California's Restructured MCO Tax Expected to Increase Premiums

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California's restructuring of its Managed Care Organization ("MCO") tax under Senate Bill 125 ("SB 125") is expected to increase premiums for many fully insured California health plans.

Several carriers subject to this tax indicate that they intend to incorporate these costs into health care premiums. If approved by the Centers for Medicare & Medicaid Services ("CMS"), the change will go into effect as of January 1, 2027.

While much remains uncertain, the following FAQs summarize what is currently known about the MCO tax and the potential impact on employer-sponsored health plans. We will continue to monitor any new developments or updates.

Q1. What is the MCO tax?

The MCO tax is a health care provider-related state tax imposed on MCOs in California. California uses the revenue from this tax to help fund the state's Medi-Cal program (California's Medicaid program) and to draw down additional federal Medicaid matching funds. While the MCO tax applies to both Medi-Cal and commercial health plans, the tax rate on Medi-Cal plans has been historically higher.

Q2. What's new with the MCO tax?

Due to changes in federal Medicaid under the One Big Beautiful Bill Act ("OBBBA"), the existing MCO tax in California will not meet federal requirements after December 31, 2026. These new federal rules prohibit taxes that assess higher rates on Medi-Cal plans than commercial plans or otherwise place a disproportionately high tax burden on Medi-Cal plans.

To meet new federal requirements, California reformed its MCO tax through Senate Bill 125, which passed June 29, 2026. The tax was restructured to apply the rate of **$8.85 per covered life per month** (roughly **$100 annually per covered life**) to both Medi-Cal plans and private insurers, subject to modification by California's Department of Health Care Services ("DHCS"), the agency responsible for administration of this tax, or per law. The tax, as enacted, would be in effect for calendar years 2027, 2028, and 2029.

In response, many health insurance carriers have indicated they intend to pass on the additional tax to consumers, likely resulting in higher premiums for fully insured health plan policies in California.

Q3. Does the MCO tax affect employer-sponsored fully insured health plans in California?

Likely yes. While the tax is imposed on carriers and not directly on employer-sponsored health plans, carriers have indicated they will be reflecting the anticipated MCO tax impact in renewals and pricing for fully insured plans. Therefore, HMOs and other fully insured commercial group health policies written in California will likely be affected by this tax in the form of increased rates and premiums.

Further clarification from the state and carriers as to which plans the tax will affect and the timing of the impact would be welcome.

Q4. Does the MCO tax affect employer-sponsored self-funded health plans in California?

The tax is not expected to directly impact self-funded health plans subject to ERISA. However, MCOs that also provide third-party administrative services to self-funded plans could seek to increase administration costs as a result of additional taxation.

Q5. When and how will this take effect?

As enacted by California, the tax is set to take effect January 1, 2027. However, California's DHCS must seek approval by CMS to implement this tax. <u>To date, they have not received this approval.</u>

Additionally, on July 24, 2026, citing the projected increase in health insurance costs for families and small businesses, six members of California's Republican congressional coalition sent a formal request to the Department of Health and Human Services and CMS requesting they deny federal approval of the restructured MCO tax.

In addition to the tax needing CMS approval to become finalized, the carriers' approaches to addressing the tax may vary. Some carriers have indicated they intend to pass on the full amount of the tax, but others may decide to absorb some of that cost. Also, for non-calendar year plans, some carriers have indicated they will implement the tax mid-year, while others may not.

Thus, it is unclear at this time whether this new tax will take effect and how it may (or may not) be reflected in rates for 2027.

Q6. What are the next steps for an employer?

No action is necessary at this time. If the tax is approved by CMS, employers with fully insured plans in California should prepare for the potential of increased premiums.