Defined contributions

How defined contribution plans can help ease the rising cost of health care

Historically, defined benefit plans have held a dominant position in the health care market since they were first introduced in the middle of the 20th century. Because the contributions were tax-deductible for employers and pre-tax for the employees, it was a popular way to increase employee benefits without raising wages.

But over the years, the rising cost of health care has caused employers to re-examine how much they pay for insuring their employees and caused them to think more about defined contribution plans.

“With a defined contribution plan, an employer can decide exactly how much they want to contribute to an employee’s health insurance and have a certainty about the cost,” says John Mills, senior director, Consumer Products, Product & Consumer Innovation at UPMC Health Plan. “And a defined contribution plan can be offered by a company of any size.”

Smart Business spoke with Mills about defined contribution plans and their increasing popularity with employers.

What is a defined contribution plan?

Technically speaking, a defined contribution plan is not any specific kind of health plan. Instead, it is a concept that can be applied to different approaches that employers can use to manage health care for employees.

With a defined contribution plan, a company gives each employee a fixed dollar amount that the employees can use to purchase health insurance and dental and vision benefits. Some employers will allow employees to put any money not spent on these benefits into a flexible spending account or to take as a cash benefit.

Why are these plans becoming so popular?

Certainly, the rising cost of health insurance is a major factor in the increased popularity of defined contribution plans. Any plan that can place some kind of limit on health care expenses, or provide some certainty about how much money will be paid, will get close scrutiny by those companies concerned about the bottom line.

But defined contribution plans also touch on areas that are becoming more important to both employers and employees than was possible under managed care. These include:

■ The consumer’s desire to have more choice and involvement in health care.
■ Concern about quality.
■ Increased information.
■ More freedom for providers.

What are some common characteristics of defined contribution plans?

The most common characteristic is choice. Defined contribution plans are intended to give members greater flexibility in benefit decisions. The choices include: plan choices, care choices and the ability to opt out.

Other common characteristics include increased cost sharing between the employer and the member, as well as greater knowledge and engagement in management of health care by members.

What do employers like about defined contribution plans?

One popular feature is that there is no limit on the amount of money an employer can contribute to an employee’s defined contribution health plan. Also, there is no minimum contribution requirement. That allows the employer to set the amount that makes the most sense for the company.

Employers also can give employees different contribution amounts based on classes of employees. The combination of cost management and decreased employer involvement makes defined contribution plans very attractive.

What other factors are driving the growing popularity of defined contribution plans?

Rising costs of premiums are a factor, as is the desire of providers to regain control over decisions concerning patient care. At minimum, they want a greater ability to advise patients who will make the final decision.

Concerns about quality are another factor. There is evidence that defined contribution plans will enhance the quality of care and also increase the amount of information available on the quality of health care, which makes them popular when there is such a focus on quality. And, small businesses find that with defined contribution plans they can have a feasible way to provide some kind of health insurance for their employees.

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WEBSITE: For more information about defined contribution plans available through UPMC Health Plan, visit www.upmchealthplan.com/employers/index.html.