Reconsidering Employer-Sponsored Health Care: Four Paths to Long-Term Strategic Change

With Supreme Court and election uncertainty now resolved over the Patient Protection and Affordable Care Act (ACA), employers are recognizing the need for immediate action and reassessing the role they play in promoting and insuring the health of their population. Centered on a consistent need to have a workforce that is healthy, present and high-performing, employers face four possible strategic paths. This article discusses those paths along with their attendant risks and opportunities.

by Jim Winkler | Aon Hewitt

The ink was not yet dry on the Patient Protection and Affordable Care Act (ACA) of 2010 when employers began questioning what the sweeping new law meant for them. How difficult would it be to comply with the new requirements and how much would it impact health care costs? Would the risk and opportunities resulting from the law help employers to better manage the health of their workforce?

Nearly three years after President Obama signed the bill into law on March 23, 2010, debate rages on. Opponents of the law took their grievances all the way to the U.S. Supreme Court, seeking to have the “individual mandate” provision, which requires most Americans to maintain minimum essential health insurance coverage, declared unconstitutional. Both political parties made ACA a centerpiece of their presidential campaigns, with Democrats claiming it as a legislative accomplishment, while Republicans continued to brand it a costly, socialistic example of government intrusion. Now, with the November 2012 election behind us, we can see how a politically split Congress and equally divided state legislatures will continue to wrestle over the implementation and funding of key elements of ACA.

The practical future of ACA, including the detailed regulations still needed for many of the law’s provisions, remains to be seen. What is clear is that all the debate and the questions surrounding the legislation have served as discussion starters, spurring important conversations about health, lifestyle, economics and the role of employers in providing health care benefits while influencing the health of their workforces. Regardless of the ultimate decisions regarding
implementation and funding of ACA, employers have come to recognize that the issues they face are serious and potentially system-changing.

Much has been written about the rising costs of health care, but it cannot be stressed enough that the kinds of increases taking place in health-related expenditures are completely unsustainable for employers and employees alike. According to data from the Aon Hewitt Health Value Initiative, tracking health care cost data across more than 350 U.S. employers, employers experienced a 40% increase in health care costs from 2006 to 2012. In 2013, employers will be spending more than $8,800 per employee. The same study shows that the impact on employees has been equally traumatic, with cost-shifting measures having led to an 82% increase in out-of-pocket and payroll contributions over the same time period. For many Americans, that level of increase in personal health care cost has effectively eliminated any raises employees may have received in recent years. Alarmingly, the trend shows no sign of abating anytime soon, as experts estimate that health care costs will continue to rise by 7-8% per year for the foreseeable future.

At the same time, the American populace has been plunged into a health crisis, the scope of which has never been seen before. Concerns over obesity have reached a fever pitch, with 34% of Americans now considered clinically obese. Another 33% are overweight. If current trends continue, 86% of Americans will be overweight or obese by 2030.1 Already, obesity-related issues account for 10% of all medical spending.2 It is not hard to imagine the level of health care cost increases we will see when nearly nine in ten Americans are overweight or obese.

Obesity is just one facet of the American health crisis, albeit a major one. Health experts continue to caution about the dangers of physical inactivity and the importance of preventive care, something far too many Americans avoid, even though such expenses are now covered at 100% as a result of ACA. Factor in the one in five American adults who smoke and the alarming number of people who fail to take their medications as recommended, and it’s easy to see why worsening population health issues are making it even harder to manage costs.

In the 2011 edition of Aon Hewitt’s annual employer health care survey, we saw employers taking a cautious wait-and-see approach to strategic health improvement and cost-management decisions. By the 2012 edition of the survey, published in the spring of 2012, we saw plan sponsors “taking plan design off pause,” exploring and advancing emerging and strategic approaches to health benefits. Against the backdrop of sweeping legislative changes and unprecedented health crises, American employers are reassessing and potentially redefining their role as provider of health care benefits. Not only are they looking to offset costs and ensure compliance, they are actively investing in improving the health of their employees.

Against that backdrop, employers are reassessing the role they play in promoting and insuring the health of their population. Centered on a consistent need to have a workforce that is healthy, present and high-performing, employers face four strategic paths for consideration. Those paths, shown in Figure 1, are:

1. Annual trend migration—staying in
2. Exit completely—paying to get out
3. Leverage/subsidize exchanges—playing, on a new field

Each path presents not only opportunities, but also risks—for employers, employees and the U.S. health care marketplace at large.

