salary, we then focused on those employees waiving coverage, since assessments would not apply for any employees actually enrolling for coverage. The table below summarizes the distribution of employees for whom the affordability assessments **could** apply.

FTE Range	Number of Employees	HDHP Employee Only Contribution >9.66% of Annual Salary	Waived Coverage
1.000	1,598	3	1
0.900-0.999	208	20	12
0.825-0.899	69	39	22
0.750-0.724	55	39	30
Total	1,930	101	65

Thus, the maximum potential assessment liability we would expect under the affordability requirements is $3,240 × 65 = $210,600 for 2016. This level of assessment liability would imply that all 65 of these employees went to the public health exchange, qualified for a premium tax credit, and enrolled for coverage through the exchange. Note that this figure could be overstated to the extent that these individuals have additional household income, either through another source of employment for themselves, or through a spouse.

Future Options

Several options to address this potential assessment liability have been discussed thus far, including:

- Maintaining the current structure
- Adjusting contributions to be affordable for all full time employees (FPL safe harbor)
- Introduce a new lower value plan that is affordable for all full time employees

This section provides some high level commentary on the latter two options.

Adjust employee only contribution for HDHP option

If the employee only contribution for HDHP coverage were set at or below the FPL safe harbor amount ($94.74 for 2016), the Trust could experience additional cost from current enrollees paying less per month, and from employees currently waiving enrolling on the plan in response to the lower price of entry. The Federal Poverty Level safe harbor is described in detail in the Appendix.

Based on the census data received, there are 157 employees waiving coverage with an FTE status between 0.750 and 0.999. If half of these waivers enrolled for employee only coverage on the HDHP option at the lower contribution amount, the additional premium cost to the trust would be $413,000 annually; if all of them enrolled, the additional cost would be $826,000 annually.

Add a new low value affordable plan

The third option discussed would have the Trust introducing a plan with a lower actuarial value (AV) - e.g. a 60% AV plan – at the FPL safe harbor contribution. For the purpose of this analysis, we have just assumed a 20% premium reduction from the HDHP option premium for illustration. If this option is pursued, actual premium will be based on that quoted by UHC or other carriers. Under this scenario, if half of the waivers enrolled for employee only coverage on the low value plan option, the additional premium cost to the trust would be $330,000 annually; if all of them enrolled, the additional cost would be $660,000 annually.

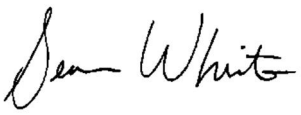
In both of the latter two options under which the HDHP is affordable for all full time employees, it is worth noting that it would impact the eligibility for subsidies through the public exchange for the families of these employees. Under the current structure, for any employees for whom the ESEBT coverage is unaffordable under the ESR provision, the family members of these employees may be enjoying subsidized coverage through the public exchange currently.

This analysis does not account for any employees currently enrolled on higher value plans moving over to the HDHP plan at the lower contribution or onto the low value plan option. We would

expect few if any employees to make this election, given that they already have the option to enroll on the HDHP plan at significantly lower monthly contribution amounts, and have elected to remain on higher value plans. In general, though, employees moving to the lower value plans would offset the premium increases noted above since the Trust would be contributing a lower dollar amount toward coverage than is currently contributed for coverage on the higher value plans.

We look forward to discussing the results of this analysis with the ESEBT trustees and Everett School District representatives.

Sincerely,



Sean White
Principal

u:\ehb\core\sea\estsea\year\2016\projects\hcr\esr analysis\esebt - esr analysis letter 4-20-2016.docx

Appendix

The relevant regulations and rules may change, but as of the date of this letter, employers with 50 or more full time employees (working an average of 30 hours or more per week) and full-time equivalent employees must offer MEC to substantially all of their full-time employees or potentially face significant assessments. In order to avoid all assessments, known as employer shared responsibility or "play-or-pay" assessments, the coverage must meet the current standards for MEC, MV, and affordability.

Minimum Essential Coverage

An employer needs to offer coverage that meets specific MEC requirements in order to avoid certain ACA assessments. MEC can be provided through an eligible plan sponsored by (or on behalf of) an employer that offers self-funded or insured group health plan coverage to employees. An eligible employer-sponsored plan is virtually any employer-sponsored group health plan, unless it only provides certain "excepted benefits" such as hospital, critical illness, or other fixed indemnity insurance or limited benefits such as a dental or vision only plan. Again, this definition and all others in this letter are intended only as a high-level overview; if you have questions about any specifics of this definition, we would be happy to discuss.

