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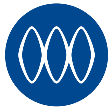

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Benefits Perspectives
Current Issues in Employee Benefits

SUMMER 2004

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Designing Effective Consumer-Driven Health Plans

by Scott A. Weltz

Consumer-driven health plans (CDHPs) that pair high deductible insurance products with individual spending accounts are capturing the attention of employer-sponsored health plan managers. The interest has been heightened further with the IRS's guidance on health reimbursement arrangements (HRAs) in 2002 and health savings accounts (HSAs) this year.

Given soaring healthcare costs, many employers are contemplating CDHPs as a "can't lose" proposition. But although CDHPs can result in significant medical benefit savings, proper plan design is essential to achieve the lofty goals that many claim are possible.

Using a case study approach, this article presents the issues an employer should consider when adopting a CDHP. Milliman's *Consumer Driven Rating Tool* (CDRT), which evaluates the costs associated with CDHPs that include an underlying healthcare spending account that may be rolled over from year to year (such as an HRA), is used in the illustrative employer's assessment of costs and the design of a financially viable medical benefits program.

Illustrative Employer

As shown in Tables 1 and 2, an employer spends roughly $5.5 million on a self-funded basis for two preferred provider options (PPOs) with different features. Plan costs have increased 10% annually over the past five years, a rate of increase that is not sustainable over the long-term.

The human resources (HR) director at the company begins to explore CDHPs, based on their reported potential to help contain

TABLE 1

FEATURES OF CURRENT AND PROPOSED MEDICAL PLAN OPTIONS

	Current Medical Plan Options		Proposed HRA Options	
Plan Feature	**PPO-1**	**PPO-2**	**HRA-1**	**HRA-2**
Individual Deductible (Ded)	$250	$500	$2,000	$2,000
Coinsurance (Coins)	90%	90%	100%	90%
Coinsurance Maximum	$750	$1,500	n/a	$2,000
Family Limits	2x	2x	2x	2x
Account (Acct) Contribution	n/a	n/a	$1,000	$600
Preventive Service Copay	$15	$30	$15	None; 1st dollar
Office Visit Copay	$15	$30	$15	Acct/Ded/Coins
Emergency Room Copay	$75	$75	$75	Acct/Ded/Coins
Rx Drug Copays (Generic/Brand Name)	$10/$20	$20/$40	$10/$20	Acct/Ded/Coins
All Other Services	Ded/Coins	Ded/Coins	Acct/Ded/Coins	Acct/Ded/Coins
Account Use Upon Termination				
Actives	n/a	n/a	Until 3/31 of year following termination	1 mo. after termination
Retirees	n/a	n/a		For retiree medical

medical costs. She suggests adding an HRA option with a $2,000 deductible and a $1,000 annual employer account contribution that employees can use toward paying their deductible. The chief financial officer (CFO) is skeptical that the HRA will save money, contending that only the healthiest employees will choose the HRA. In fact, the CFO suspects the HRA adoption will actually cost more, because the company will effectively be contributing $1,000 annually to each account, including for employees who previously cost virtually nothing.

Assume Full Replacement

Most large employers do not fully replace all of their existing plan options with one CDHP. Instead, a CDHP alternative will often be added to current plan options, as suggested by the HR director. But determining a feasible plan design is easier by first assuming that all plan options will be fully replaced. If savings are not expected under full replacement, savings certainly will not materialize in a multiple option setting that allows employees to select the plan that optimizes benefits for their personal situation (i.e., adverse selection). Table 2 compares the employer's current medical plan costs with the proposed HRA design using results from the CDRT assuming full replacement.

Modify Plan Design

The proposed HRA (as shown in Table 1 as HRA-1) would cost the employer over $841,000 more if offered to all employees in place of the current plan options. But this does not imply that an HRA is not feasible. A closer look at the proposed design points to inefficient design features that hamper its cost effectiveness:

- *Account contribution*—HRA-1 costs the employer $1,000 for every single employee and $2,000 for every employee with a family. The high deductible plan would have to reduce costs by about $1,500 per employee annually for HRA-1 to break even with the current PPOs. To address this, the account contributions could be lowered to $600 for singles and $1,200 for families, as shown in Table 1 as HRA-2.