Path 1: Annual Trend Migration

Struggling to cope with the rapidly escalating cost of health care, the vast majority of employers have adopted an approach that has them annually deploying tactics to mitigate near-term health care trend. Aon Hewitt’s 2012 employer survey showed that 75% of employers are currently on this path (see the table). They shift some costs to employees via design changes and payroll deduction increases, change from health plan A to health plan B, and perhaps introduce newer ideas such as an account-based health plan as an option. The focus is on finding the mix of tactics that reduces the year-over-year increase to a level the organization can tolerate. Once done, these employers take a deep breath and start the process all over again.

Given how health costs are trending, we do not view this
path as being sustainable for the long term for most employers. In fact, the 2012 Aon Hewitt employer survey suggests that within three to five years, only 43% of employers expect to be on this path. For employers in highly competitive industries, this path may remain viable for a longer period of time. Continuously engaged in a war for talent, employers in those industries have no choice but to maintain a benefits package that’s at least as attractive as what the competition offers.

Employers that are considering this path need to remember that employees have already shouldered a significant portion of recent health care cost increases. They cannot simply rely on cost-shifting measures to carry them through the rising tide of health care costs. Employers on this path will need to begin aggressively pursuing strategies such as narrow provider networks, health plan vendor consolidation and strict enforcement and auditing of rules regarding benefit program eligibility, all as a means of finding offsets to health care trend. Employers on this path must balance short-term cost increases, employee impact and the need for a competitive benefits program.

**Path 2: Exit Completely**

Alarmed by the increasingly rapid pace of health care cost increases, some employers have begun to question whether they should get out of the business of providing health care benefits altogether. Over time, U.S. employers have effectively become health plans for their employees, devoting a significant portion of their human resources staff time to managing their benefits program. As ACA creates pathways to guaranteed access insurance in the individual market, some employers are questioning their role as a sponsor of benefits. Recognizing that it may be less expensive to pay any applicable penalties under federal and state laws, they are taking a serious look at whether they should simply opt out of sponsoring health care benefits for their workforce.

In considering this scenario, we can learn from the transformation of the retirement income space. Thirty years ago, employers would not have been able to fathom the notion of expecting employees to manage their retirement investments themselves. Yet somehow, between then and now, pensions stopped being the prevalent retirement vehicle, having largely been replaced by 401(k) plans. How did it happen? Driven by a desire to reduce the financial volatility associated with a traditional defined benefit pension plan, a small

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**FIGURE 1**

Four Strategic Paths

- **House Money, House Rules**
  “Play by New Rules”

- **Leverage/Subsidize Exchanges**
  “Play on a New Field”

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**Healthy and High-Performing Workforce**

- **“Stay”**
  Annual Trend Migration

- **“Pay”**
  Exit Completely

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group of leading-edge employers began to move toward models that transfer retirement management to participants. While those early adopters experienced much scrutiny, once the dust settled, other employers began to see the potential for similar change in their own organizations.

Along the way, we have learned valuable lessons instructive for the health care dialogue. Recent studies by Aon Hewitt and others suggest that the vast majority of Americans lack adequate retirement income resources, with many having undersaved during their working careers. According to Aon Hewitt’s 2012 Universe Benchmarks study of 147 defined contribution plans covering 3.6 million employees, the average 401(k) plan balance for participants who are aged 60 or older is $37,300, and the median is $114,500. Employers have begun to implement strategies to enhance retirement income results for employees, including autoenrollment, automatic increases in employee savings deferrals and target-date retirement funds. In other words, even on a path toward “exiting completely” in the retirement space, employers remain actively engaged in meeting the needs of their employees.

So far, few companies are seriously considering this approach, with just 6% of employers in the Aon Hewitt’s 2012 employer survey identifying this as their chosen path in three to five years. In the near term, the potential risk in selecting this path may be too great to overcome to most employers. Under ACA, the penalty for an employer that fails to provide benefits is $2,000 per employee, a non-tax-deductible cost to the business. If mass numbers of employers were to jump on the “exit” bandwagon, thus weakening the employer-sponsored system, it is widely anticipated the government would respond with an increase in that “free rider” penalty, potentially eliminating any perceived financial benefit to the employer.

And then there are the employee relations consequences. Aon Hewitt’s employee benefit surveys have consistently shown that medical is by far the most highly valued benefit, by a margin of two to one, and is no longer considered “fringe.” For many employers, a critical element of their talent culture is to be viewed as an employer of choice; eliminating medical benefits ahead of a broader market trend to do so would likely be seen as directly contradictory to that objective. Thus, employers that take this path will need to consider the potential impact such a decision could have on the competitive nature of their employment brand. Some may find themselves compelled to increase taxable pay to employees to soften the blow of losing the nontaxable employer contribution toward the cost of health benefits.

