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Can Defined Contribution Plans Help You Stabilize Costs?

Skyrocketing health insurance premiums are forcing many businesses to rethink their approach to health benefits, particularly following the rollout of the Affordable Care Act (ACA), which has increased the buzz around alternative approaches to employee benefits. For many employers, the defined contribution model is emerging as a strategic way to contain costs while maintaining the quality of coverage.

Defined contribution is not a new idea in the benefits world. Most employee retirement plans have followed this approach for years. Here's how defined contribution plans compare with the traditional defined benefit health plan model:

Traditional approach: Defined benefit group coverage	The employer sponsors group coverage for certain medical benefits, such as doctor visits, trips to the emergency room, and surgeries. The annual cost of these benefits can vary greatly from employee to employee.
Emerging model: Defined contribution	The employer sets a dollar amount for each employee (the "defined contribution") and establishes a menu of coverage options in a private exchange—or directs employees to the public health care exchange. The employer contribution is generally managed via health reimbursement accounts (HRAs) or Section 125 (cafeteria) plans. The employee shops for the coverage he or she wants from the private or public exchange, up to the set dollar amount.

A Wide Range of Plan Options

A defined contribution model can be applied to many different plan designs. Employers using a private exchange can give employees a choice of coverage levels as well as providers. Alternately, they can open up their program to all plan options available on the public exchange.

All defined contribution programs have the following in common:

- Participant choice of plan and providers (although the amount of choice can vary widely in a private exchange).
- Higher cost sharing for the participant. The general expectation is that people will be more strategic with their health spending if their own money is involved.
- Greater involvement from the participant in managing their own care.
- An emphasis on health education to empower participants to take control of their own wellness.
- Web-based tools for administrative functions such as billing, claims, etc.

Other Benefits of the Defined Contribution Model

Cost control isn't the only advantage of the defined contribution model. There are a number of other reasons businesses might look into it:

1. It addresses rising consumer demand for choice and information. The American consumer has become a citizen of the Internet, accustomed to on-demand information and near-limitless shopping choices. It was only a matter of time before these realities trickled into the health care arena. Millennials and Generation Y, in particular, often don't see a tremendous value in benefits ("I never go to the doctor"), and they value choice and lower premiums far more than 100% coverage. For employers with a large number of young, healthy participants, a defined contribution model may be an especially good fit.
2. It encourages informed consumption of health care by increasing access to health and wellness information—and by putting some of the employee's own money on the line.
3. It provides another pathway for employers to stay competitive with their benefits. Employers can even define different contribution levels for select groups of employees—for example, to attract and retain senior leadership or unique skillsets.
4. It can ease the administrative burden on HR. Online tools reduce or eliminate paperwork, and there's no company-to-insurer relationship to maintain.
5. It ensures flexibility for a diverse employee group. Traditional health plans are one-size-fits-all. A defined contribution model enables employers to offer a variety of coverage levels, from which employees can choose the plans that best fit their individual circumstances.

Potential Pitfalls to Avoid

When establishing a private exchange, employers should consider their participant group very carefully. Where an older employee might be overwhelmed by 10 choices, a Millennial might not be satisfied with 15 or even 20 choices.

When adjusting the defined contribution annually, employers should be mindful of the overall health care cost picture. A flat percentage increase may not be enough to keep up with rising premium and other health costs. For example, an employer might adjust a flat contribution of $1,000.00 by two percent, while the premiums are going up 15-20 percent. It's important to make sure that the contribution is reasonable enough for the average person to purchase coverage.

Is Defined Contribution Right for Your Business? Consult an Expert

It's been said that defined contribution is the future of health insurance in the U.S. While it's true that this model offers a number of advantages, it may not be right for all businesses.

To thoroughly understand and evaluate the full range of health plan options, it helps to find a partner that specializes in employee benefits. An experienced partner can help you parse the mixed messages and assess whether a defined contribution approach will truly meet your needs.

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