- *Copays for discretionary care*—Effective CDHP designs force employees to consider the cost of care for discretionary services by increasing the levels of cost sharing. For example, the consumer becomes aware that the true cost of a doctor's visit is $250 rather than the $15 copay. The HRA-1 design, by retaining copays as with the current PPOs, does not take advantage of such potential areas for savings. In effect, only nondiscretionary services such as hospital stays and surgeries are reimbursed via the account. Conversely, HRA-2 makes most services—notably office visits and prescription drugs, for which alternative treatments exist—eligible for the account, deductible, and coinsurance. HRA-2 also provides first-dollar coverage for preventive services (with an annual maximum) to encourage employees to visit doctors annually and receive appropriate immunizations.

- *Coinsurance*—Many CDHPs are structured along the lines of HRA-1 and pay 100% of costs beyond the deductible. However, more effective designs can keep the employee engaged beyond the deductible. For example, the HRA-2 design requires employees to pay 10% of the insurance costs until the total coinsurance dollars paid (excluding the deductible) reach $2,000 for singles and $4,000 for families.

- *Account use upon termination*—HRAs are typically forfeited upon an employee's termination of employment. While the effects of this practice cannot yet be determined, a serious concern is raised. If HRAs are not viewed as "real" money for future use, employees are unlikely to use it wisely. HRA-2 is designed to allow employees who retire from the employer to access their unused HRA balances to pay for retiree medical premiums or medical expenses, thereby providing an added incentive to preserve the HRA funds for future use. In addition, employees under the HRA-2 design will only have one month after termination to use their HRAs for expenses that were incurred during employment, thereby mitigating unnecessary use of the accounts.

TABLE 2

Employer Costs for Current and Proposed Medical Plan Options

	Current Medical Plan Options			Proposed HRA Options	
	PPO-1	PPO-2	Average of PPO-1 & PPO-2	HRA-1	HRA-2
Annual Costs Per Employee	$7,411	$4,219	$5,480	$6,321	$5,123
Number of Employees	x 395	x 605	x 1,000	x 1,000	x 1,000
Annual Total Employer Costs	$2,927,345	$2,552,495	$5,479,840	$6,321,064	$5,122,933

A comparison of the employer's current medical plan costs with the HRA-2 design (assuming full replacement) shows expected savings of more than $356,000 for the employer if offered to all employees in place of the current plan options, and nearly $1.2 million less than the proposed HRA-1, based on a few tweaks.

What about the Employee?

The HR director, like most benefits managers, insists that shifting to employees the entire cost of healthcare is not acceptable. An analysis of the effect HRA-2 will have on employees is necessary to ensure a reasonable outcome. Table 3 shows that employees will annually save an average of $100 relative to their current situation, based on:

- *Employee contributions*—The employee is assumed to pay about 20% of total plan costs. HRA-2's leaner design over the current PPOs produces $83 in annual savings.

- *Cost sharing and account payout*—HRA-2's high deductible increases employee costs $918 annually relative to the current PPOs. To offset some of the cost sharing, the employee will be reimbursed from the HRA-2 account. The expected account payout is $740 annually, resulting in a net increase in employee cost sharing of $178 with the HRA-2 design.

- *Year-end account balances*—HRAs allow employees to rollover unused dollars to the following year to pay for future medical expenses. HRA-2 essentially produces a deferred savings for the employee equaling $195 annually.

While HRA-2 increases employee cost sharing, the amount is more than offset by the reduced premiums and the employer's additional account contributions. The average employee will be in a better financial position with the HRA-2 design than under the current PPOs.

TABLE 3

COST EFFECTS ON EMPLOYEES

Per Employee Costs	Current*	HRA-2	HRA Savings
Employee Contribution	$1,363	$1,280	$83
Cost Sharing	$1,355	$2,273	($918)
Account Payout	n/a	($740)	$740
Year-end Account Balance	n/a	($195)	$195
Total Net Costs	$2,718	$2,618	$100

*Weighted average of PPO-1 and PPO-2

TABLE 4

MULTIPLE OPTIONS COST COMPARISONS (COSTS PER EMPLOYEE)

	PPO-1 and PPO-2	PPO-1, PPO-2, and HRA-2	Savings
Employer Costs	$5,480	$5,257	$223
Employee Costs	$2,718	$2,604	$114

Multiple Option Offerings

CDHPs generally are expected to attract employees who are healthier than average since the potentially lower premium contributions outweigh the higher deductible levels and serve such workers' financial interests. When this occurs, adverse selection might result with respect to the employer's other health plan offerings, as the less healthy remain in non-CDHPs and drive up costs. However, the impact of adverse selection need not create an unbearable cost for the employer.