At the same time, as we learned with the retirement plan transformation, employers that do not see this as a vi-

### TABLE

**Approach to Providing Health Care Benefits for Largest Active Employee Population**

<table>
<thead>
<tr>
<th>Approach</th>
<th>Current Approach</th>
<th>Future (Next 3-5 Years) Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees choose a plan on their own from options available on the open market (employer neither sponsors nor contributes to health benefits).</td>
<td>1%</td>
<td>6%</td>
</tr>
<tr>
<td>Employer provides access to a corporate or private health exchange giving employees various plans to choose from (employer sponsorship through a fixed dollar amount).</td>
<td>2%</td>
<td>26%</td>
</tr>
<tr>
<td>Employer actively manages and provides a few plans for employees to choose from (through sponsorship of traditional health benefit plans where employer pays a percentage of premium).</td>
<td>75%</td>
<td>43%</td>
</tr>
<tr>
<td>Employer selects a single health plan for all employees (employer pays most, if not all, of the cost).</td>
<td>21%</td>
<td>20%</td>
</tr>
</tbody>
</table>

*Source: 2012 Aon Hewitt employer survey.*
health care reform

Employers have moved an increasing portion of their cash compensation program to pay-for-performance bonus programs; under this path, employers will begin taking a similar approach to health care—rewarding good health behaviors with financial incentives/consequences and access to better benefits, features and programs.

able path for the near term still need to continue to monitor actions of other employers. If and when some larger employers move in this direction, it will be important for all other employers to have a “what if” strategy prepared, considering company and employee impact as well as the competitive landscape.

Path 3: Leverage/Subsidize Exchanges

As an alternative to the two previously discussed paths, several employers have determined the best approach lies in continuing to support health insurance financially, but through playing on a different field.

Similar to the approach employers have taken in moving employees from a defined benefit pension plan to the 401(k) space, this approach represents a movement along the defined contribution continuum, as employers change from plan sponsor (defined benefit) to coverage facilitator (managed defined contribution). One in four employers is considering making this shift in the next three to five years, according to Aon Hewitt’s 2012 Health Care Survey findings.

This approach entails changing the mechanism or vehicle with which the employee engages to select and enroll in medical benefits. In the health care arena, this can take two different forms: private market exchanges or state/federal exchanges. Basically speaking, an exchange is simply a competitive marketplace consisting of suppliers and buyers. Granted, health care exchanges are not an entirely new concept, as a number of entities, including Aon Hewitt, have such offerings in the marketplace focused on Medicare-eligible retirees, where individual insurance products already exist on a guaranteed issue basis. In this new environment for active employees, however, private and government-run health care exchanges will introduce new strategic options that plan sponsors must evaluate closely. They create a consumer experience, akin to shopping at Amazon.com or Expedia, with the branding focus being on meeting the needs of the consumer.

The migration to a defined contribution model requires two critical elements. First, an employer decides how much it is willing to spend, per employee, to offset its employees’ health care expenses. The amount can vary, based on what kind of coverage the employee requires—if he or she is single or married or has children, for example.

Second, the employer needs to decide the mechanism through which the employees will review benefit choices—in other words, where and how they can spend the employer’s defined contribution. While some employers may choose to self-manage the range of options available for employees (akin to the “flex plans” popular in the 1990s), many employers will opt to engage with an administrator to manage the consumer enrollment experience via an exchange. In that mode, the employee takes that designated amount of money and goes shopping on the exchange, where he or she chooses from an array of plan design choices. The advent of these private and public exchanges means that, for the first time in more than a decade, health plans must compete at the consumer level. Consequently, they are finding they must make a compelling offer—on covered services, premium rates and network access—to consumers to win their business.

The advantages to this path are multifaceted. Employees enjoy a greater choice of plans and carriers, along with the flexibility to tailor benefit/contribu-
tion trade-offs. Meanwhile, employers reap the benefits of having transferred health trend risk back to the insurance carriers providing the plans, gaining financial predictability and trend migration through competition, efficiency and best-in-market contracting. For private exchange models to have sustained success, several key factors must exist:

- Employees must have a clear and meaningful choice of design options, ideally with a choice of health plan networks.
- Health plans must have financial skin in the game in order to be motivated to manage population health, chronic disease and other factors that drive up cost.
- The administration experience must be highly consumer-centric, easy to navigate, with a variety of decision support tools.
- Pricing for employees must tie back to the employer’s population.

