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Education Foundation

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LEGISLATIVE NETWORK

Retiree Health Maintenance of Cost Protection (MCP)

Congress Should Enact a Business Tax Credit to Encourage Companies to Maintain Contributions to Retiree Health Coverage

2/1/2017

Executive Summary

The ongoing cancellation or reduction of employer-sponsored retiree health care benefits has had a devastating impact on the lives and financial security of millions of America's retirees. During the decades when today's retirees earned these benefits, they were a bargained-for promise that more than two-thirds of the workforce counted on when calculating what it would take to retire. With repeated assurances after 20 or 30 or 40 years of service that their health, disability and death benefits would be there when needed, few workers ever suspected or prepared for the possibility that courts would agree that a "reservation of rights" clause buried in the fine print of plan documents that had never been disclosed would trump years of promises.

In an October 2005 investigative report entitled "The Broken Promise," *TIME* magazine reported that Congress had passed bankruptcy reforms and other measures "encouraging companies to repudiate lifetime benefit agreements. Businesses in one industry after another are revoking longstanding commitments to their workers. It's the equivalent of your bank telling you it needs the money you put into your savings account more than you do – and then keeping it."

The share of large firms (200 or more employees) that offer any retiree health coverage has dropped dramatically over the past two decades – from 66 percent in 1988, to 40 percent in 1999, to 29 percent in 2009. Only 5 percent of employers with fewer than 200 workers offer retiree coverage. Even among the large firms still offering coverage, while nearly all offer benefits to early retirees, since 2003 the share maintaining supplemental coverage for Medicare-eligible retirees has tumbled from 81 to 68 percent. Most of that decline came soon after the Equal Employment Opportunity Commission's 2007 ruling allowing companies to cancel coverage for Medicare-eligible retirees 65 and older, while maintaining coverage for early retirees.

During the 2009 historic health care debate, the legislation enacted by the U.S. House included a provision (Section 110) prohibiting employers from reducing an individual retiree's health care benefits after he or she retires. The provision would have superseded any "reservation of rights" clause in plan documents, which many companies have used to cancel or reduce promised health and welfare benefits. Benefits as of the date of retirement would have been protected *unless* the reduction was also made with respect to active workers under the group health plan (a counter-productive loophole the NRLN opposed), *or* if the company received an "undue hardship" waiver from the Department of Labor. The House bill would not have required the restoration of previously reduced benefits. Unfortunately, the failure to include any part of Section 110 in the final legislation has left retirees vulnerable to further cutbacks in employer-paid coverage.

The number of companies offering retiree health benefits will undoubtedly now fall further considering the impact of the economic downturn on the auto sector and other industries that traditionally provide such benefits, as well as the pressures of global competition. This has a particularly negative impact on the health status of near-elderly adults who took early retirement, but who are not yet eligible for Medicare. In 2006, roughly 16 percent of adults age 55 to 64 relied on employer-provided retiree health insurance – while 18.6 percent of active employees worked for employers still offering coverage to retirees under 65. While these numbers have certainly declined somewhat during the current downturn, it should be a policy priority to encourage the continuation of employer-based coverage for as many in this group as possible.

The Retiree Reinsurance Trust Fund included in the final health reform bill is a positive step in this direction, as it reimburses employers for a substantial share of catastrophic claims paid on behalf of retirees aged 55 to 64. However, because it excludes Medicare-eligible retirees and is inadequately funded, the Trust Fund should be replaced or at least enhanced with a broader and longer-term tax subsidy along the lines of the Maintenance of Cost Protection proposed here.

The MCP proposal described here would offer companies a tax credit to partially offset the cost of maintaining retiree health coverage in return for an obligation that plan sponsors will not reduce their contribution to the cost. The MCP credit is analogous to the 28 percent subsidy paid under Medicare's Part D to companies that agree to maintain prescription drug coverage for retirees. Although it only reimburses firms for 28 percent of their drug benefit costs, the Part D subsidy has proven effective in maintaining superior employer plans, with no 'doughnut hole,' for roughly 30 percent of Medicare-eligible retirees. This has benefited millions of retired Americans while reducing Medicare costs.

Key features of the MCP include:

- Plan sponsors (including VEBAs) would be eligible for a tax credit equal to 50% of actual expenditures on retiree health (not including retiree payments). Retiree payments would remain non-deductible except over 7.5% of AGI.
- An employer (or VEBA) electing the subsidy would be obligated to maintain their current nominal level of contribution (as maintenance of effort is defined in the tax code with respect to Section 420 transfers).
- Employers could claim the credit for retirees 55 and older. The firm's minimum required contribution (MCP) in each year would be equal to its nominal contribution to the cost of an individual retiree's health benefit at the date of enactment, or at the date of retirement (for future retirees), whichever is later. **The firm's MCP remains fixed in subsequent years, gradually reducing the cost to employers and the government in real terms each year.**
- As early retirees enroll in Medicare, they would be entitled to a reduced MCP sufficient to purchase supplemental insurance in an amount that would maintain parity with their coverage in effect on the date of enactment, or date of retirement, whichever is later.
- Employers could elect to contribute the Maintenance Cost Protection toward the cost of full or supplemental coverage under a plan purchased through a state health care Exchange, or selected by the retiree from another provider, with retirees paying the difference. The firm's eligibility for a federal subsidy based on its actual MCP contribution would continue.