Offering multiple options is manageable due to the unpredictability of medical expenditures. As Table 4 illustrates, the employer will save $223 annually per employee by adding HRA-2 alongside the two PPO options. While healthier-than-average employees tend to choose CDHPs when other options exist, a number of employees with high medical costs will also elect to participate. This is because individuals have difficulty predicting whether they will incur high-cost claims unless they have a chronic condition or a potentially predictable event such as pregnancy. In addition, most employees are generally unwilling to switch plans unless their current option is eliminated.

Conclusion

As CDHPs continue to gain momentum, employers are realizing that these multi-faceted plans pose unique risks that must be considered prior to implementation. In addition to administrative complexities, the task of designing a feasible plan is daunting and riddled with pitfalls. However, with proper analysis, employers can design innovative health plans that are financially viable while offering employees meaningful medical benefits.

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Defined Benefit Plan Commencement Exercises

by Dawilla Madsen and Dominick Pizzano

Since the passage from employment into retirement is in essence a graduation from career years to golden years, one may logically conclude that an employer will want to mark this transition by conducting certain commencement exercises. If the employer sponsors a tax-qualified defined benefit (DB) plan, careful attention to this transition is crucial: once employees enter their senior years, plan sponsors and administrators must address questions of distribution.

Although the ultimate goal is a diploma for students and a pension for retirees, determining eligibility for and timing of commencement for each group requires a similar evaluation process. While college administrators must be mindful of their written minimum graduation requirements and review the academic credits of each candidate for graduation, DB plan administrators must be cognizant of the terms and provisions of their written plan documents and procedures and review the employment status of each candidate for benefit commencement.

To Commence or Not To Commence?

For the answer to this key question, plan administrators should turn to the plan document. Typically, DB plan documents will include an early retirement age (e.g., age 55 and 10 years of service) and a normal retirement age (usually age 65, sometimes with an additional requirement of five years of plan participation). Many DB plans also contain "suspension of benefits" provisions that, as the term suggests, mandate that the pension payments be suspended if the participant continues or returns to work for the employer. The commencement of benefits after the participant attains normal retirement age while still employed by the employer is permissible, but most DB plans require that the participant actually terminate employment with the employer to qualify for a distribution.

Although the plan provisions may seem straightforward, plan sponsors often view the concepts of retirement and termination of employment differently than the IRS and the Department of Labor (DOL) do. Plan sponsors might automatically consider an employee has retired when they hold an official retirement ceremony with food, toasts, and that old standby—the gold watch. However, the IRS and DOL care little about the pomp and circumstance surrounding the "retirement" and much more about the facts and circumstances of any relationship the employee may have with the employer afterwards. If the employee "retires" and then is back on the payroll sometime thereafter—even if on a part-time basis—there may be problems when the pension commences upon the initial retirement and then continues during the period of reemployment.

The Clean Break

If the participant retires at his or her normal retirement age and stays retired, the commencement decision is fairly straightforward. Generally, the only provisions to check in the plan document are whether or not the plan: (a) permits the participant to defer receipt of the benefit to the maximum age permitted by law (i.e., April 1 of the calendar year following the year in which the participant attains age 70-1/2) or requires the participant to begin receiving benefits at normal retirement age; and (b) has discretion to either pay the benefit from the trust or buy an immediate or deferred annuity for the participant. The age 70-1/2 deferral option has a downside: unless it is accompanied with the discretion to buy a deferred annuity, the plan sponsor must keep track of the participant's whereabouts until the age 70-1/2 mandatory distribution date. If the plan does provide this option and purchases a deferred annuity for a participant who wishes to defer commencement, however, the participant-tracking onus shifts to the insurance company.

Never Can Say Goodbye

Due to employers not wanting to lose a valued employee or employees not wanting to lose much-needed income, many individuals today stay employed past their retirement ages, either in their original positions or in other capacities. This trend has been compounded by longer life expectancies coupled with insufficient savings. As more participants decide to extend their careers beyond their "normal" retirement date, plan sponsors need to consider several factors to determine the most appropriate course of action.