Even if an individual is eligible for employer-sponsored MEC, that MEC must still meet Minimum Value and affordability requirements to avoid all potential assessments. Otherwise, the individual could still be eligible for a public subsidy and the employer can face employer shared responsibility assessments if the individual is a full-time employee in one or more months of the year.

Minimum Value

Under the employer-shared responsibility requirements, group health plans must provide meaningful coverage at or above a threshold actuarial value, known as MV, or assessments may be imposed on the employer. MV is met when a plan pays on average 60% of the actuarial value of the total cost of benefits under the plan and the plan provides substantial coverage for in-patient hospitalization services and for physician services. In other words, participants pay (via deductibles, co-payments, and other out-of-pocket costs) no more than 40% of the cost of covered benefits. More specifically, a plan satisfies the required "minimum value percentage" if its anticipated covered medical spending for benefits based on the plan's cost-sharing provisions divided by the total anticipated allowed charges for coverage is 60% or more.

There are two ways to determine whether a plan meets the 60% threshold.

- **MV Calculator -** The Department of Health and Human Services (HHS) has published a MV calculator that can be used for a plan with standard features and utilizes underlying costs for a typical, standard population. The MV calculator does not account for all benefit features; for example, it does not consider true family deductibles and out-of-pocket limitations, which are typical in high deductible health plans. The current MV calculator may produce a value of 60% even for plans that fail to provide substantial coverage for in-patient hospitalization services or for physician services (or for both), but see discussion regarding such plans above. For these reasons, the MV calculator results will likely not match Mercer's proprietary pricing tool (MedPrice).
- **Actuarial Certification Method -** Where the plan has features that cannot be measured with the MV Calculator, an actuary can use reasonable methods to determine whether the plan meets a 60% minimum value. The actuary must also consider whether the plan provides substantial coverage for in-patient hospitalization services and for physician services before issuing a certification of MV.

Affordability

An MV plan provides affordable coverage if employee contributions don't exceed a specified percentage of the employee's household income (9.66% for 2016). The affordability definition for purposes of employer-sponsored coverage is based on the following:

- Contribution for self-only coverage, regardless of the actual level of coverage selected.
- Contribution for the lowest MV plan option ***offered*** to an employee even if the employee chooses a higher cost option.
- Can use the lower employee contribution as a wellness reward solely related to any tobacco cessation programs. Must use the higher employee contributions for any wellness program not related to tobacco cessation

The IRS has provided three **safe harbor tests** that may also be used to determine whether a plan provides affordable coverage for purposes of employer shared responsibility.

- *Federal poverty line (FPL) safe harbor.*
    - Employer coverage will be treated as affordable if an employee's contribution for self-only coverage does not exceed 9.66% (for the 2016 plan year) of a monthly amount determined using the FPL for a single individual for the calendar year, divided by 12. Employers are permitted to use the poverty guidelines in effect within six months before the beginning of the plan year. This means that calendar year plans must use the prior year's Federal Poverty Level.

- The 2016 safe harbor contribution of $94.74 per month (based on the 2015 Federal Poverty Level of $11,770 for the 48 contiguous states and the District of Columbia) will apply in most cases.
- The employer must use the FPL for the state in which the employee is employed. The FPL for 2015 is higher in Alaska ($14,720) and Hawaii ($13,550) than the other 48 contiguous states and DC.

- *W-2 wages safe harbor.*
  - Employer coverage will be treated as affordable if the employee's contribution does not exceed 9.66% (for the 2016 plan year) of the employee's wages reported in Box 1 of Form W-2 in the current year.
  - Since the safe harbor applies to wages in the current year, not the prior year, this retrospective determination may make this approach impractical for many employers.
  - The employee's required contribution must remain a consistent amount or percentage of all form W-2 wages during the plan year.
  - The rules include special methods for determining the wages of employees who are not offered coverage for an entire year.
  - Reductions in an employee's wages for contributions to a 401(k) plan or a cafeteria plan may not be added back into W-2 wages, and wages may not be imputed during periods of unpaid leave.

- *Rate of pay safe harbor.*
  - Affordability is determined differently for hourly and salaried employees.
  - For hourly employees, the coverage is affordable for a given month if the employee's monthly contribution does not exceed 9.66% (for the 2016 plan year) of an amount equal to 130 hours multiplied by the lower of (i) the employee's hourly pay rate as of the first day of the plan year or (ii) the employee's lowest hourly pay rate during the month, regardless of whether the employee worked 130 hours in a given month.
  - If an employee's hourly pay rate is reduced during the year, the pay rate applies separately for each month, and affordability is based on the lowest pay rate for the calendar month.
  - For salaried employees, the coverage is affordable for a given month if the employee's monthly contribution does not exceed 9.66% (for the 2016 plan year) of the employee's monthly salary on the first day of the plan year.
  - If an employee's salary is reduced, including due to a reduction in work hours, the safe harbor can't be used for months following the salary reduction.

