Employers:
The Keystone in the Employee Benefits Structure

2013 CORPORATE BENEFITS BRIEF
Executive Summary

Arches are used to build massive, enduring structures. Central to an arch’s ability to bear weight is the center stone found at its apex. That stone is known as the keystone. The keystone supports the two sides of the arch by distributing the supporting weight to the top of the arch. It is the final piece placed during arch construction, locking all of the arch’s stones into position. Without the keystone, the arch, and the structure it supports, would collapse. In the employee benefits structure, employers are the keystone.

While the two sides of the employee benefits arch are health and welfare and retirement, the employer, as the facilitator and sponsor of health and retirement plans, acts as the keystone, locking both areas together. By providing employee benefits, employers create a more stable and healthy – both physically and financially – employee base upon which to build a strong business. Without employers as the keystone in employee benefits offerings, the health and wealth of American workers, and the businesses they support, will crumble. With well-being as a core company value trending upward, employers must understand their important keystone role in the provision of employee benefits and form strategies to fulfill that role.

On the health and welfare side, 2012 brought much-needed clarity on the future of health care reform by way of the Supreme Court’s ruling and the November election results. However, challenges to the employer’s roles and responsibilities remain. Employers need to weigh their options under the employer mandate and stay abreast of health care reform regulations and responsibilities. Knowledgeable employers will be better positioned to overcome challenges and implement strategies to not only stay compliant with health care reform, but to create a more stable and healthy workforce — paramount to future business success.

On the retirement side, 2012 brought lucidity on fee disclosures for plans and participants, but questions about the overall retirement readiness of American workers remain. The answers to those questions reaffirm the employer’s critical role as facilitator and sponsor of retirement plan savings. Employers that encourage retirement plan participation and strive for better retirement plan outcomes will find themselves with a happier and more productive employee base, upon which a business can grow and succeed.
For plan-sponsoring employers, 2012 brought much clarity and stability in many areas of health and welfare benefits, particularly with respect to the Patient Protection and Affordable Care Act (PPACA — also known as “health care reform”). First, in a monumental ruling in summer 2012, the U.S. Supreme Court held PPACA’s individual mandate constitutional. Second, the November 2012 national elections resulted in a continuance of the status quo at the federal government level: a Democratic-controlled White House and Senate, and a Republican-controlled House. The Supreme Court ruling and the election results mean PPACA will not likely be invalidated or repealed. Rather, PPACA is the law of the land, and its implementation will continue.

With PPACA a reality, employers digested new federal regulations and implemented procedures to comply with provisions that took effect in 2012. Specifically, 2012 brought federal guidance on:

- Medical loss ratio (MLR) rules and rebates
- Preventive services (including the controversial contraceptive benefit coverage mandate)
- W-2 reporting requirements
- Flexible spending arrangement (FSA) limits
- The summary of benefits and coverage (SBC) requirement
- Preliminary guidance on the employer mandate and state exchanges

In addition, employers began complying with PPACA-related MLR rebate distribution rules and SBC delivery requirements, and started tracking plan and employee information for W-2 reporting and the FSA limitations. Employers also explored alternative means for driving down and shifting health costs, including implementing consumer-driven health plan options and wellness programs.

With major health care reform obligations still ahead (primarily under the employer mandate), employers should consider not only costs in offering health and welfare benefits, but also ulterior considerations, such as employee attraction and retention, and the effect any plan design could have on the physical health and welfare of its employees. Being able to identify the best health and welfare strategies is a critical task for plan sponsors in 2013, and knowledgeable plan advisors will assist sponsors in exploring options and in designing strategies that may be available to employers.

Challenges Facing Health and Welfare Plan Sponsors

Although 2012 brought much clarity and stability, there are several challenges creating uncertainty for employers in their role as health plan sponsors, including PPACA’s employer mandate, state exchanges, and additional taxes, fees and reporting obligations, in addition to new administrative roles. All of these new challenges, coupled with the ever-present struggle against rising costs, are causing many to reassess the system by which health insurance is delivered. However, the current system’s challenges only reaffirm the need for employers to be facilitators of health and welfare benefits to American workers. Working with their advisors, forward-looking employers will view the challenges as a chance to adopt health and welfare benefits plan strategies that promote employee well-being as a core company value, thus establishing a healthy employee base on which to grow business. Before discussing possible strategies, it is important to understand the challenges.

Pay or Play

With respect to the employer mandate (also called the “shared responsibility for employers” provision), PPACA requires companies that employ 50 or more full-time equivalent employees to provide sufficient (of minimum value, meaning that the plan will pay no less than 60 percent of total allowed benefit costs) and affordable (generally, cost of single-only coverage must not exceed 9.5 percent of an employee’s W-2 wages) health insurance coverage to its full-time
employees or pay a penalty. Often referred to as “pay or play,” the employer mandate itself is a direct challenge to the employer’s keystone role as facilitator of health benefits: Offer a plan that meets specific guidelines or pay a penalty.

**Health Insurance Exchanges**

Integral to the employer mandate is the requirement for states to establish and operate a health insurance exchange by 2014, initially open only to individuals and small employers employing 50 or fewer employees. Through an exchange, individuals who meet income guidelines will be eligible for premium tax credits and cost-sharing subsidies if they do not have access to sufficient and affordable coverage. In turn, the number of an employer’s employees receiving credits or subsidies will affect the amount of the penalty the employer must pay if they do not provide coverage or provide coverage that does not meet the minimum value or affordability requirements. Thus, the exchanges represent the mechanism whereby the employer mandate is facilitated.

While some states established exchanges, others are turning to the federal government to either partner with them or fully operate the exchange in their state, resulting in varying exchange blueprints across the nation. It is unknown at this point whether a particular state’s exchange will offer a viable alternative for small employers to purchase insurance. The viability will be based, in part, on the exchange’s efficiency, in terms of premium cost and support services. Without more information on the exchanges, an employer’s ability to determine their role in offering health and welfare benefits to employees is clouded.

