The Defined Contribution Health Plan:  
What is it? What’s in it for you?

A Luncheon Briefing presented by
The American Academy of Actuaries
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The Defined Contribution Health Plan

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Defined Contribution Health Plans – A Continuum

Patrick L. Collins F.S.A., M.A.A.A.
Vice President, American Re Healthcare
Objective

• Define “Defined Contribution” plan designs
• Discuss its relationship to DC pension plans
• Describe the objectives of these plans
• Issues & challenges
Defined Contribution Health Plans

• DC name from the retirement analogy
• AKA
  – “Consumer-driven”
  – “E-health”
  – “Self-directed”
• Not a particular type of health plan
• A concept giving rise to alternative approaches to financing health care
DC Health & DC Pension

• Accounts
  – Health: immediate non-catastrophic health care needs
  – Pension: long term capital accumulation

• Benefits
  – Health: catastrophic insurance component
  – Pension: no catastrophic insurance component

• Benefits
  – Health: short term emphasis
  – Pension: long term emphasis
Common Characteristics

- Employer sets/controls their cost
- Participant choice
- Increased participant cost-sharing
- Participant education
- Internet enabled systems capability
The DC Health Plan Continuum

• Several ways to array range of DC plans
  – Level of employer management
  – Market in which coverage is purchased
  – Degree of financial risk born by employer
• Our continuum reflects the level of employer/sponsor management
  – And reflects the level of employee responsibility as well
The DC Health Plan Continuum

Management by Plan Sponsor

 HIGH

 LOW

Participant Responsibility

 HIGH
The DC Health Plan Continuum

- Management by Plan Sponsor: Higher to Lower

- Participant Responsibility: Low to High
The DC Health Plan Continuum

Management by Plan Sponsor

Higher to Lower

Then

Lower to Higher

Participant Responsibility
The DC Health Plan Continuum

As Employer Management Decreases Employee Responsibility Increases

Higher To Lower

Then

Lower to Higher

Participant Responsibility

Management by Plan Sponsor

HIGH

LOW

DC HEALTH PLANS CONTINUUM
The DC Health Plan Continuum

Management by Plan Sponsor

Active Management by Plan Sponsor

Participant Responsibility

HIGH

LOW
Active Management by Plan Sponsor

• Similar in many ways to a DB health plan or perhaps a cafeteria plan
  – The sponsor
    • Determines and offers a limited number of benefit plan options
    • Sets maximum contribution
  – The participant
    • Chooses a plan option
    • Pays the difference between cost and sponsor contribution
Active Management by Plan Sponsor

• Sponsors’ plan contributions can be…
  – Pre-determined budget
  – The cost of the lowest-cost plan
  – Vary contributions based on tenure, family status, or salary
  – To encourage the selection of certain plans
Active Management by Plan Sponsor

An alternative:

• Sponsor offers a list of recommended plans
  – The sponsor may have arranged for discounted premium rates
  – Recommendations may reflect plans’ service, premium rates, or some quality measures
The DC Health Plan Continuum

- **Active Management by Plan Sponsor**
- **MSA/Savings/Spending Account**

Management by Plan Sponsor

- LOW
- HIGH

Participant Responsibility

- LOW
- HIGH
MSA/Savings/Spending Account

- The participant has an “account” to use to purchase health care
  - High-incidence, low-severity health services
  - Year end balance usually can carry forward
- The plan includes an insurance component
  - High-severity, low-incidence health services
- Provide participants incentive to more actively participate in health care process
  - thereby leading to more efficient decisions
MSA/Savings/Spending Account

- The three types of accounts vary by whether cash or notional dollars are used, and whether they are tax advantaged:
  - MSA accounts use cash dollars and are tax advantaged
  - Savings accounts use cash dollars but are not currently tax advantaged
  - Spending accounts use notional dollars instead of cash dollars and are intended to result in tax treatment similar to traditional DB plans
MSA/Savings/Spending Account

• Some issues to be addressed
  – Funded or notional account? If funded, who funds the account / Investment options?
  – Tax implications to the sponsor or participants
    • deposits, distributions or interest earned to and from the account?
  – Are tax advantages related to health care benefits portable beyond the year of coverage, and do they carry into new employment situations or into retirement?
  – What expenses are eligible for reimbursement from the account?
The DC Health Plan Continuum

**Active Management by Plan Sponsor**

**MSA/Savings/Spending Account**

**Management by Plan Sponsor**

**Intermediary Approach**

**Participant Responsibility**
Intermediary Approach

- Sponsor transfers its management role to an intermediary
  - Insurance carrier, employer coalition or independent organization
  - One or multiple sponsors may use same intermediary
  - Intermediary sets rules and offers choices
Intermediary Approach

• Intermediary models
  – One carrier offering multiple benefit choices
  – An intermediary offering a number of health plan options
  – An intermediary that contracts with or facilitates access to individual providers

