

## Benefit Fact Sheet

### What is it?

Defined Contribution Health Care is an employer funding *strategy* that seeks to fully or partially limit (i.e., "define") an employer's cost for delivering health insurance to employees. Rather than defining the benefit to be provided (e.g., \$15 copayment, \$250 deductible, 80% coinsurance), an employer contributes a defined dollar amount and plan participants decide for themselves how to best spend the money.

Traditionally, a form of defined contribution has been used by employers to set annual employee contributions. For example, employers might give employees an annual allowance to elect options within a cafeteria plan. If the employer contribution is inadequate to fund the option, the employee has to pay the difference. While this cost sharing exercise helps limit employer expenses in a given year, it does little to limit annual increases in cost as most employers have been compelled to adjust their annual contribution to keep pace with health care inflation.

Defined contribution health care in its purest form would evolve to parallel what employers accomplished in retirement plans, where they moved away from defined benefit pension plans to defined contribution savings plans like 401(k)s. From an employee's perspective, 401(k) plans are highly regarded because the employee self-directs how their retirement money is invested and they can take their money with them if they change jobs.

It's possible that health care delivery will make a similar transition, with employees self-directing their employer's and their own dollars to purchase the health insurance plan(s) that make the most sense for them. These purchases might be made from within a health care "exchange" or "supermarket" that removes employment as the driver for health care coverage. Employers would not maintain health plans; they would merely fund employee accounts based on a defined contribution formula. An employee's account within an exchange or supermarket might include contributions from the spouse's employer, the employee, the government, or investment earnings on the principal in the account. The employee and his/her family would select from a menu of available health plans, and premiums would be deducted from the account on a regular basis. Changes in employment, including retirement, would not necessitate a change in health plans since the employee's coverage would not be directly tied to his/her employer.

With the stall of Federal health care reform in Washington, state-managed exchanges may gain traction. Utah launched the [Utah Health Exchange](#) in August, 2009 for individuals who do not have access to employer coverage as well as employers with 2-50 employees; they will expand employer eligibility to large groups in the fall of 2011. Massachusetts also enacted an exchange in 2006, requiring all residents, with a few exceptions, to obtain health insurance.

The broader transition to a defined contribution strategy that is based on an exchange or supermarket for health care would be a lengthy process with some significant obstacles to overcome. Among these obstacles are 1) the absence of an efficient marketplace for employees to purchase plans; 2) employee populations that are generally unwilling, unready, and unable to make informed decisions about health insurance; 3) the reality that a defined contribution approach may be successful in limiting employer costs, but may not make health care more affordable or accessible to the end consumer.

The defined contribution concept appeals to employers who seek to control costs while encouraging informed consumption of health care. Advocates of defined contribution plans believe that limiting available dollars but promoting access to available knowledge will lead to health care that is both more cost efficient and of higher quality. Consumer Directed Health Plans (CDHPs) may provide employers more long term traction in cost control for both themselves and their employees.

### Why offer it?

- Controls employer costs
- Shifts responsibility from employer to participants
- Encourages participants to be price-sensitive and educated consumers of health care
- Increases flexibility and choice for participants

## Benefit Fact Sheet

### What types and size of employers offer it?

Many employers (large and small) already incorporate a defined contribution into their employee contribution rate setting process. The supermarket or health care exchange concept is still some ways off for the majority of states and as with Utah's exchange, will likely be rolled out first with smaller employers and may incorporate association health plans or purchasing cooperatives.

### What are the critical underwriting or participation requirements?

Since defined contribution is a funding strategy as opposed to a health care option, there are broad financial considerations rather than specific underwriting requirements. Additionally, significant and formal tax changes that promote tax favored employee and employer funding of health care exchanges will have to occur to create an environment that promotes its growth.

### How much does it cost?

Because this is a strategy that can incorporate a variety of delivery systems and plan designs, there is no definitive price.

### Informational link(s)

- [Consumer Directed Health Plans Fact Sheet](#) (ArlenGroup)
- [Understanding Defined Contribution Health Plans](#) (American Academy of Actuaries)
- [Defined Contribution Health Insurance](#) (National Center for Policy Analysis)
- [Consumers Take Charge: Defined-Contribution Health Plans](#) (Wharton School of the University of Pennsylvania)

This Fact Sheet is designed to provide a general overview of the benefit program, service, or regulatory act it describes. The information included in this document is not a substitute for legal or professional opinion relative to a plan sponsor's particular fact pattern. Your ArlenGroup consultant can answer more specific questions relative to its application for your organization. A menu of additional topics is available online at: [www.arlengroup.com/facts](http://www.arlengroup.com/facts).