**Taxes and Fees**

In addition to the challenges presented by the employer mandate and the exchanges, employers are facing new taxes and fees (direct and indirect) under PPACA. These include:

- New annual fees on health insurers (known as the “health insurance tax”)
- Reinsurance fees on fully insured plans and third-party administrators of self-insured plans (estimated at $63 per covered life)
- The Patient-Centered Outcome Research Institute fees on fully insured and self-insured plans ($1 per covered life for the first year and $2 per covered life thereafter, until 2019)
- Taxes on medical device manufacturers
- Cadillac tax on plans that provide richer benefits (effective in 2018)

Although many of these obligations are payable by the insurer or other third party, those fees will most likely be passed through to the employer, increasing costs and further challenging the employer’s role as enabler of health benefits for American workers.

**Reporting and Administrative Obligations**

Lastly, employers will need to take on new reporting obligations and administrative roles to become compliant with PPACA rules. For example, employers will need to track the cost of coverage for each employee to accurately comply with the W-2 reporting requirement. They will also need to define and measure which employees are full-time employees with respect to the employer mandate penalty. PPACA also adds several notice and filing obligations, including the SBC and exchange notice requirements and Internal Revenue Service quality of care and transparency in coverage reports. At least some of these reporting requirements apply regardless of whether the employer actually provides coverage.

While all of the above challenges and uncertainties are legitimate, none present a viable argument for employers to stop offering health insurance coverage to their employees. Rather, each supports the need for the employer to be the keystone, the central facilitator of benefits, in the health and welfare world.
Employers as the Keystone for Health and Welfare Benefits

The employer mandate affirms employers’ central role in the health insurance delivery system by making them responsible and accountable for providing coverage to their employees. While it may be tempting to avoid the additional confusion, cost and administrative burden by dropping coverage altogether, employers need to consider several ulterior effects of such a choice, including employer trends, tax consequences, and talent attraction and retention.

In terms of employer trends, employers generally anticipate continuing their health care insurance coverage offerings, even in the face of the employer mandate. According to a recent Deloitte survey, 81 percent of companies (representing 84 percent of the workforce) do not anticipate dropping health insurance coverage in the next one to three years.¹

On tax consequences and talent attraction and retention, data suggests that there is no immediate or long-term cost advantage for employers to eliminate group health benefits. To keep employees satisfied and attract new employee talent, employers would have to compensate for the loss of coverage in some manner, likely by increasing employees’ salaries and sending them to the state exchanges, or by offering other taxable benefits. Employers that eliminate coverage and replace it with salary increases will be subject to an increase in payroll tax, and would lose the tax deductibility of employer-sponsored health insurance. Importantly, the additional cost of the employer mandate penalty is not tax-deductible, so choosing to eliminate benefits will generally result in adverse tax consequences for the employer.

In addition, there is no guarantee that cutting coverage will actually save money. One study concluded that it will cost employers more to make employees whole when shifting their benefits to an exchange (by increasing salaries so employees can purchase individual health insurance) than to continue existing group health plans.² The conclusion was based on the finding that employees would suffer a significant reduction in overall compensation when they assume the incremental cost of benefits as a result of the employer’s discontinuance of coverage.

There are several reasons for the incremental cost to the employee. First, individual health insurance may not be paid for on a pre-tax basis through an exchange. Second, employees will not have the benefit of employer contributions. Third, federal premium tax credits for employees purchasing through the exchanges will phase out as income increases (and some employees will not be eligible for subsidies at all). As a result, it is estimated that employees will pay $12,881 more for health insurance through an exchange than if the employer sponsored the coverage.³ This estimated cost may increase due to the influx of individuals from state high-risk pools into the exchanges. Clearly, this increased burden on employees would impact employee retention, attraction and satisfaction (found in one study to be the top three reasons that employers offer health benefits),⁴ and may not even be a financial boon to the employer, considering the additional tax increases outlined above.
Conversely, many employers recognize a distinct advantage in providing employee benefits for recruiting and retention of key employees. According to a recent Harvard Business Review (HBR) survey related to attracting and retaining employees, being a company that cares about the well-being of its employees is twice as important to employees as providing a high base salary. Another study by MetLife found a strong link between employee satisfaction with benefits and their loyalty to their employer.

Importantly, an employer’s focus on employee well-being has meaningful implications for the company’s ability to thrive. According to the same HBR survey, companies that place a high priority on employee well-being experience significantly fewer workforce reductions than do companies that do not place a high priority on employee well-being. In addition, companies that focus on employee well-being are more likely to have high employee engagement. While employee well-being and engagement may be more difficult to measure, both have a significant impact on business operations. Thus, employers should continue to use health and welfare benefits offerings, which are highly valued by employees and will result in a stronger, more engaged workforce.

Overall, the consequences of the decision to pay or play are much more complex than simply balancing the current group health plan costs against the employer mandate penalties. The true cost may include tangibles, in the form of employee retention/attraction and higher taxes, and intangibles, in the form of employee morale and well-being. Alternatively, employers may view the challenges presented by PPACA – and particularly the employer mandate – as an opportunity to review and improve their benefits offering strategies to cultivate employee well-being and engagement, thereby strengthening the base upon which their business is built.

**Employer Strategies for Promoting Employee Well-being**

The most successful companies recognize the inseparable link between their health benefits offerings and workforce health and productivity, and those companies integrate the link in every aspect of their health plan strategy. At the core of a healthier workforce is a company’s commitment to providing employees with the tools and resources they need to lead stable, healthy and productive lives. Employers can do so through several strategies relating to the employer mandate and cost containment.

**Employer Mandate Plan Design Strategies**

To begin with, employers need to define their workforce. Generally, to avoid a penalty under the employer mandate, employers must offer affordable coverage that is of minimum value to all full-time employees (defined as those working 30 hours or more per week). Thus, employers need to determine which employees fit that definition. In making that
determination, special challenges may arise with respect to seasonal, temporary or other employees with irregular work schedules, and for special-industry employers, such as staffing agencies. For those employees, employers may use look-back periods to measure whether they meet the 30 hours per week threshold.

Once the employer makes that determination, they will need to decide whether to extend benefits offerings to only full-time employees or to include part-time employees. One study indicates that nearly 40 percent of companies that traditionally hire a large number of part-time workers expect to limit those workers’ hours to fewer than 30 hours per week to avoid application of the employer mandate penalty. Employers may also choose to overhaul their workforce by hiring more part-time employees while eliminating benefits for them altogether.

