

Defining What 'Defined Contributions' Mean For Work-Based Health Insurance

TOPICS: INSURING YOUR HEALTH, HEALTH COSTS, HEALTH REFORM

By MICHELLE ANDREWS

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What if employers started giving workers a chunk of cash to buy health insurance on their own instead of offering them a chance to buy into the company plan? Are workers ready to manage their own health insurance like they do their 401(k)?



The idea that employers might decide to drop their health plans and replace them with a “defined contribution” for employees has been around for years. It’s one way for employers to control their expenses in the face of relentlessly rising health care costs. Now that the health law has created new online marketplaces where people can shop for coverage and made the individual market more accessible and affordable, the idea is gaining traction.

“The technology has caught up to the concept,” says Paul Fronstin, director of the health research and education program at the Employee Benefit Research Institute.

Some experts anticipate a major shift in coming years. [A recent study by S&P Capital IQ predicted that 90 percent of workers with employer-sponsored coverage will be moved to health insurance exchanges by 2020.](#)

In his new book, *Reinventing American Health Care*, Ezekiel Emanuel, a former White House special advisor on health care reform, made a similar prediction, [projecting that fewer than 20 percent of private sector workers will have traditional job-based coverage by 2025.](#)

But others say a wholesale shift away from employer-sponsored coverage is unlikely. [For one thing, under the health law, starting in 2015 employers with 50 or more workers that don’t offer health insurance would probably face a penalty of \\$2,000 per worker \(minus the first 30 workers\).](#)

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This could be a huge change from the way things are now. Premium contributions for employer-sponsored group coverage aren't taxed as income to the worker. If an employer dropped group coverage and instead offered employees \$5,000 to buy an individual plan on an exchange, workers would owe income tax on that amount. Those earning less than 400 percent of the federal poverty level (currently \$45,960 for an individual or \$94,200 for a family of four) could qualify for premium tax credits to reduce their costs, but higher wage workers wouldn't benefit.



Rather than abandoning group coverage altogether, some experts expect employers to move more assertively into a slightly different health insurance benefit setup: private health insurance exchanges. These online marketplaces, which got their start several years ago as a way to transition retirees from company plans to Medicare, are increasingly being offered to active employees. Benefits consultants including Mercer, AonHewitt and Towers Watson run private exchanges for a growing roster of companies like Walgreens, Arby's restaurants and Petco.

Once employers have selected a private exchange for their workers, many employers give employees a set dollar amount -- a defined contribution --to shop among sometimes dozens of health plans offered by different insurers. The employer may limit the plan choices available to employees, and typically subsidizes a portion of the premium. Since the employer is sponsoring the coverage for the group workers don't owe income tax on the contributions they receive.

"Employees get a much broader choice of plans and a choice of insurance company," including access to multiple insurance company provider networks, says Ken Sperling, national exchanges strategy leader at AonHewitt. Typically people would have a choice of five plan levels and at least three but up to five insurers, up to 25 options in all, he says.

Employers, meanwhile, get what they want: predictable health care costs. With a defined contribution arrangement, "the employer can increase or decrease the amount over time depending on business needs," says Eric Grossman, a senior partner at Mercer.

While giving employees more plan choice could be a plus for some workers, some experts are wary of a shift toward defined contributions in health benefits, which they say may encourage employees to buy less expensive, less comprehensive coverage than they would otherwise have through their employer.

They scoff at the notion put forward by some private exchange proponents that wider choice allows employees to "rightsize" their coverage.

"This idea that people are overinsured -- somewhere along the way this became the conventional wisdom," says Karen Pollitz, a senior fellow at the Kaiser Family Foundation (KHN is an editorially independent program of the foundation.) People are only overinsured if they don't get sick, she adds. Continued cost shifting to employees means that "we've gone way beyond skin in the game. Now people have vital organs in the game."

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