Both philosophical and fiscal issues must be examined before deciding how to handle participants who remain for "post-graduate" work. Given the original idea that a DB plan is for participants to begin receiving pensions at normal retirement age, is the plan sponsor philosophically opposed to employees collecting a pension while still working? Doing so is often seen as "double dipping" since the employee is collecting both a salary and a pension benefit at the same time. In contrast, allowing participants to commence benefits while continuing or returning to work might be viewed as a way to reward the participant while keeping a valued employee. However,

even if "double dipping" aces the plan sponsor's philosophy exam, the economics test often proves much tougher to pass as budgetary restraints cause many plan sponsors to opt for the suspension of benefits alternative.

Commencing While Continuing to Work

Some plans allow participants to commence benefits upon their putative retirement and permit them to continue to work, either on a part-time basis or in a consulting position. While believing they are acting solely in the participant's best interest, these plan sponsors fail to realize that they may be violating the plan document or the Employee Retirement Income Security Act (ERISA) and could face IRS sanctions or plan disqualification.

Unless an individual legitimately passes from employee to "independent contractor" status, he or she will not be considered terminated for purposes of the plan and thus will not be eligible to commence receiving benefits unless the plan permits pension payments to begin after normal retirement age. Independent contractor status is not easy to prove and is left to an IRS "facts and circumstances" test, the gist of which is, if it looks and acts like an employee, it probably is an employee.

The easy solution for those plan sponsors that have hurdled the philosophical and fiscal considerations is to amend the plan to allow everyone who remains employed past normal retirement age to commence their benefit while continuing to work. The additional benefits they accrue under the plan while continuing to work may be offset by the actuarially equivalent value of the in-service pension payments received during the year.

Another option is to amend the plan to allow pension payments only for selected individuals that plan sponsors wish to keep on as employees beyond retirement age. However, if one or more of these retained employees meet the IRS's definition of a highly compensated employee (generally, earning over $90,000), such an amendment could be prohibited because it would create a discriminatory right under the plan. Even if none of the participants is highly compensated, plan sponsors could still face employee morale concerns if word leaked that some were not among the selected individuals. In addition, the IRS might not consider the selected individuals a legitimate class worthy of extra benefits and disallow the amendment.

Suspension of Benefits

For plan sponsors that cannot either philosophically or fiscally accept permitting employees to "double dip," benefit payments may be suspended after normal retirement age. Under ERISA's suspension of benefits rules, if an employee continues working or is rehired for more than 40 hours (or eight days) per month, the payments may be suspended (or in the case of an employee who continues to work, they never start), if the plan so provides and the employer timely notifies and explains the suspension to the employee in writing. Although employees participating in a DB plan that contains this provision will never recoup the payments that are suspended, they do accrue additional benefits for the period they continue working.

The most common error sponsors make is not timely or properly notifying participants. Just as an institute of higher learning faces severe consequences for suspending students without first providing adequate notice, a plan administrator that fails to give a proper suspension of benefits notice to participants will not comply with the regulations or the plan provisions. Accordingly, plan sponsors should correct such a failure to maintain the plan's qualified status. Because different correction methods produce significantly different results in terms of cost, operation of the plan, and likelihood of IRS acceptance, plan sponsors should obtain professional advice for help in determining the most suitable option.

Taking it Up a Degree

Satisfying the cumbersome suspension of benefits rules is not necessary for all DB plans that prohibit benefit payments to commence upon an actively employed participant's attainment of normal retirement age. The plan may instead provide that the participant's pension upon actual retirement will equal the greater of the additional accruals earned or the participant's pension benefit actuarially increased to reflect the delayed payment. However, the price of this elective course of action may hoist a fiscal red flag because providing such an actuarial increase may raise plan costs.

Gone Today, Here Tomorrow

Rather than go through the decision-making process and amending the plan one way or another, an employer often will allow the participants to retire and rehire them shortly thereafter. Even if the participants actually retire, get the big send-off, and then are rehired only on a part-time basis, there may be several potential pitfalls. If the rehire date is too close to the retirement date, the IRS may view the "retirement" merely as a mechanism to manipulate the plan's commencement provisions. Because there is no IRS guidance on what is an appropriate amount of time from retirement and rehire dates and such a determination is left up to facts and circumstances, legal assistance should be sought.