Employers will also need to consider whether to offer different benefits plan options or employer contribution levels to different groups of employees, all while adhering to nondiscrimination rules (which generally prohibit plans from favoring highly compensated individuals). For example, employers may choose to offer a base plan – one that meets the minimum value and affordability requirements under the employer mandate – to all employees, while also offering richer “buy-up” plans. Employers may also have a contribution strategy whereby the amount of the contribution paid by lower-paid workers is less than the amount paid by higher-paid workers to comply with the affordability requirement.

In summary, alternative employer mandate strategies include:

- For plan eligibility purposes, defining or redefining the term “part-time employee” as employees with fewer than 30 hours per week, and offering benefits only to full-time employees
- Restructuring employer contributions so that lower-paid workers receive a greater contribution to maintain affordability
- Setting employee contributions at a level that minimizes the number of employees for whom the coverage is unaffordable
- Decreasing employee contribution requirements for the self-only tier, while increasing all other tiers
- Adding a spousal surcharge, when permitted by state law

Employers should engage tax counsel for the exact tax consequences relating to changes in employee benefits offerings. In addition, any changes in workforce strategies, such as reducing part-time hours in response to the shared responsibility provision, should be reviewed by employment counsel, as there may be implications under ERISA.

Cost-containment Plan Design Strategies

In the face of PPACA and the employer mandate, cost containment remains a primary goal for employers that sponsor health and welfare benefits plans. In fact, 78 percent of employers reported that managing benefits costs is one of their three top challenges with regard to benefits and workforce management (the other two relate to the impact of PPACA, as discussed above, and improving employee engagement, as discussed below). That challenge is a direct result of the ever-increasing average total health benefits cost per employee, estimated at $10,558 per employee in 2012 (a 4.1 percent increase from 2011). Importantly, in 2013, employers that make no cost-reducing changes can expect an additional increase of between 5 and 7.4 percent.

Thus, implementing effective cost-containment strategies is vital to control these continually increasing costs. As outlined in the chart on the next page, employers are using several different strategies to achieve cost-containment, including increasing employee cost-sharing and employee premium contributions, and implementing wellness and preventive health programs. In addition, some employers are considering reducing covered benefits, shifting to a defined contribution plan structure, narrowing hospital and physician networks, purchasing health insurance from a nontraditional company (such as a retailer), and terminating any company subsidy for full-time employee insurance coverage.
While all of those are certainly options for employers, information from surveys supports the effectiveness of some of those strategies over others. The more successful strategies are discussed below, including implementing consumer-directed health plans (CDHPs), wellness programs, voluntary benefits offerings and specific funding methods. Employers should also consider different strategies with respect to retirees and providers.

**Consumer-directed Health Plans**

CDHPs can be a valuable tool in managing benefits costs. A CDHP is usually a higher-deductible plan offered in conjunction with a personal account (either a health savings account (HSA) or a health reimbursement arrangement (HRA) that can be used to pay a portion of the medical expenses not paid by the plan.) CDHPs have gained in popularity over recent years. Fifty-nine percent of companies had a CDHP in place in 2012, up from 53 percent in 2011, and another 27 percent of companies without are expected to adopt one in 2013.\(^{14}\)

There is good reason for the rise in CDHP sponsorship. They are effective at: 1) achieving a significant amount of cost savings for the employer; 2) addressing the employer's responsibilities under the employer mandate; and 3) benefitting employees financially. With respect to employer cost savings, companies with at least 50 percent of employee CDHP enrollment report more than $1,000 in total per-employee cost savings.\(^{15}\) The savings, however, are dependent on the employer increasing employee and provider accountability, and cultivating smarter health care-consuming employees. So to achieve the highest cost savings, employers need to go beyond offering a CDHP and engage providers and educate employees.

In addition to the cost savings, an employer that offers a CDHP will likely satisfy its obligations under PPACA's employer mandate. Most CDHPs will be considered as providing “minimum value” coverage to employees, and current guidance suggests that an HSA or HRA may be used in determining whether the coverage is affordable (although an exact answer on that issue is forthcoming). So long as the CDHP is affordable, the employer can use it as a way to meet its employer mandate obligations.

CDHPs also provide financial benefits to employees in both the short term and long term. In the short term, CHDPs provide a way to pay current medical expenses (through the plan, the HSA or the HRA). In the long term, CDHPs – when coupled with an HSA – provide employees with a tax-advantaged vehicle to accumulate wealth for retirement. Not only do HSAs allow employees to salt away money on a tax-free basis for future medical expenses, but at least
one study shows a direct correlation between those who establish and contribute to an HSA and higher 401(k) retirement account levels. That study concluded that 401(k) retirement levels were 23-28 percent higher for HSA participants versus non-HSA participants.16

The primary challenge for using a CDHP to achieve cost containment is employee participation. While employee participation in CDHPs is up 80 percent since 2010,17 employers should do more to encourage participation. Tactics that might encourage participation include using significantly lower employee premium contributions for CDHPs (as compared to traditional copayment plans) and establishing either an HSA or HRA. Employers have honed in on the use of an HSA as a means of encouraging CDHP participation. In fact, nearly twice as many companies offered an HSA in 2012 than five years ago (25 percent to 48 percent — expected to rise to 60 percent in 2013).18 In addition, 39 percent of companies in 2012 contributed employer funds to HSAs, and another 11 percent anticipate doing so in 2013.19 Providing matching or seed HSA contributions is an effective way to encourage participation in a CDHP. That said, HRAs are also an effective way to help mitigate the employees’ out-of-pocket costs. Employers need to consider which account is right for their workforce composition.

Because of the savings and other advantages, employers should establish and promote CDHP plans as part of their overall benefits strategy. Establishing and encouraging participation in a CDHP (coupled with an HSA or HRA) is an effective way for employers to control costs, yet still provide value to employees with respect to their health care needs.

