REINVENTING HEALTH BENEFITS WITH DEFINED CONTRIBUTION
Current trends in health care and challenges in the business and regulatory environment have led to an increased interest in defined contribution plans delivered through private exchanges. According to the Employee Benefit Research Institute, insurance market reforms combined with the exchange structure set in motion by the Patient Protection and Affordable Care Act (PPACA) have brought renewed focus on a fixed contribution (or defined contribution) funding approach that limits employers’ cost exposure.¹

CLIMBING COSTS CALL FOR CHANGE

Defined contribution addresses the steepest challenge facing employers today—volatile, ever-increasing health insurance and benefits costs. A shift toward a defined contribution model with the potential for lower, fixed costs is expected as employers search for solutions to stay competitive while controlling costs.

A survey by Mercer in 2011 showed that 38 percent of U.S. employers were interested in some type of defined contribution model.²

Aon Hewitt’s 2012 Corporate Health Care Exchange Survey found that 44 percent of employers believe private health insurance exchanges will be the preferred approach to offering employee health care benefits in the next three to five years. Not surprisingly, reducing costs ranked highest with employers (86 percent) as a top feature when considering the exchange model, followed by improving access to quality plans (45 percent), enhancing health and wellness programs (43 percent) and increasing health care choices (43 percent).³

READY FOR A BENEFITS REVOLUTION?

Employers who understand how defined contribution plans work will be ahead of the curve in navigating changes in health benefits and identifying new cost-saving opportunities. Defined contribution may be a particularly worthwhile alternative for employers to consider because it represents a completely different approach to benefits (so it is a true alternative choice), and has unique potential to better meet employee needs.
In a **defined contribution plan**, the employer decides how much to contribute toward employee benefits each year, and the employee can use those benefit dollars toward the purchase of health coverage and/or a variety of other insurance products to fit their needs. Fixed contributions may be determined from year to year by the employer based on the annual budget, or contribution amounts may be set to increase with inflation. In contrast, a traditional **defined benefit plan** offers a fixed benefit to employees. The employer selects the plan offerings and the employer’s costs generally fluctuate based on claims risk and plan performance.

The defined contribution model is not new; in fact, the concept has been evolving for years through section 125 cafeteria plans offering a selection of health, dental, life, disability and other coverage available to participants on a pre-tax basis. The financial markets experienced a similar shift from defined benefit (pension plans) to defined contribution (401(k) plans) over the past two decades. Defined contribution retirement plans allow employers to contribute a fixed amount to the plan instead of paying a defined benefit amount to employees in retirement.

Today defined contribution plans are offered on private health exchanges equipped with “shopping” and comparison tools to help employers and employees make informed buying decisions. Powered by technology, the defined contribution model has been revitalized as a solution to current challenges and an alternative to traditional defined benefit programs. Moving from defined benefit to defined contribution may provide more predictability and financial control for employers, as well as greater choice for employees to purchase the coverage they value most.

**WHAT IS A HEALTH INSURANCE EXCHANGE?**

Starting in 2014, state-run health exchanges will be up and running according to the PPACA guidelines. They will serve as an online marketplace for certain individuals to purchase health insurance and/or enroll in government programs such as Medicaid and Medicare, with federal subsidies for those who qualify based on income. There’s a fair amount of uncertainty regarding the status of these public exchanges and how they will be run.

**THE ROLE OF PRIVATE HEALTH EXCHANGES**

In addition to the public exchanges, which will serve individuals benefiting from government subsidies, private exchange solutions are being embraced today by employers making the strategic decision to continue offering employer-sponsored benefits. The private exchanges are currently available in the form of online benefits stores offering defined contribution benefits to large and small group employers. These exchanges allow employers to offer a range of coverage options tied to a fixed employer contribution amount. When employees use the online system, they are guided by interactive resources (such as questionnaires, videos, FAQs and calculators), backed by benefits advisors, to the plans that best fit their needs. They can shop for different features and compare plan prices using side-by-side comparison tools. The exchange allows groups to offer more choices to fit the unique needs of individuals while controlling costs on a fixed budget. Moving forward, as the public exchanges are brought online, the public exchanges would operate in parallel with the private exchanges—each serving the needs of their respective “customers.”
There are a number of situations in which a defined contribution solution may be particularly well-suited:

- **Employers who do not offer health coverage** due to costs may find the risk/benefit structure manageable and affordable with fixed contributions.

- **Small, midsize and large businesses on an unsustainable path of rising costs** and/or shrinking health benefits may enjoy greater financial control with a defined contribution plan that allows them to more effectively hold the line on costs while still being able to offer attractive benefits options to their employees.

- **Groups that have struggled with cost shifting** to manage rising costs may be receptive to defined contribution. In a traditional defined benefit model, employees may be stuck paying disproportionate cost increases from year to year; with defined contribution employees have some control over how much they spend.

- **Groups that have successfully offered choice** of more than one plan in the past may find defined contribution plans on a private exchange to be a natural and easy next step in maintaining or even improving choices while simplifying administration and potentially lowering costs.