• These intermediaries may provide tools to compare costs, quality of care, and the benefits offered under various options
The DC Health Plan Continuum

- Active Management by Plan Sponsor
- MSA/Savings/Spending Account
- Intermediary Approach
- Vouchers

Management by Plan Sponsor

Participant Responsibility

- LOW
- HIGH
Vouchers

- The sponsor grants vouchers to participants for purchase of health care
  - Choice from among a pre-defined selection of participating benefits/plans (group or non-group)
  - The selections may be from within one health plan or from among more than one health plan
  - The participant pays the difference between the plan cost and the voucher amount
  - Unused voucher balances are forfeited
The DC Health Plan Continuum

- Active Management by Plan Sponsor
- MSA/Savings/Spending Account
- Intermediary Approach
- Vouchers
- No Active Management by Plan Sponsor
- Participant Responsibility
No Active Management

- The sponsor pays a pre-determined dollar amount to the participant intended to be used for health benefits
- It is then up to the participant to purchase individual health insurance in the local marketplace
The DC Health Plan Continuum

- **Management by Plan Sponsor**
  - HIGH
  - Low

- **Participant Responsibility**
  - LOW
  - HIGH

- **Approach**
  - Intermediary
  - Vouchers
  - No Active Management by Plan Sponsor

- **Active Management by Plan Sponsor**
  - MSA/Savings/Spending Account
Objectives of DC plans

- Better educate employees about the true costs of health care services
- Begin to get employees more involved with the management of their own health care
- Attempt to stabilize health care costs
Issues & Challenges

- Tax treatment
- Contribution strategy
- Anti-selection
- Education
Conclusion

• What we know.
• What we don’t know.
Evaluating the Cost Effectiveness of HRA Products

Brent Greenwood, A.S.A., M.A.A.A.
Principal, Reden & Anders Ltd.
Common Business Objectives of Health Reimbursement Arrangement (HRA) Products

• Produce lower cost trends by:
  – Rewarding consumers who actively manage their medical care by creating greater benefits (but at a lower cost).
  – Offering lower benefits to those consumers who do not take an active role in managing their medical care.

• Educate the consumer through use of technology:
  – On how much health care costs.
  – Evaluate quality between providers.
  – How they can better manage their own medical care and health.
### Basic Structure of HRA Product

<table>
<thead>
<tr>
<th>Catastrophic Insurance</th>
<th>100% (Plan Liability)</th>
</tr>
</thead>
<tbody>
<tr>
<td>80% (Plan Liability)</td>
<td>20% Employee</td>
</tr>
<tr>
<td><strong>Employee Cost Sharing</strong></td>
<td></td>
</tr>
<tr>
<td><strong>PCA can get larger with carry forward provision</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Personal Care Account (PCA)</strong></td>
<td>Preventive Services 100%</td>
</tr>
</tbody>
</table>

- **Catastrophic Insurance**: 100% of plan liability.
- **Employee Cost Sharing**: 80% (plan liability) and 20% by employee.
- **PCA**: Can get larger with carry forward provision.
Product Design Characteristics That Influence Costs

• Level of PCA by contract (Single, Double, Family):
  – New employees
  – Change in life status
• Level of catastrophic insurance coverage:
  – Deductible
  – Coinsurance
  – Maximum out-of-pocket
• Eligible services covered by PCA.
Product Design Characteristics That Influence Costs (cont’)

- Carve-outs to PCA and insurance.
- PCA carry-over and forfeiture provisions.
  - At termination
  - At retirement
- Carrier replacement vs. multiple option offering.
- Regulatory issues/restrictions.
Other Items That Influence Costs

- Employee turn-over.
- Long-term impact of carry-over provision:
  - Incremental benefit.
- Long-term impact of high deductible
  - Leveraging of health care costs
- Paid vs. future unpaid obligation of employer from PCA.
  - At termination.
  - At retirement.
- Adverse selection in multiple option.
- Measuring potential impact of consumer decisions on utilization of services and shift in providers.
HRA Product Pricing Model

The purpose of this model is to:

• Evaluate the long-term cost impact of a HRA product.
• Determine which consumers will likely benefit from this product (versus existing coverage).
• Determine the level of PCA balances over the long-term and percentage of contracts having balances.
• Explore potential impact of selection between products.
• Analyze the impact resulting from consumer decisions.
# Illustrative Benefit Design