**Wellness Programs**

Consistent with findings in previous years, poor employee health habits are the top challenge that employers face in managing their health care costs in 2013.20 Wellness programs remain the primary tool that employers use to target poor employee health, and the use of wellness programs is trending upward. According to a recent MetLife study, the number of employers that offer wellness programs has grown significantly, from 27 percent of employers in 2005, to 44 percent of employers in 201121 — a percentage that will only increase. In addition, of those offering a wellness program, 73 percent believe the program is effective in improving employee health.22

Most wellness programs are designed to improve employee physical health and come in a variety of forms, including:

- Weight loss programs
- Biometric screenings
- Smoking cessation programs
- Lifestyle or behavioral coaching
- Gym membership discounts
- On-site exercise facilities
- Classes in nutrition or healthy living
- A wellness newsletter
While larger employers are more likely to offer a wellness program, smaller employers are beginning to offer them as well.

Offering wellness programs is one thing; getting employees to participate is a challenge in itself. Overall, there is low interest and participation in wellness programs. To increase employee interest, employers primarily use frequent communication through emerging technologies. More and more, employers are interested in using social media tools, online discussion groups and gaming software to promote and support wellness programs. Competition among employees, usually tracked through gaming software, and employee testimonials are also increasing in popularity among employers as a way to stimulate wellness program interest.

In addition to communication and technology, employers need to creatively incentivize employees to maximize wellness program participation. Although incentives come in many forms, employers are turning more toward financial rewards. Since 2009, the use of financial incentives or rewards among those companies offering a wellness program increased exponentially (36 percent in 2009 versus 61 percent in 2012 — anticipated to increase to 82 percent in 2013).

Other incentives gaining in popularity include using penalties (e.g., an increase in premiums or deductibles if an employee does not participate in a wellness program); rewards based on smoker or other biometric status; and rewards based on completion of a health risk assessment or annual physical exam. PPACA allows wellness rewards in the form of premium differentials of up to 30 percent (50 percent in the case of differentials based on tobacco use), so long as certain requirements are met. Employers seeking to implement wellness programs that offer rewards based on health factors should consult with outside counsel, since such programs may face challenges under HIPAA, the Americans with Disabilities Act and state law (including smoker protection laws).
Health & Welfare

Employers should also consider offering dependent participation in employee wellness programs, since much of the cost in a typical employer health plan is directly tied to an employee’s dependents (primarily the employee’s spouse) and since spouses can be key influencers of the overall family health environment.

**Reasons to Offer a Wellness Program**

Among firms offering health benefits and wellness programs, percentage of firms reporting the following as the firm’s primary reason for offering wellness programs, by firm size, 2012.

<table>
<thead>
<tr>
<th>Reason</th>
<th>All Small Firms (3–199 workers)</th>
<th>All Large Firms (200+ workers)</th>
<th>All Firms</th>
</tr>
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<tbody>
<tr>
<td>Improve the health of employees and reduce absenteeism*</td>
<td>37%</td>
<td>34%</td>
<td>35%</td>
</tr>
<tr>
<td>Reduce health care costs*</td>
<td>28%</td>
<td>24%</td>
<td>26%</td>
</tr>
<tr>
<td>Improve employee morale and productivity</td>
<td>18%</td>
<td>16%</td>
<td>17%</td>
</tr>
<tr>
<td>Part of the health plan</td>
<td>27%</td>
<td>23%</td>
<td>25%</td>
</tr>
<tr>
<td>Other*</td>
<td>11%</td>
<td>11%</td>
<td>11%</td>
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</tbody>
</table>

*Estimate is statistically different between all small firms and all large firms within category.

Note: Eight percent of firms reported “don’t know” to the question about their primary reason for offering wellness. Source: Kaiser/HRET Survey of Employer Health Benefits, 2012.

Finally, while cost-containment may be the primary reason to offer a wellness program, there are other reasons to offer one. Those include improving the health of employees, reducing absenteeism, and improving employee morale and productivity. Whatever the reason, employers should consider making wellness programs an integral part of their overall health and welfare strategy going forward.

**Voluntary Benefits Offerings**

Voluntary benefits offerings – those for which employees pay 100 percent of the cost – allow employers to balance cost management with the unique needs of their diverse employee populations. Common voluntary benefits offerings include dental, vision, life, disability, supplemental health, critical illness and cancer insurance, and are usually promoted by an insurer directly to employees with minimal employer involvement (other than to collect and remit premiums through post-tax salary reductions).

Employers view voluntary benefits as a flexible and customized way to expand benefits offerings at minimal cost, not as an alternative or compensation for a reduction in core benefits or to replace benefits that were previously offered as employer-paid.28

**Employer’s View on Voluntary Benefits Role in Benefits Strategy**

Employers who agree that voluntary benefits are a significant part of their company’s benefits strategy

<table>
<thead>
<tr>
<th></th>
<th>All companies</th>
<th>Under 50 employees</th>
<th>Under 500 employees</th>
<th>500+ employees</th>
<th>5,000+ employees</th>
<th>10,000+ employees</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2010</strong></td>
<td>32%</td>
<td>23%</td>
<td>26%</td>
<td>43%</td>
<td>47%</td>
<td>52%</td>
</tr>
<tr>
<td><strong>2011</strong></td>
<td>41%</td>
<td>27%</td>
<td>31%</td>
<td>57%</td>
<td>57%</td>
<td>58%</td>
</tr>
</tbody>
</table>

Employers are beginning to recognize employee interest in voluntary benefits offerings, and voluntary benefits are growing in strategic importance across all sizes of companies. Employers cite many reasons for making voluntary benefits available to their employees, including:

- Expanding the types of benefits offered without increasing benefits costs
- Giving more choices to meet the diverse needs of the employee population
- Helping fill gaps in coverage under other benefits offerings
- Helping employees achieve greater financial security through protection against illness, disability or death

As with other benefits offerings, the success of an employer’s voluntary benefits offerings rests on effective communication. Many companies are falling short with their voluntary benefits communications. One study shows that while 68 percent of employers indicated that they had an effective benefits communication strategy in place, only half of those measured employee satisfaction with that benefits communication. Clearly, employers need to focus on improving the quality and timeliness of employee benefits communications and education, particularly with respect to voluntary benefits.