- The safe harbor can't be used for tipped employees or employees paid entirely by commission.

An employer can elect to use one or more of the three safe harbors for all employees or any reasonable category of employees, so long as the rules are applied uniformly and consistently for all employees in a category (i.e., specified job classifications, employee status as hourly or salaried, geographic location and similar bona fide business criteria). Even if contributions satisfy the requirements using one of these safe harbors, employees may still be eligible for a subsidy through the public exchanges based on their household income in certain circumstances.

There are advantages and disadvantages to each safe harbor approach. The FPL safe harbor is the easiest to calculate, is determined prospectively, and the calculations are fairly straightforward. But, using that approach likely will reduce the amount of permissible affordable employee contributions because the poverty line thresholds are low. The W-2 and rate of pay safe harbors require individual tracking and the calculations are more complex.

General Overview of Employer Shared Responsibility (ESR) Provisions

Employers may be required to pay assessments for failing to offer full-time employees MEC or whose coverage does not meet the standards for MV and affordability. There are two types of assessments, commonly referred to as "play-or-pay" assessments.

The first assessment is imposed pursuant to Internal Revenue Code section 4980(H)(a) for failing to provide MEC. For 2016, the payment is generally calculated for each month as 1/12th of $2,160 multiplied by the number of full-time employees for the month. The employer must pay this assessment for any calendar month in which: a) the employer doesn't offer substantially all (95%) of its full-time employees (and certain dependents) MEC through an employer-sponsored plan; and b) at least one of the employer's full-time employees receives a premium tax credit to buy insurance on a public health exchange.

The second assessment is imposed pursuant to Internal Revenue Code 4980(H)(b) for failing to offer MEC that lacks MV or is not affordable. For 2016, this assessment is calculated for each month as the lesser of the 4980H(a) payment described above, or 1/12th of $3,240 times the number of full-time employees who meet both of these conditions in a calendar month:

- The full-time employee either is not offered coverage at all or is offered employer-sponsored health coverage that is either unaffordable or doesn't meet the ACA's MV standards, or both; and
- The employee receives a premium tax credit to buy insurance on a public health exchange.

Important caveats and limitations of Mercer's analysis

Mercer has prepared this letter exclusively for the Everett School Employee Benefit Trust (ESEBT), about whether your 2016 plans meet the current requirements for affordability under the Affordable Care Act. These determinations apply to ESEBT's medical plans for the first plan year beginning January 1, 2016. It does not predict a plan's ability to meet these requirements in the future. These determinations may not be used or relied upon by any other party or for any other purpose. Mercer is not responsible for the consequences of any unauthorized use.

In conducting our analysis, we have relied on information supplied by ESEBT on April 7, 2016. ESEBT is solely responsible for the validity, accuracy and comprehensiveness of this information. If the data supplied is not accurate and complete, this determination may need to be either revised or withdrawn as no longer valid.

The ACA's shared responsibility provisions include complex rules for determining the number of full-time employees, which impacts reporting requirements, calculations of employer shared responsibility assessments, and which assessments may apply. Mercer does not provide any determinations about the full-time employment status of particular employees or groups of employees. This letter does not address which employees need to be offered this coverage in order to avoid or minimize employer shared responsibility or other penalties or assessments. All of those questions should be discussed with your legal counsel.

Mercer has tested affordability based on average monthly contributions, but the regulations require affordability to be tested for each month. There aren't any detailed regulations at this time about how to test when contribution cycles do not align with a monthly frequency. Mercer cannot provide a legal opinion or an opinion on how to test under those circumstances.

All of our analyses, including estimates/determinations, are based on the information and data available at a point in time and the projections are not a guarantee of any financial or other results that might be achieved. Any projections are subject to unforeseen and random events and so must be interpreted as having a potentially wide range of variability from the estimates/determinations.

This analysis is based also on requirements arising under the ACA as in existence on the date of this letter. These requirements could change or be clarified in a manner that may materially impact the analysis and resulting determinations. In such case, this determination would need to be revised or withdrawn as no longer valid. ESEBT understands that Mercer is not engaged in the practice of law and this report, which may include commenting on legal issues or regulations, does not constitute and is not a substitute for legal advice. Accordingly, Mercer recommends that ESEBT secures the advice of competent legal counsel with respect to any legal matters related to this report or otherwise.