That said, an exchange model isn’t for everyone. Some employers feel an obligation to sponsor benefits in a more traditional fashion, some view benefits as an attraction and retention tool that shouldn’t be messed with, and others may have unions where this option can’t play out, at least in the short term. For others, while the model itself is conceptually attractive, it does represent a new way of managing an old challenge; as such, those employers want to see the models emerge and gain some traction before adopting the approach for their own organization.

**Path 4: House Money, House Rules**

Regardless of the actions taken by those around them, a large percentage of American employers will always consider health care benefits an important facet of the employment contract. According to Aon Hewitt’s 2012 Health Care Survey findings, plan funding strategies remain constant, with employers funding 80% of the cost. With no drastic change expected anytime soon, employers will continue to spend a significant amount of “house money” on health care benefits, and they are seeking ways to spend that money differently. Employers have moved an increasing portion of their cash compensation program to pay-for-performance bonus programs; under this path, employers will begin taking a similar approach to health care—rewarding good health behaviors with financial incentives/consequences and access to better benefits, features and programs. In other words, if employees want to be able to spend house money on benefits, they will need to play by “house rules” to get to do so. The focus of those rules will be on identifying and managing health risk via health risk questionnaires and biometric screenings, en-
enhancing consumer behaviors in choice of providers and services, and moving toward improved health outcomes as the measure of success.

The need for this type of path stems from what data tells us about the link between health behavior and increased health care costs. A 2010 World Economic Forum demonstrated that eight modifiable health risks and behaviors—including poor diet, physical inactivity, smoking and lack of health screenings—drive 15 chronic conditions, accounting for 80% of total costs for all chronic illnesses worldwide. By targeting some or all of these risks and behaviors (Figure 2), employers can reduce the frequency and severity of those costly 15 chronic conditions. According to Aon Hewitt’s Consumer Health Mindset survey, 85% of employees say good health is mainly a result of making smart choices in their health care and getting regular preventive care. By creating an improved climate of health, employers have the potential to reverse not only the decreasing health of our nation, but also the related increases in health care costs, lost productivity and absenteeism.

By assuming a leadership position and making some bold moves, employers are engaging employees and asking them to assume ownership of their behaviors and health (Figure 3). In exchange for becoming more engaged in their own health and by making better decisions about how they use the health care system, employees and their families can earn incentives, including enhanced benefit designs and additional health account funding. Eighty-two percent of Aon Hewitt’s 2012 Health Care Survey respondents said they reward participants for using health awareness tools such as health risk questionnaires, biometric screenings and onsite prevention and wellness services. Other strategies include waiving a prescription drug copay if an employee demonstrates he or she is following doctor’s orders with regard to a chronic condition. ACA includes a provision that expands the employer’s ability to provide financial incentives for better health, from the current 20% to 30%, with provisions that allow that to increase to a 50% differential for those engaging in health improvement.

While most employers find the elements of this path to be attractive, most are not fully there yet. Sixty-five percent of respondents to Aon Hewitt’s 2012 Health Care Survey said that motivating participants to promote behavior change remains their top challenge. In large part, that stems from employers needing to define the role they want to play in the health and well-being of employees and their families. Over the last decade, employers have become somewhat comfortable taking a hard line against smoking, with most impos-
ing a set of house rules around that particular risky behavior. However, we have yet to see employers taking a similar approach to other health issues, held back by concerns about perceptions that the employer is somehow overstepping its boundaries around the personal lives of employees.

Before an employer heads down the house money, house rules path, it must have senior leadership support for creating a climate that engages employees in shared ownership of those eight health risks and behaviors and the resulting costs. If an employer cannot feel comfortable having that dialogue and creating that climate, then making the company’s contribution to employee health care contingent on adherence to specific actions and behaviors, via the house money, house rules path, is not for them.

**Conclusion**

Regardless of which path an employer chooses, employee health and well-being will remain a driver of workforce performance and a core influence on business results. All businesses need healthy, present and productive employees in order to be successful. The national dialogue around health care reform has prompted many employers to reconsider their approach and engage in meaningful conversations with their employees. With Supreme Court and election uncertainty now resolved, employers are recognizing the need for immediate action. Those that have taken steps to reassess and restructure their health care offerings are well on their way to a long-term strategy for dealing with rising costs and declining population health. Those that remain focused merely on reform specifics are missing an opportunity to use this galvanizing event and the resulting national dialogue about health to drive toward a different strategic outcome.

**Endnotes**


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