**Alternative Financing Methods**

Yet another cost-containment strategy relates to the employer methods for premium contributions and plan benefits funding, including self-insurance. With respect to premium payment strategies, as discussed above in connection with the employer mandate strategies, employers may want to offer different employer contribution levels to different sets of employees. For example, employers could establish a contribution structure whereby they contribute higher amounts for lower-paid employees, or different contribution levels based on employees’ geographic locations.

Employers may also consider moving to a defined contribution strategy, whereby the employer determines in advance the amount that the employer contribution toward the cost of coverage will be, and then the employee becomes responsible for any premium payment in excess of that amount. This allows the employer to know its fixed costs in advance, thereby controlling costs relating to the plan, and also allows employees to save money by choosing a lower-cost plan. According to one study, nearly half (49 percent) of employers currently use or are considering using a defined contribution strategy in one form or another.

With respect to self-insurance, a self-insured plan is an arrangement in which the employer assumes direct financial responsibility for the costs of enrollees’ medical claims. Employers sponsoring self-insured plans typically contract with a third-party administrator or insurer to provide administrative services for the plan. In some cases, the employer may purchase stop-loss coverage from a reinsurer to protect the employer against very large claims. In certain situations, employers may consider using a captive to insure their risk.

… nearly half (49 percent) of employers currently use or are considering using a defined contribution strategy in one form or another.
### Percentage of Covered Workers in Partially or Completely Self-insured Plans

<table>
<thead>
<tr>
<th>Firm Size</th>
<th>Self-insured (employer bears some or all of financial risk)</th>
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<tbody>
<tr>
<td>200–999 workers</td>
<td>52%*</td>
</tr>
<tr>
<td>1,000–4,999 workers</td>
<td>78%*</td>
</tr>
<tr>
<td>5,000 or more workers</td>
<td>93%*</td>
</tr>
<tr>
<td><strong>All small firms (3–199 workers)</strong></td>
<td>15%*</td>
</tr>
<tr>
<td><strong>All large firms (200 or more workers)</strong></td>
<td>81%*</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northeast</td>
<td>61%</td>
</tr>
<tr>
<td>Midwest</td>
<td>61%</td>
</tr>
<tr>
<td>South</td>
<td>64%*</td>
</tr>
<tr>
<td>West</td>
<td>48%*</td>
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<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture / Mining / Construction</td>
<td>43%*</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>67%</td>
</tr>
<tr>
<td>Transportation / Communications / Utilities</td>
<td>75%*</td>
</tr>
<tr>
<td>Wholesale</td>
<td>43%*</td>
</tr>
<tr>
<td>Retail</td>
<td>69%</td>
</tr>
<tr>
<td>Finance</td>
<td>68%</td>
</tr>
<tr>
<td>Service</td>
<td>46%*</td>
</tr>
<tr>
<td>State / Local government</td>
<td>72%*</td>
</tr>
<tr>
<td>Health care</td>
<td>68%*</td>
</tr>
</tbody>
</table>

**ALL FIRMS** 60%

*Estimate is statistically different from estimate for all other firms not in the indicated size, region or industry category.


While they may not be aware, nearly 60 percent of covered workers are in a self-insured plan. Larger employers (those with 200 or more employees) are much more likely to sponsor a self-insured plan than smaller employers (81 percent versus 15 percent), but there are advantages to any size employer that self-insures its plan (and smaller employers are becoming more interested in self-insuring their risks).

For example, unlike fully insured plans, self-insured plans are not required to cover health care services for state-mandated benefits. In addition, self-insured plans may not be subject to certain carrier restrictions, such as eligibility and participation rules. Finally, some experts believe that some of PPACA's mandates that apply to insurers (but not self-insured plans) – including the minimum creditable coverage requirements; breadth of essential health benefits; taxes on insurers, medical device manufacturers and pharmaceutical companies; and reinsurance fees – will all drive up the cost of health insurance coverage. Employers – particularly smaller ones – that are concerned about rising costs may view self-insurance as a more attractive means to mitigate any anticipated cost increases resulting from PPACA's implementation.

Overall, employers should consider the contribution and funding methods they currently use in employee benefits offerings. There may be advantages to moving to either a defined contribution or self-insured model. Employers should work closely with advisors and outside counsel when it comes to implementing any new contribution or funding methods, since there may be ERISA and nondiscrimination issues to consider.
Retiree Strategies

Retiree health benefits are an important consideration for older employees, both before and after reaching Medicare eligibility at age 65. Interestingly, the area of retiree medical programs is one in which traditional employer involvement is trending downward. This is because of the rising health care cost for employees considering retirement, especially those under age 65 and still ineligible for Medicare. The additional subsidies provided by the Medicare Part D prescription drug benefit donut hole, coupled with the emergence of new solutions through the state exchanges, make it easier for employers to transition out of their traditional role of providing direct financial support and plan sponsorship.

Nonetheless, employers can still play a pivotal role for retirees by providing account-based alternatives to traditional retiree medical plans. Such alternatives include adding HSA coverage for active employees, converting current subsidies to retiree health accounts or offering retiree medical savings accounts. These account-based alternatives provide current retirees with retirement benefits while also allowing the employer to focus on cost containment.

These alternatives appear to be the trend for employers. One study estimates that account-only coverage for pre-65 retirees will increase to 13 percent by 2014 or 2015 (up from only 1 percent in 2012).35 The study also states that 39 percent of companies in 2012 consider their HSA for actives as an integral part of their retiree medical strategy, and another 20 percent are planning on considering such a strategy over the next three years.36 Employers that use HSAs in this manner view the strategy as a valuable, tax-effective way for employees to pay for current medical expenses during their working years and to save for medical expenses in retirement.

So while employer sponsorship of traditional retiree medical programs will likely continue to decline, employer involvement in retiree medical strategies will continue to increase through the sponsorship of account-based alternatives. Employers should work closely with their trusted advisors to determine the best retiree medical strategy for their workforce.
Finally, employers can employ cost-containment strategies by connecting directly with health providers. More and more, employers are creating transparency in health care costs and services, adjusting plan designs and using incentives to improve provider quality and enhance the value of services used by enrollees.