- **Groups with a diverse workforce** that spans generations, income levels, life stages and other factors. Employees have the freedom to decide exactly how much they want to spend and where to focus their benefit dollars, allowing them to tailor their benefits portfolios to their particular situations.

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**IS DEFINED CONTRIBUTION A GOOD FIT?**

**LARGE EMPLOYERS: AVOID PENALTIES**

Large employers with 50 or more full-time equivalent employees may be subject to PPACA penalties (effective 2014) for not offering affordable coverage to employees. Offering a qualifying defined contribution plan within a private health exchange may be a viable option for large employers who wish to avoid penalties, as long as the worker share of health coverage does not exceed 9.5 percent of income.

**SMALL EMPLOYERS: STAY COMPETITIVE**

Small employers with fewer than 50 employees are not subject to penalties; however, other insurance market reforms such as guaranteed issue and community rating may effectively raise rates—for small groups in particular. Stay competitive and control costs with a defined contribution plan.
Here’s a breakdown of potential benefits of moving to a defined contribution plan.

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<th>For the Employer</th>
<th>For Employees</th>
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<td>Employer sets the benefits budget and enjoys greater predictability, financial control and fixed costs.</td>
<td>Employees can maximize their allotted benefit dollars in the ways that fit their needs.</td>
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<td>Employer is not responsible for choosing the “right” plan or one-size-fits-all plan. Employer can offer employees choice and flexibility; adds value without adding cost.</td>
<td>Option to buy different levels of coverage is attractive for employees with a range of budgeting needs.</td>
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<td>When employees buy plans with just the features they actually need, there’s greater efficiency and fewer wasted dollars.</td>
<td>Employees may be more engaged in their health care decisions because they are choosing how to spend their money versus having benefits chosen for them.</td>
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<td>Employee satisfaction may be enhanced by recognizing the diverse needs of workers and giving them greater control of their health care choices, which is of clear benefit to the employer because it can facilitate staff retention and greater productivity.</td>
<td>Employee satisfaction may be enhanced when workers have the opportunity to pick a benefits portfolio from a range of choices and customize it to their needs.</td>
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<td>Defined contribution plans provide yet another way to educate employees about the full cost of health coverage as total compensation transparency becomes more prevalent in benefits administration and reporting.</td>
<td>Defined contribution makes it clear to employees how much benefits are worth, which helps them recognize and understand the employer’s contributions to their total benefits package.</td>
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<td>Employer may offer a variety of types of benefits from different carriers, while working through a single organization for centralized enrollment and plan administration. Less time and fewer resources spent on enrollment, plan selection, compliance and employee claims questions.</td>
<td>Online enrollment features allow employees to “shop” when it’s convenient for them and compare options from work or home, as well as to share information and collaborate with other decision makers in their household.</td>
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For employers seeking to simplify benefits administration while adding greater predictability and control to their financial planning, defined contribution may be the answer. There’s no pressure to choose a one-size-fits-all plan suitable for everyone in the group—because employees choose for themselves—and the cost savings can be a win-win for employer and employee. It also leverages a highly sophisticated online platform (i.e., private health exchange) for an interactive experience that adds efficiency and reduces strain on internal resources. The steps for setting up a defined contribution plan are simple and generally include:

1. **Employer determines the budget.** The amount contributed per employee to benefits may vary based on family vs. single coverage, employee level, location and hours worked, among other factors. Benefits contributions can also be partitioned with a certain amount allocated toward health, life, disability, etc. Depending on the group size and defined contribution solution, the employer may also have varying degrees of ability to customize the particular benefits that are offered within the store.

2. **Employees shop the online store.** Private health exchanges offer an online marketplace with benefits provided by high-quality national and regional carriers. Plans are available to suit a variety of employee needs and price points, typically including an assortment of health care (e.g., EPO, PPO, HDHP) and supplemental health plans, dental, vision, life, disability, HSAs, FSAs, wellness and telemedicine options.

3. **Employees purchase individual plans.** Each employee navigates the benefit selection process and enters information necessary to produce personalized portfolio recommendations (which the employee may choose to follow, at their discretion). Employees then choose their preferred plans given their budget, using the employer contribution with the option to make additional contributions through payroll.

4. **Benefits administration is streamlined.** Built-in online plan administration tools may be available to streamline the benefits administration process. Depending on the exchange, employers and employees may also have access to a dedicated support team to handle their questions online or via phone—providing support for open enrollment and throughout the year.

**BLUEPRINT FOR A DEFINED CONTRIBUTION PLAN**

**HAVE YOU HEARD?**
- Employees get more choices.
- Employers get more predictable benefits costs.
- Everyone gets a bigger say in how their benefits dollars are spent.

To learn more about defined contribution, contact your broker or MVP representative.

**Sources:**

Note that neither MVP Health Plan nor any of its affiliates give tax advice. Consult your tax attorney or financial advisor for further information.
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