Plan sponsors face a particularly detrimental situation when allowing early retirees to come back to work if the retire/rehire chain of events is deemed solely a means to start the pension. The plan not only will be at risk for failing to operate in accordance with its

terms but also in violation of the regulations prohibiting DB plans from commencing payments prior to normal retirement age for participants who are still employed.

Another administrative failure may occur if a plan sponsor wrongly treats rehired employees as participants who are no longer eligible to accrue additional benefits because they have commenced their benefits. Depending on the plan's method of crediting service for benefit accrual purposes, the employees may be entitled to additional accruals, even if they are rehired on a part-time basis. For example, if the plan credits a year of service for 1,000 hours of work in a plan year, a rehired participant could reach that threshold by working on a part-time basis.

Graduation Day

When can benefits commence? When must they commence? When are they suspended? How must they be increased? How may they be reduced? Where did all those participants go? When dealing with DB plan participants and the amount and timing of their pension payments, the list of questions sometimes may seem as long as the roll call of graduates for a given year at a major university. To become a "Dean of Distributions," plan sponsors will have to pass the challenging curriculum covering the smooth running of a DB plan's commencement exercises. Plan sponsors that do not have internal faculties to master these subjects should seek the assistance of an adjunct or visiting professor of pensions (e.g., ERISA attorney or benefits consultant) to ensure their plan's tenure.

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Keys to Effective Benefits Communications

by Steve Juetten

Rising healthcare and pension plan costs force many employers to ask, "How can we persuade our employees to understand and appreciate their benefits?" By their very nature, employee benefit plans are complex, confusing, and convoluted, so how do you overcome this underlying challenge?

This article discusses five keys to effective communications that can improve understanding or help you "sell" the value of your benefit plans to employees.

Aim for Skimmers and Thinkers

Your employee population is made up of skimmers and thinkers when it comes to benefits topics. Skimmers are people who go over the surface of an issue, not really thinking about it. Thinkers are those who closely examine a subject. Psychologists say that people in general skim over most topics most of the time.

The same is true about your employees and their interest in your benefits programs. Most employees are not thinking deeply about the benefit programs you offer most of the time. The only time the majority of your employees think about benefits is when they either need to use them or have to make a decision about them. Otherwise, most of your employees skim the surface on benefits topics.

To effectively communicate with your skimmers and thinkers, you must treat them differently. Thinkers react to well organized presentations. Providing examples and repetition are effective ways to reach your thinking population. What works for skimmers is to be brief and use cues.

Cues are the small signals that the brain takes in when people are skimming. The five most common cues are:

- comparisons,
- liking the source,
- reacting to authority,
- scarcity, and
- reciprocity.

When persuading new employees to participate in your 401(k) plan, for example, you could tell them that it is an excellent package as evidenced by the seven out of 10 employees who already participate (comparison cue). You might have managers and supervisors encourage employees to attend a meeting (liking the source or reacting to authority cue). Tying a gift (such as a computer monitor cleaner) to a brief message (such as suggesting that employees enroll in the health plan through the online system) also can be an effective communications approach (reciprocity cue). Limiting eligibility for a prize drawing to only the first 50 employees who sign up online (scarcity cue) will get an employee's attention in a communications piece.

The key to communicating benefits to both your skimmers and thinkers is to use separate but coordinated tools: Posters and postcards are for skimmers, 12-page booklets are for thinkers; data tables for skimmers, footnotes for thinkers; detailed presentations for thinkers, seven-minute highlight videos for skimmers; headlines and highlights for skimmers, long articles for thinkers; and e-mail blurbs for skimmers, links within documents for thinkers.

Use a Variety of Media

Plan to tell your benefits story in as many different ways as possible. Master storytellers use their hands, eyes, voice, and movement to capture and hold the audience's attention. Similarly, you need to use print, audio-visual materials, the computer, and small group meetings. You also should use colored pictures, graphs, tables, and worksheets. Words must be spoken, heard, and read.

Using a variety of media works best because adults learn optimally in one or a combination of three ways: hearing, seeing, or by experience. Roughly one-third of your employees are in each group. If you only provide information through print media (which is how most benefits communications take place), two-thirds of your audience will not easily learn your story. As an example of mixing media, try educating your employees about their healthcare benefits through a slide presentation given by a dynamic speaker, an article in the company newsletter that uses a series of simple pie charts, postcards mailed home, a poster series in the lunchroom, worksheets employees can use to compare their total cost under each plan option, and a DVD that employees can pop into their home computers.