The case for transparency is straightforward; it helps employees choose the care they value and helps employers avoid unnecessary costs while still providing the health insurance coverage their employees need. The intended result is that both employees and employers become more cost-conscientious in their health care consumption. In the past, a lack of transparency has led to massive price disparity for the same medical procedures or services, even within the same geographies and health plans. But it appears that employers recognize the need to improve transparency in prices and hospital quality so that employees are better health care consumers.

On plan design adjustments and incentives, one survey states that 25 percent of employers plan to differentiate cost sharing for the use of a high-performance network, and 18 percent plan to offer specialty networks to provide dedicated treatment to employees with specific illnesses, such as cancer or diabetes. In addition, employers may consider offering direct incentives to providers for improved care coordination and the use of emerging technologies and evidence-based treatments. By incentivizing providers to improve care coordination, use more efficient technologies and prescribe better treatments, employers are aligning provider interests with their own. The improved provider efficiency will lead to better cost containment for employers.

Health & Welfare Summary

Overall, 2013 is a critical year for employers as they consider their obligations under PPACA’s employer mandate, while also attempting to control costs. Importantly, employers will need to educate themselves on PPACA’s intricacies and effectively communicate plan design strategies to employees. Whether using consumer-driven health plans, wellness programs or other cost-saving strategies, driving up employee awareness and participation will be essential. By providing employees with robust benefits offerings, employers will be able to better attract and retain talent. Employers that center themselves as the keystone of health and welfare benefits offerings to employees will be in position to build a strong, healthy and stable workforce, and, in turn, a successful business.

With all the complexities and challenges surrounding them, companies cannot be expected to develop well-informed strategies on their own. The engagement of a knowledgeable independent advisor, who is familiar with and understands all of the company’s benefits and insurance needs, and who can act as its benefits partner, remains paramount to a company’s benefits strategy success.
Similar to the health and welfare side of benefits, 2012 brought newfound clarity on the retirement side. After navigating several rounds of guidance on retirement issues, plan sponsors were able to begin implementing regulatory requirements relating to the “reasonableness” of fees. First, beginning July 1, 2012, service providers of ERISA-covered plans were required under ERISA 408(b)(2) to provide certain disclosures to plan fiduciaries. These disclosures are meant to provide plan fiduciaries with sufficient information to make well-informed decisions – an obligation under ERISA’s fiduciary provisions – about the service provider, its services and the associated costs, including compensation.

Second, 2012 saw the initial effective date of new regulations under ERISA 404(a)(5) relating to plan sponsor disclosure of fees paid by plan participants, including investment-related disclosures, administrative fee disclosures and transactional administrative fee disclosures. These disclosures are meant to assist participants and their beneficiaries in making informed decisions about their investment choices within a plan.

No one knew what type of reaction to expect from plan sponsors, fiduciaries and participants when the two waves of disclosures were implemented. So far, they have not produced the tsunami of action some predicted. Fidelity Investments, one of the first providers to send out participant disclosures, sent 17 million notices, yet received only 1,200 phone calls with related questions or concerns. In addition, a recent Plan Sponsor Council of America (PSCA) survey indicated that an average of only 1.4 percent of participants asked fee-related questions after receiving their disclosures. The survey also found that 95.9 percent of employers reported no change in behavior by participants as a result of the fee disclosure information.

Initial anecdotal reports indicate that plan sponsors also have not raised many questions with their advisors or their plan providers and record keepers about the new 408(b)(2) disclosures. But there does appear to be an increase in the amount of Request for Information (RFI) or Request for Proposal (RFP) activity among employers. The PSCA survey indicated that 15 percent of employers sent out an RFI/RFP as a result of the fee disclosures (a typical year is around 10 percent).

However, those statistics do not mean that the disclosures will not ultimately have a huge impact on the world of employer-sponsored qualified retirement plans. As affected parties become more comfortable with disclosures, plan advisors will need to work with plan sponsors to help them further understand the disclosures and seek value in plan investment options and services, and not simply seek out low prices.

Challenges to the Current 401(k) System

Understandably, implementation of the new fee disclosures has not solved all of the challenges in the retirement world. In fact, even though employers have not asked many questions of their advisors and service providers, a recent survey shows that 83 percent of small business owners (those with fewer than 100 employees) were more confused after reading the fee disclosure forms. Their confusion centered on the meaning and fairness of the fees. Also, 68 percent of those owners stated that they would not know how to answer their employees’ questions relating to the plan fees.

Additionally, there are still unanswered questions with respect to the definition of “fiduciary” for the purpose of ERISA’s fiduciary obligations. Much-anticipated guidance on this issue is expected from the U.S. Department of Labor (DOL) in 2013, which could expand the compliance obligations to a broader base of fiduciaries.

With Americans’ confidence in their ability to retire comfortably stagnant at historically low levels (just 14 percent are very confident they will have enough money to live comfortably in retirement), many have begun to rethink the entire system by which retirement benefits are offered. Indeed, some in Washington and in the media are questioning the effectiveness of the current 401(k) system.
Alternative Proposals

As a result of the questioning, alternative systems have been mentioned. One suggested system is to cap employee and employer retirement contributions at a certain level — for example, $20,000 per year or 20 percent of compensation, whichever is less. This, in essence, is a reduction or elimination of the tax deductibility of retirement plan contributions, which is problematic for two reasons. First, it would limit retirement contributions overall, which clearly would not result in Americans becoming more retirement ready. Second, a cap may act as a disincentive for employers, and without incentive, employers may choose to no longer offer a plan at all.

Another suggested system, which has several variations, is to have companies offer an individual retirement account (IRA) to each employee. These IRAs would be required, professionally managed and come with a guaranteed rate of return and pay out annuities.

All of the retirement reform talk in Washington and in the media, together with the unanswered questions on the definition of “fiduciary,” has been confusing to employers. This is particularly true considering the fee disclosures discussed above, which puts the onus on employers to gather all of the information and determine if their fees are reasonable. With all of the confusion and added obligations, some 401(k) sponsors might consider dropping their plans altogether.

However, if employers drop these plans (or if lawmakers or regulators eliminate or reduce them), where does that leave our country? What happens when workers are no longer able to physically work, and they do not have adequate retirement savings? Where are they going to look for help? The logical answer is the government, which would ultimately result in a higher overall burden on taxpayers. Further, the current system is established and, as discussed below, pointed toward success. Therefore, it is important that our country addresses individuals’ savings needs now through the current system rather than taking additional time to build a new system, as some have suggested.