<table>
<thead>
<tr>
<th></th>
<th>HRA</th>
<th>PPO (In-Network)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PCA</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single</td>
<td>$750</td>
<td>N/A</td>
</tr>
<tr>
<td>Double</td>
<td>1,100</td>
<td>N/A</td>
</tr>
<tr>
<td>Family</td>
<td>1,500</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Deductible</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single</td>
<td>1,500</td>
<td>$200</td>
</tr>
<tr>
<td>Double</td>
<td>2,200</td>
<td>300</td>
</tr>
<tr>
<td>Family</td>
<td>3,000</td>
<td>500</td>
</tr>
<tr>
<td><strong>Coinsurance (Plan Liability)</strong></td>
<td>80%</td>
<td>80%</td>
</tr>
<tr>
<td><strong>Maximum Out-of-Pocket</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single</td>
<td>2,500</td>
<td>1,000</td>
</tr>
<tr>
<td>Double</td>
<td>3,500</td>
<td>1,500</td>
</tr>
<tr>
<td>Family</td>
<td>5,000</td>
<td>2,000</td>
</tr>
</tbody>
</table>

Approximately same benefit value.
Comparative Cost Analysis
Definitions

- **HRA Liability** – Total of claims paid from HRA and insurance plus value of remaining unused HRA balance.
- **HRA Claims Paid** – Total claims paid from HRA and insurance.
- **PPO Standard** – Representative of paid claims for employer’s PPO plan currently in force.
- **3-Year Employees** – Employees present for all three years of the analysis.
### Average “Future Obligation” of HRA (Unused Balance)

<table>
<thead>
<tr>
<th>Employee Cost-Sharing</th>
<th>All Contracts with HRA Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</td>
</tr>
<tr>
<td>Single</td>
<td>$750</td>
</tr>
<tr>
<td>Double</td>
<td>1,100</td>
</tr>
<tr>
<td>Family</td>
<td>1,500</td>
</tr>
</tbody>
</table>
Basic Structure of HRA Product

- **Catastrophic Insurance**: 100% (Plan Liability)
- **Employee Cost Sharing**: 80% (Plan Liability) / 20% Employee
- **Personal Care Account (PCA)**: PCA can get larger with carry forward provision
- **Preventive Services**: 100%
## Comparative Cost Analysis – All Employees

Note: Employee turn-over average 12%.

<table>
<thead>
<tr>
<th>Year</th>
<th>HRA Liability</th>
<th>HRA Claims Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.300</td>
<td>1.000</td>
</tr>
<tr>
<td>2</td>
<td>1.330</td>
<td>1.010</td>
</tr>
<tr>
<td>3</td>
<td>1.380</td>
<td>1.010</td>
</tr>
</tbody>
</table>

**PPO Standard = 1.00**
Comparative Cost Analysis – 3 Year Employees

- **HRA Liability**
- **HRA Claims Paid**

Note: These employees are approximately 11% more costly than average.
Percentage of Employees Who Are Better Off - OOP Expense Viewpoint

% Where OOP Expense Lower under HRA vs. PPO

Year

1

2

3

.66

.69

.68
Percentage of Employees Who Are Better Off - OOP Expense Viewpoint

% Where OOP Expense Lower under HRA vs. PPO

Average 3 years based on health status and contract type.
Enrollment Assumptions for Multiple Offering Scenario

<table>
<thead>
<tr>
<th>Contract Type</th>
<th>Percentage Enrolled:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PPO</td>
</tr>
<tr>
<td>Low Cost</td>
<td>75%</td>
</tr>
<tr>
<td>Average Cost</td>
<td>90%</td>
</tr>
<tr>
<td>High Cost</td>
<td>95%</td>
</tr>
<tr>
<td>Overall</td>
<td>81%</td>
</tr>
</tbody>
</table>
Comparative Cost Analysis with Selection

Year

0.50
0.75
0.911
0.957
0.647
0.771
1.104
1.359
1.50
0.647

HRA Liability
HRA Claims Paid
PPO Standard = 1.00
Key Observations from HRA Modeling

- If start from same equivalent benefit, over time the HRA product may have a higher trend rate due to leverage of PCA roll-over.
- The HRA should start at a benefit level 5%-10% below current PPO plan, if one of the objectives of the employer is to reduce costs.
- Employee turnover has a large impact on products’ long-term cost.
- “Future obligation” of HRA pushes total potential liability significantly above PPO.
- If additional services covered by HRA, total cost to employer would increase.
Key Observations from HRA Modeling (continued)

- Those who benefit most are employees with lower medical care costs on average (equity issue).
- When offered in multiple setting, adverse selection will likely occur.
- Wild card is impact of consumer decisions on health care costs.
Early Feedback from Existing HRA Products

• Emerging experience indicates:
  – Lower frequency of routine office visits.
  – Lower frequency of Rx.
  – Greater percentage of generic Rx.
  – Minimal impact on large cost cases.

• Product design variation:
  – Multiple HRA product offerings with increasing cost-sharing.
  – Integration of employee funded FSA within HRA product (FSA used first).
Early Feedback from Existing HRA Products (continued)

• Keys to success:
  – Valid and comparable quality/cost measures (standardization).
  – Effective modes of communication.
  – Enough financial incentives for consumer to be active participant.
  – Consumer acceptance of concept and ownership in health behavior.
The Defined Contribution Health Plan

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