Make the Message Relevant and Understandable

Taking into account skimmers and thinkers and the need to use multiple media, you still must craft good content. At this step, the "twin towers" of benefits communications come into play—relevance and understanding. If your message is not relevant, employees will not pay attention and if the content is not understandable, they will not try to learn it.

But relevancy, like beauty, is in the eyes of the beholder. Your audience will determine what is relevant, not you the employer. When an employee receives information on benefits, the first question asked is, "What's in it for me?" If you do not or cannot answer that question in the first 30 words or 30 seconds, you will have lost your opportunity to reach your audiences.

Under most circumstances, your retirement program will not be very important to the employees who are age 25, but very relevant to a 50 year-old. Your paid time-off program is probably important and relevant to all of your employees. Healthcare is important to most employees, but most relevant to employees with families.

The point is—you need to direct your benefits story to the groups that care the most. Otherwise, you might find yourself speaking to an empty room. Consider targeting your benefits communications to sub-groups of your employees based on age or family status. For example, basic retirement communications could be presented to all employees, yet more detailed information could be provided to employees aged 45 and older.

Even if your communications are relevant, they must be understandable. Messages must be in plain, simple terms. If an employee finds a topic relevant but cannot get through the jargon, acronyms, and mysterious sounding words, your story will be lost. The solution is to create your benefits communications as if you were telling the story to your cousin Carla, who knows nothing about benefits. The message must be clear, simple, and direct. If your word processing program can check for readability, consider using it, rewriting your communications if necessary to keep the score down.

Avoid legal and technical terms ("vesting," "medically necessary"), long words ("retroactive"), complex sentences, and sentences longer than 20 words. If you must use a technical or legal term, provide a glossary that defines the word in simple terms. Using more common words might make a document longer, but it will improve understanding.

Know Where You Want to Go

Changing employee perceptions or behaviors takes time and good benefits communications require consistency and repetition over time. Therefore, to stay focused and be effective, you need a solid communications plan.

The old saying about planning is true: "If you don't know where you're going, any road will get you there." The first item to include in your plan is a clear statement of your communications goals. What do you want your employees to do, think, or feel as a result of the communications effort? For example, you might want your employees to understand the cost pressures affecting your medical plan and their role in containing costs. Or you might want your employees to appreciate the value of their overall benefits program. Whatever the goal, state it in specific, measurable terms. For example, your goal might be to increase overall understanding and appreciation of benefits by 25% after one year, as measured by a survey conducted before and after a communications campaign.

In addition to clearly stating goals, a good communications plan includes:

- a discussion of the key audiences you are trying to reach,
- the challenges you will face in achieving your goals,

- the key messages you will repeat with every communications piece,
- the most and least effective media you will use,
- the resources you have to accomplish your goals (time, people, money), and
- a mechanism for measuring your success.

Documenting your plan will give you a roadmap for accomplishing your goals. This will serve you well over time as you implement your communications tactics.

Get Feedback

Good benefits communications are audience focused, not employer focused. Accordingly, you need to know if your communications are on target from your employees' perspective. This requires feedback from your employees about your communications. Ask employees, "Is what we're giving you relevant and understandable? Is it prepared in ways that you can easily absorb it?" Without knowing the answer to these simple questions, you have no way of knowing if your efforts are working.

How do you obtain feedback? The choices range from informal (e.g., asking employees if they read the newsletter you sent out last week) to formal surveys and focus groups. Some employers use the Intranet or Internet to gather employee responses to a simple survey. Others use postcard surveys or regularly scheduled feedback sessions. However it is accomplished, you should get feedback on the media as well as the content of the message. For example, if you are doing a simple postcard survey after a major benefits change, you need to know if the information was relevant, understandable, and presented in a way that made understanding easy. This is at least as important as gauging employee perceptions about the content of a new program.

Conclusion

Your benefits communications can be effective if you use these five keys. Start by understanding that your employees are skimmers as well as thinkers and that you will need to reach them using a variety of media. Follow that up by making all content relevant and understandable. You will need to have a plan to coordinate your efforts and regularly seek feedback from your audiences to know if you are on target.

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