Current System – Pointed Toward Success

While the current system might not be perfect, it is certainly not broken. Today, over 61 million American workers – 75 percent of whom earn less than $100,000 per year – participate in a 401(k) plan. In addition, retirement savings now represents over 65 percent of American families’ financial assets. Data also shows that workers are far less inclined to save for retirement if there is no plan available at work. According to the Employee Benefit Research Institute (EBRI), one segment of the workforce (those earning between $30,000 and $50,000) was 65 percent more likely to save for retirement if a 401(k) was available at work.

In addition, the suggested alternative systems do not pose viable alternatives to the current system. Take the proposal to cap retirement contribution levels. According to EBRI’s retirement confidence survey, 1 in 4 full-time workers saving for retirement said they would reduce, or totally eliminate, their retirement savings plan contributions if the tax deductibility of retirement contributions is limited or eliminated. In addition, studies show that reducing or eliminating the tax deductibility for retirement plan contributions would lead employers to reduce or eliminate their retirement plan involvement — which would lead to fewer employers sponsoring and contributing to the retirement savings of Americans. With less support from employers, it would be unlikely that American workers would become more ready for retirement.

An even more compelling statistic is that for those workers who do not have access to a 401(k), less than 5 percent of them save for retirement on their own. Thus, even if the proposed “auto-enroll” IRA is implemented in place of the 401(k), the IRA contribution rates would be lower than those of a 401(k) plan. Further, IRAs encourage less employer involvement, since there is no employer match component for employees contributing to their IRAs — a consequence that surely cannot be seen as furthering Americans’ retirement readiness.
So while some workers may have inadequate retirement savings, there are many positive signs and trends within the current system. Most notably, even during the last few years of the “Great Recession,” many Americans saw an increase in total household retirement savings.50 The positive trends suggest that the system is effective. That said, there is no question that the system can be improved, and employers need to play a key role in that improvement.

Employers as the Keystone in Retirement Readiness

Overall, if employers are eliminated from the retirement-readiness equation for American workers, who or what entity will step in? Despite the numerous proposed alternatives, none introduce a viable replacement to the employer. Rather, the discussion above provides a collective nod to the central role that employers play in workers’ retirement readiness. In addition, if employee wellness – both from a health and a financial perspective – is essential to the success of a business, employers have an even greater incentive to fill the role of retirement benefits facilitator. As employers embrace their keystone role, they will reap the benefits of a healthy and strong employee base.

Several studies support the notion that a retirement-ready employee base results in a stronger business. Specifically, those studies conclude that financial distress, including retirement unpreparedness, causes distractions that interrupt employee performance, attendance and overall productivity. One study states that 60 percent of workers are experiencing moderate to high levels of financial stress, and that up to 80 percent of those financially stressed workers spend time worrying about and dealing with financial issues instead of working.51 That study estimates that financially stressed workers waste up to 25 percent of their work time dealing with personal financial matters.52

In addition, MetLife’s 2012 annual study of employee benefits trends states that 22 percent of employees said they took unexpected time off of work in the past 12 months to deal with a financial issue.53 In addition, that same 22 percent said they spend more time than they think they should at work on personal financial issues.

Clearly, taking unexpected time off of work or spending excess work time on non-work-related issues is detrimental to the employer’s productivity and growth. Although some financial issues may arise at unexpected times or may be unrelated to retirement, providing a generous retirement plan option and encouraging employees to participate in that option can only help reduce such financial stress on employees. Such a reduction in stress will likely result in lower absenteeism and presenteeism (attending work while sick) and higher productivity.

If employers do not offer retirement benefits or fail to encourage employees to participate, it is more likely that employees will have financial stress. Like removing the keystone from an arch, the result will be problematic. Instead, employers should establish, maintain and encourage participation in retirement plans for employees, all of which result in more stable and productive employees. Ultimately, stable and productive employees can help lead to a stable and productive business.
Striving for Better Outcomes: 
Stability for Employees and Solutions for the Employer

As employers fill their role as the keystone in employee retirement preparedness, they will be more likely to retain talent, increase productivity of that talent and be better positioned to attract new talent. Employers can take several steps to cultivate this positive environment by encouraging participation in retirement plans, improving the rate of retirement readiness, avoiding compliance audits and efficiently dealing with fee disclosures. Of course, employee communication plays an essential role in all of these steps.

Encouraging Participation

To run a “successful” plan, employers should strive for what is known as “90/10/90.” The idea behind 90/10/90 is that at least 90 percent of American workers should be saving for retirement; that savings rates should be more than 10 percent; and that 90 percent of workers should let professionals – those with their fingers on the pulse of the markets – construct their retirement portfolios. If, as a nation, we can achieve these goals, we would be on a more sustainable path to financial stability. But how do we get there?

Auto-enrollment and Default Deferral Rate Increases

Before we consider how to get there, consider why we are not there already. The answer is found in one word: inertia. Employees do not seem to take action for themselves — even when they know it could be good for them. It is difficult to gain momentum. So how can employers use inertia in a positive way to help employees become more retirement ready?

One answer is to automatically enroll employees in a plan (requiring them to take action if they want to opt out of the plan) and then implement an automatic increase in employee contributions (deferrals) each year thereafter. Automatic enrollment and deferral increases are the most effective ways to achieve the 90/10/90 goal.

Employers that implemented automatic features, including automatic enrollment and automatic escalation, have found them to be successful in driving higher participation and deferral rates, according to recent studies. Interestingly, a higher auto-deferral rate does not compel employees to opt out of the plan. Historically, most employers have used a 3 percent automatic deferral rate, thinking that employees would scoff at anything higher and actually opt out of the plan. However, those same recent studies show that if employers use a 6 percent deferral rate versus the typical 3 percent, there is no increase in the opt-out rate.

