Helping Employers and Employees Navigate the Health/Wealth Convergence

A White Paper by Manning & Napier

Unless otherwise noted, all figures are based in USD.

Introduction

Mariners understand that some of the trickiest waters to navigate are located where two strong currents converge, creating powerful and dangerous swirls. Both employers and employees find themselves attempting to navigate the waters where the strong currents of retirement planning and health care planning meet. It is almost impossible to read a trade journal, and of late even a major newspaper, without seeing articles detailing the rising cost of health care services and/or challenges facing employees saving for retirement.

It is no secret that health care costs have been rising dramatically over the last ten to twenty years. Unfortunately, the strong currents on the retirement savings front have many employees feeling like they are paddling upstream. The decline in the use of defined benefit plans, fears about the future of Social Security, the two severe bear markets since 2000, low interest rates for savers, and a weak economic environment have resulted in many employees falling well short of the level of savings needed to secure a dignified retirement. Increasingly, it is becoming clear that health and wealth are intersecting and are very likely closely linked. Once employers and employees recognize this relationship, they can begin to proactively take steps to successfully navigate this potentially turbulent convergence of retirement and health care costs.

Health & Wealth – Increasingly Becoming One and the Same

As health care spending has grown to represent a larger portion of the overall economy, and in turn a larger portion of employers' and employees' budgets, the wealth impacts of health spending have become clear (see the Appendix for a detailed discussion of recent health care and retirement trends). For employers, plan design strategies have also been converging as both health and retirement plans have moved to more of a defined contribution approach, with employers capping their contributions to the plans and employees bearing responsibility for funding a larger portion of both their health care expenses and their retirement income.

A well-documented example of the increasingly inter-related nature of health and wealth decisions is the impact that current health care costs have on participants' ability to save for retirement. As employers have shifted more of the costs for health insurance to employees, employees have had a harder time sustaining or increasing their retirement plan contributions. According to the Bank of America Merrill Lynch, 2012 Workplace Benefit Report, when asked what would encourage them to save more in their 401(k), 73% of employees cited more affordable health care as an answer, which was second only to increasing the company match. The growth in consumer driven health plans suggests that, for many participants, as well as employers, deciding how to allocate savings dollars between retirement accounts and health savings accounts will be an important consideration going forward.

Recently, the issue of health care costs in retirement has also gained prominence. Health care costs can be hard to estimate over the long-term and are dependent on many personal characteristics, but the costs are likely to be significant. For example, a married couple age 65 with median drug expenses is estimated to need approximately $151,000 to have a 50% chance of meeting their retirement health care costs and approximately $255,000 to have a 90% chance[1].

While awareness of the health/wealth convergence has initially centered on the amount of money retirees may need to meet their health care expenses in retirement, the reality is that wealth issues (or the lack of wealth) are just as likely to cause health issues. For example, the economic difficulties faced by many in recent years have also taken their toll on the health of Americans.

- Eight in ten Americans in a 2008 study reported money and the economy as significant sources of stress[2].
- The cost of health care was found to be 46% higher for employees with high levels of stress[3].
- The 2008 Associated Press and AOL Health Poll reported that employees suffering from financial stress are more prone to a variety of health risks, as shown in the chart below.

Health issue	High level of stress from debt	Low level of stress from debt
Migraines/headaches	44%	15%
Severe depression	23%	4%
Insomnia/sleeping problems	39%	17%
Severe anxiety	29%	4%
High blood pressure	33%	26%
Heart attack	6%	3%
Ulcer/digestive problems	27%	8%
Muscle Tension/low back pain	51%	31%

In addition to increased medical expenses, these employees also cost employers in terms of missed work time due to medical issues, and lost productivity due to worrying about financial issues and spending work time dealing with personal financial matters. Financial distress has been noted as one of the strongest predictors of workplace absence[4].

Yet another intersection between health and wealth is the employer impact of an aging workforce that is unable to retire due to a lack of savings and/or the need to retain employer provided health care insurance. Therefore, employers also need to be cognizant of rising costs related to an aging workforce. Medical claim costs generally rise with employee age, and for employees age 60-64, average per employee costs are more than double the costs of employees age 35-39[5]. Employees who are not able to retire on time due to insufficient retirement funding may be adding costs to the employer's health plan.

How Employers Can Help Employees Navigate These Waters

As these forces converge, employers are faced not only with their own rising costs, but also with a workforce that struggles to manage:

- High costs for health care and health insurance (especially for individuals hoping to retire early and with a gap between COBRA and Medicare eligibility)
- Inadequate retirement savings and Social Security to fund retirement expenses
- Chronic health conditions caused by unhealthy behaviors
- Increased financial stress – exacerbated by insufficient retirement funds and contributing to even greater health care costs and greater need for savings to fund those costs

Employers looking to help employees stem the tide of rising health care costs and inadequate savings must understand that there is no single silver bullet that will solve these problems, but rather multiple steps that should be taken over time to begin chipping away at the issue. Specific components of a comprehensive solution for helping employees address the health/wealth convergence include:

