



AMERICAN ACADEMY *of* ACTUARIES

THE BOTTOM LINE ON Understanding Defined Contribution Health Plans

The current U.S. health care environment can be characterized by escalating health care costs, concerns with health care quality, and the desire for more consumer involvement and education. Employers are asking themselves how to respond to these trends. One option that is becoming more attractive to plan sponsors, and to other participants in the health care system, is a shift from providing a specific health insurance benefit package (i.e., a “defined benefit” or “DB” approach), to providing a specific contribution that employees can use to purchase the plan of their choice, perhaps from among a group of employer-selected options (i.e., a “defined contribution” or “DC” approach.)

Also referred to as “consumer-driven,” “consumer-directed,” “e-health,” and “self-directed” health plans, a DC health plan is not a particular type of health plan. Rather, it is a concept that provides alternative approaches to financing health care for employees. These approaches can be arranged along a continuum of alternatives that realign responsibility, or choice, from the employer or sponsor to the employee/participant. Primary differences among the approaches reflect the degree to which responsibility and choice are shifted. The following DC health models provide some points along the continuum of potential DC health plans:

- **Active management by plan sponsor** – Plan sponsor has an active role, and the participant’s role is relatively passive.
- **MSA/Savings/Spending account approach** – Participant has an “account” to use to purchase health care, which acts as an incentive for the participant to become more involved in the health care purchasing process.
- **Intermediary approach** – Plan sponsor transfers its management role by adopting a group purchasing mechanism through an intermediary (insurance carrier, employer coalition, or independent organization.)
- **Vouchers** – Plan sponsor grants vouchers to participants for purchase of health insurance from among a pre-defined selection of participating benefits/plans, which could be either group or non-group health plans.
- **No active management by plan sponsor** – Plan sponsor pays a pre-determined dollar amount to the participant to purchase individual health insurance in the local marketplace.

Health plans using a DC approach share many common characteristics:

- **Participant choice** – Participants would have greater flexibility in making benefit decisions.
- **Increased participant cost-sharing** – Participants are expected to assume an increased financial role.
- **Participant education** – Sponsors provide information and various tools to enable the participant to make effective and informed decisions.
- **Internet enabled systems capability** – Many plans use the Internet as one of the information delivery mechanisms as well as for other administrative functions.

Understanding Defined Contribution Health Plans provides an overview of the DC approach to health coverage, including discussions of trends in health plan approaches, the factors contributing to the emergence of DC health plans, and the characteristics and types of DC health plans. This issue brief is the first in a series that will be published by the American Academy of Actuaries on issues related to DC health plans. Future issue briefs will address the impact of a shift to DC type plans on insurance, employer groups (particularly employee equity issues), health care costs, adverse selection, and employer/employee control, as well as implementation issues such as consumer education, health care quality, and administrative concerns.

Staff Contact: To receive a copy of this issue brief please contact Holly Kwiatkowski, Health Policy Analyst, at (202) 223-8196 or kwiatkowski@actuary.org. The issue brief will also be available on the Academy’s Web site at www.actuary.org.

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