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In addition, at least one study shows that auto-enrollment and auto-deferral plans increase the chance of retirement readiness, which the study defines as achieving an 80 percent replacement income ratio. According to the study, for plans that raised the default contribution rate from 3 to 6 percent, at least one segment of the workforce (those with 31 to 40 years of simulated 401(k) eligibility) saw a 25 percent increase in the number of workers who would achieve retirement readiness. Thus, plans that implement an automatic deferral escalation feature of up to 6 percent (or higher) would further bolster retirement readiness rates.

Research also shows that employees generally do not opt out of plans where their deferral percentage automatically rises from year to year (called an automatic step-up). Specifically, 97 percent of respondents said they would not opt out of a plan if their deferral rate was automatically raised annually to a total of 5 percent of salary, and 72 percent said they would not opt out if their deferral rate was automatically raised annually to a total of 10 percent of salary. Therefore, employers should strongly consider an auto-enrollment option that initially defaults to more than 3 percent of compensation, and includes an automatic step-up of 1 to 2 percent each year. With this method, more employees will be in the plan, and more will reach the optimal 10 percent deferral rate within a reasonable amount of time. Employers will need to take the necessary steps to properly communicate these automatic enrollments and deferrals to employees.

Employer Match as an Incentive

401(k) plan experts have always suggested that employers should commit to matching their employees’ 401(k) contributions as a way to increase participation rates and contribution rates. Now, some experts are taking that same concept a step further and proposing a way that could increase employee contribution rates while avoiding an increase to the employer’s matching contribution (cost).

Using creative plan design methods can be a useful way to increase participation and contribution rates, which ultimately leads to greater success. In fact, studies show that the contribution rate plays the most significant factor in the employees’ final account balance — more than funds selection or asset allocation. So if employers can implement and advertise an employer match program, then employees are more likely to join the plan. With a greater incentive through the employer match, deferral rates will increase, and employers will have created a better opportunity for employees to reach their retirement goals.

Again, properly communicating the employer match to employees will be pivotal in the plan’s success — and provides another opportunity for employers to promote their retirement plan to employees.
Managing Fee Disclosures and Easing the Burden of a DOL Audit

As outlined earlier, new fee disclosure requirements have placed a heavy burden on employers, since they are the ones responsible for knowing the fees the plan is paying and determining if those fees are reasonable. At the same time, DOL compliance audits are an obvious concern for retirement plan sponsors.

Unfortunately, such audits are likely to increase rather than decrease in the future. That said, there are steps employers can take to deal with their fee disclosure obligations that will simultaneously help them avoid compliance audits altogether, or help them go more smoothly should they arise:

• Ensure that service providers formalize a procedure for 408(b)(2) notices and updates. Previously, the DOL could challenge whether providers’ compensation was reasonable or fraudulent. However, under the new 408(b)(2) rules, service providers must include a great deal of information in all of their notices.

• Ensure that service providers maintain model documents reflecting the current law. This means reviewing RFP material to ensure that it is in compliance with new 404(a)(5) and 408(b)(2) rules, qualified default investment alternative rules, field assistance bulletins and any other DOL guidance.

• Check that all client service agreements are signed.

• Ensure that provider responses to Form 5500 information requests look professional and include all of the necessary information.

• While not necessarily required, provide ongoing education and training for employees.

• Assess whether the advisor is using benchmarking to determine the amount they charge for specific services, so as to show a reason for selecting the service provider.

Using these tips will not only help employers manage the fee disclosures, but also help them avoid compliance audits. The result will shore up the stability of the employer’s retirement plan offerings and allow the employer to avoid committing valuable time and resources to negotiating the audit process.

Retirement Summary

Despite Americans’ general retirement unpreparedness, employers remain prominently involved as sponsors and facilitators of retirement plan savings. Employers that encourage retirement plan participation (through auto-enrollment, default contribution rate increases, employer contribution matches or otherwise) and that strive for better retirement plan outcomes will find themselves with a happier and more productive employee base and an ability to better manage fee disclosures and audits. The overall result is a business that can grow and succeed.
Conclusion

Employers are the keystone in the employee benefits structure. Without them, employees will struggle to become financially and physically healthy, particularly in terms of finding sufficient health care coverage and building retirement savings. But employers that sponsor and encourage participation in their health and retirement plans create a more stable and healthy employee base, which helps workers to achieve health and retirement readiness and the employer to build a strong and successful business.

Working with an advisor who has the resources to stay current on all of the upcoming health care reform and retirement changes and trends can help plan sponsors spend less time adapting and more time executing. Benefits Partners remains committed to empowering you and your employees to make smart – and successful – health care and retirement decisions.
3. Ibid, Figure 4A.
9. Ibid.
10. Any such workforce realignment inherently carries with it risks of litigation under ERISA Section 510, which generally prohibits interference with a participant's benefits or other rights under ERISA. Some experts believe that the employer mandate requirement, which is forcing many employers to realign their workforce, is setting the stage for class action lawsuits under this ERISA provision. Employers will need to consider ERISA Section 510 with respect to any workforce realignment.
12. “Mercer’s National Survey of Employer-Sponsored Health Plans,” Figure 1 (2012). (For larger companies, the cost is $11,003 per employee, up 5.4 percent from 2011.)
13. Ibid.
15. Ibid.
16. “Fidelity 401(K) Participants with Health Savings Accounts Continue to Outpace Average 401(K) Savings Levels,” Fidelity Investments (Oct. 5, 2012).
18. Ibid, Page 32, Figure 35.
20. Ibid, Page 17, Figure 17.
25. Ibid.
27. Ibid, Page 25, Figure 27.
30. Ibid, Page 29, Figure 2.11.
32. “Mercer’s National Survey of Employer-Sponsored Health Plans,” Figure 9 (2012).
34. Ibid, Page 190, Exhibit 10.3.

36. Ibid, Page 15, Figure 15.

37. Ibid, Page 21, Figure 22.


39. Ibid.

40. Ibid.

41. shareBUILDER 401K National Survey, (September 2012).

42. Ibid.


45. Ibid.

46. Ibid.


48. Ibid.

49. Ibid.


52. Ibid.


About Benefits Partners

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We work to give our member firms a powerful competitive advantage when providing corporate benefits for their customers. We empower collaboration and innovation on every level — from the knowledge we share, to the products we offer, to the tools we create. And we push the development of new platforms, technologies and signature solutions you won’t find anywhere else.