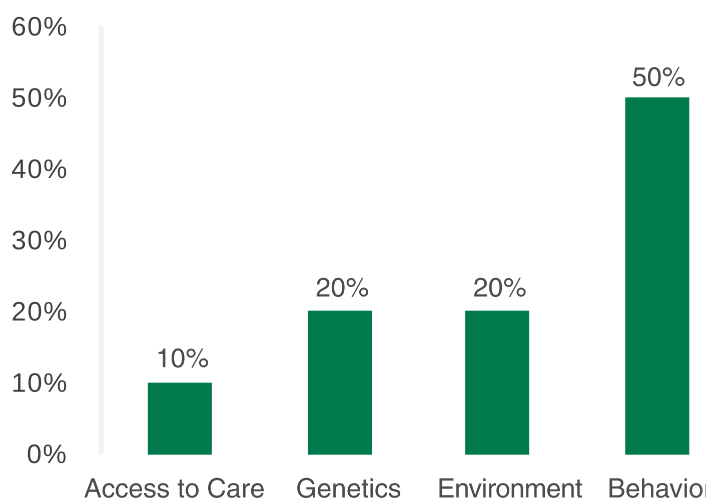
- effective benefit plan designs that facilitate behavior change,
- a straightforward and concise communication strategy emphasizing the importance of savings, and
- planning tools and resources to help participants be wise consumers of health care and diligent savers.

Plan Design

For both health and retirement plans, an increasing focus on employee personal responsibility and behavior change has become the norm. Health plans can accomplish this through the following design strategies.

- Consumerism – Behavior accounts for a significant portion of rising health care expenses and for health in general. According to the IFTF (Institute for the Future) and the Centers for Disease Control & Prevention, behavior is the major determinant of health, having as much effect as genetics, environment and access to care combined.

Determinants of Health



Studies have found that anywhere from 50% to 80% of health care costs can be attributed to an individual's lifestyle[6]. The Centers for Disease Control and Prevention estimates that more than 75% of health care costs are due to chronic conditions, which are largely preventable by reducing behavior-based risk factors.

Consumer-based plans are designed to capitalize on this connection between behavior and overall health. They typically include a high deductible health plan coupled with a health savings account (HSA) or a health reimbursement arrangement (HRA). These plan designs give employees more responsibility for managing health care dollars and making wise consumer choices in how they spend them. HSAs also give employees the ability to save on a pre-tax basis for their health care costs, with unused funds available for health care expenses in retirement.

- Value-based designs – Value-based plans are also designed to change behavior, by creating incentives to encourage the appropriate use of high-value services and providers that ultimately lead to better health and reduced catastrophic claim costs. Examples include lowering - or eliminating - the prescription cost-sharing for certain medications, to encourage compliance with prescription treatment, and promoting the use of providers with the best performance on cost and quality measures.
- Health promotion – Employers also have the ability to drive behavior change through implementation of health promotion programs designed to change unhealthy behaviors that can lead to high medical costs. These include wellness and disease management programs which stress the importance of proper preventive care and adherence to treatment plans to improve employee health and reduce the incidence of chronic illnesses and the high costs associated with them. Employers should also consider covering dependents under these programs in order to positively impact dependent medical claims as well as employee claims. A recent Mercer study found that employers with a greater commitment to employee health and wellness experienced average annual medical premium cost increases of 2 percentage points lower than those of other employers. Including employees who are not covered by a company medical plan can also have benefits, as improving overall employee health can help reduce the incidence of employee absence, disability, and workers' compensation claims.

On the retirement plan design front, there is already positive momentum in the 401(k) space. The growing field of behavioral finance has provided valuable research and insights into participant behavior that has led to the next generation 401(k) plan actually using participants' behavioral tendency to encourage participation and increased savings. For example, auto enrollment and auto escalation have helped boost employee participation rates (especially amongst younger workers) and will continue to increase the level of contributions going forward. Additionally, the growth in the use of Qualified Default Investment Alternatives (QDIAs) has allowed plan sponsors that use auto enrollment to "default" non-responsive participants' savings into a professionally managed, diversified, age appropriate investment strategy.

While this is a good start, employers should also consider revisiting their employer match policy in order to encourage increased savings rates for participants. For example, an employer with a 50% matching contribution on up to 4% may want to consider adjusting the match to a 25% matching contribution on up to 8% to provide participants with an incentive to contribute more to the plan. Another 401(k) plan design concept starting to gain attention is the idea of re-enrollment on a periodic basis in order to increase the number of participants in the plan (e.g., capturing longer tenured workers not actively participating in the plan who were not picked up in the auto enrollment process for new hires). This also limits the chances of participant inertia leading to inappropriate asset allocations for participants who have failed to rebalance their do-it-yourself allocations over time.

Communication

A strong communication strategy is key to effecting employee behavior change. Wherever possible, the connection between health and wealth should be highlighted. Both health and retirement plan communications should stress the importance of savings and the advantages of doing so through a tax-favored plan – a health savings account for health care expenses, and a 401(k) plan for retirement savings. Other information that should be communicated regularly includes:

- Estimated savings needed to retire comfortably, including the cost of health care in retirement
- Importance of starting to save early
- Information on the true cost of health care in different settings and potential for savings (e.g., generic instead of brand-name medications, urgent care or physician office visit instead of emergency room)
- Questions to ask your doctor related to the costs of treatment options
- Guidelines regarding health savings account contribution and withdrawal rules.

