BENEFITS INSIGHTS

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Salary-based Health Insurance Premiums

Employee health insurance premiums at most companies differ only by family size and type of plan (for example, deductible amount). At some companies, though, another factor is taken into account—salary. Meaning that employees who earn less, pay lower insurance premiums.

Several companies like GE and Pitney Bowes have based insurance premiums on employees' salaries for more than 20 years. So while the idea of salary-based premiums isn't exactly new, the concept has not been widely used in the past. According to a study from Mercer, only 10 percent of employers reported using salary-based health coverage programs in 2011.

In recent years, though, compensation-based premiums have been gaining traction as a result of the Affordable Care Act (ACA). Under the ACA, applicable large employer's health insurance coverage must be considered affordable, meaning it does not exceed 9.5 percent of the employee's household income for the taxable year (adjusted to 9.66 percent for plan years beginning in 2016). "Household income" means the modified adjusted gross income of the employee and any members of the employee's family.

If premium costs exceed the threshold, employees have the option to purchase subsidized coverage on their state's health insurance Exchange. Employers, though, will be penalized up to $3,000 for each employee who buys insurance on the Exchange. With this in mind, some employers are looking to salary-based premium models as a way to ensure health plans remain ACA-compliant.

Designing a Salary-based Premium Program

There are various ways to structure a compensation-based insurance premium program. GE, for example, divides its U.S. employees into two categories—those that are paid by the hour and those that are salaried. Employee premium contributions are based on seven salary ranges, in which higher-wage employees pay more than lower-wage employees. For instance, an employee earning less than $25,000 a year may pay $631 a year for individual coverage while an employee making $150,000 or more may pay $2,151.

At Pitney Bowes, out-of-pocket expenses vary based on salary. Hourly employees may have a $1,500 deductible and a $3,000 out-of-pocket maximum, while higher-earning employees may be responsible for a $2,500 deductible and a $5,000 out-of-pocket

At most companies, insurance premiums vary only by the type of plan selected and family size. However, as a result of the Affordable Care Act, some employers are looking to base health insurance premiums off of an employee's salary instead in an effort to make coverage more affordable for lower-wage earners.

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maximum. “That $2,500 deductible for someone making $25,000 is a big hit, whereas for someone earning $200,000 a year, it’s not such a big deal,” says Mary Bradley, director of health care planning at Pitney Bowes.

Other companies may choose to set up salary bands or classes. For instance, employees making $25,000 to $50,000 per year may pay one rate, while those making $50,000 to $100,000 per year and so on would have higher premiums.

Benefits of Salary-based Premium Programs

Not only can such a program help employers ensure their coverage is affordable, as mandated by the ACA, but it can also help improve morale and retention for lower-wage workers since it can increase their take-home pay. In addition, if an employer chooses to reduce out-of-pocket expenses for lower-wage earners, it can help make care more affordable.

High-wage employees may support compensation-based premiums since it may make them feel like they are helping others out. Furthermore, because employee contributions to health insurance premiums are exempt from income taxes, higher earners may even potentially get a tax break as a result of decreased taxable income from a salary-based premium program.

Disadvantages of Salary-based Premium Programs

On the other hand, if your program does not adjust out-of-pocket expenses like deductibles for lower-wage workers, plan offerings may still be unaffordable and deter employees and their families from seeking care due to concerns about costs. Furthermore, not all workers may think the program is “fair” and this can lead to resentment—especially from employees who are close to the salary line. This strategy can also incur higher administrative plan costs for employers since it requires greater HR oversight.

Determining the Best Fit for Your Business

In order for this strategy to be successful, a company must have enough employees in each salary tier so premium differences can balance each other out. Therefore, companies that employ larger numbers of lower-wage employees like restaurants and retailers may not be good candidates for this type of program since there may not be enough high-wage earners to offset the difference. Salary-based premium programs are most common among large employers in the financial services industry, according to a Mercer study.

If you choose to implement a compensation-based premium program, communication is key. Health insurance can already be a stressful subject for many employees, so make sure you clearly explain to employees the rationale for this change, how it will affect them and the benefits of this model.

For more information on salary-based insurance premium programs, contact Sullivan Benefits today.