Communications on the cost of health care should point out that, beyond the obvious benefit of helping employees reduce their share of health care costs associated with lower premium increases and out-of-pocket expenses, they also have the potential to direct monies saved on health care costs to their retirement savings program. In addition to giving all employees year-round access to the above information, employers should also use targeted communication wherever possible. Targeted communication involves sending tailored messages to certain individuals based on their personal situation. Examples on the health side included automated reminders for recommended treatment, preventive screenings or prescription refills, and messages based on an individual's health risk status or on their diagnosis with a specific medical condition. For retirement plans, a few examples include targeted communications to reach employees who:

- Are not contributing to a 401(k) or taking advantage of catch up contributions
- Are contributing an insufficient amount
- Haven't adjusted investment elections
- Are within a few years of retirement age, for specific retirement planning information

Targeted messages are more effective in motivating employees and covered dependents to take the desired action. These targeted messages can be sent by traditional methods, but more recently, electronic forms of transmission (e-mail, text messages, and automated phone messages) are becoming commonplace.

Planning Tools and Resources

A key step employers can take to assist employees in managing the health/wealth convergence is to provide employees with access to planning tools and resources. An example is information to help them to be better consumers of health care services. Studies continue to show the wide variation in prices for health care services in a given geographic area (as much 100% in some cases[7]). In response, insurance companies and health care technology companies are developing tools to allow users to compare expected costs across different providers. With the advent of high deductible plans, employees have a built-in incentive to "shop" for the best price on health care services, as they are responsible for a much more significant portion of the cost.

These price transparency tools provide the information needed for employees to make an informed decision on where to purchase health care services, as they would when purchasing any other major product or service. Some transparency tools also allow consumers to compare providers based on quality ratings, which are essential to making a decision on where to receive care. Additionally, employers should take steps to provide employees (and their spouses) with tools related to successfully making the transition from a traditional HMO or PPO insurance plan to a consumer driven health plan, such as cost calculators comparing traditional plans to consumer driven plans.

Access to good information and helpful tools is also important to ensure that employees are taking full advantage of their 401(k) plan and establishing an appropriate retirement savings strategy. First and foremost, employers should make sure that their employee communications program emphasizes the importance and benefits of starting to save for retirement at an early age. A commonly cited piece of advice that current retirees would share with younger workers is the importance of saving for retirement early and of saving more. Helpful tools and services that the employer should consider include on-line savings calculators to help employees establish a savings strategy and for monitoring that savings strategy over time, budgeting tools to help participants indentify additional savings opportunities, and potentially even financial coaching services offering employees the chance to receive personalized guidance in pursuit of their retirement goals.

Employers may also want to incorporate a financial wellness program alongside the health wellness offerings that are becoming common in the workplace. The financial wellness offering might provide employees with examples of productive financial habits, financial literacy tools, budgeting tools, impulse savings tools, and examples of how small spending changes can translate into significant wealth accumulation over the long term.

Summary

While the convergence of inadequate retirement savings and unchecked health care costs has led to a dangerous junction, changing course now can help employers and employees to avert the disaster looming on the horizon. By changing retirement and health plan designs to provide meaningful incentives for avoiding behaviors that are both financially and physically unhealthy, and providing necessary education and planning tools to assist with decision making, employers can help employees chart a path through murky waters to a successful retirement. The benefits to the employer of providing these types of offerings include greater appreciation of the total benefits package, reduced health care costs, enhanced productivity, a reduced risk of employees remaining on the job simply because they cannot afford to retire, and the recognition that they are investing in their employees' futures.

APPENDIX

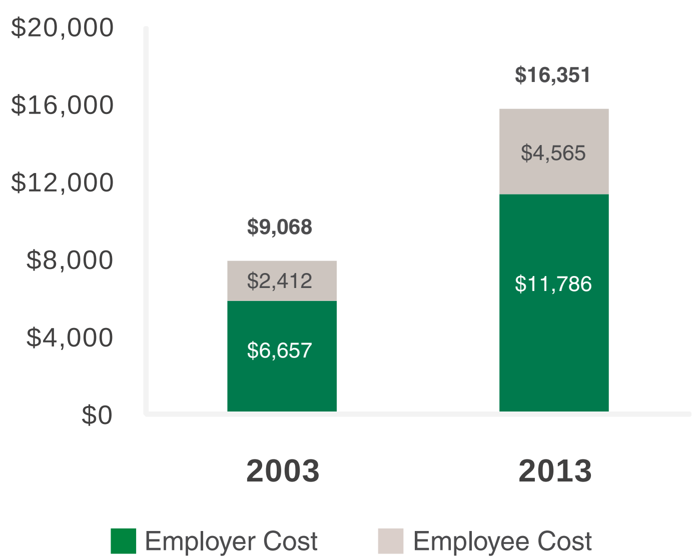
Health Care Trends

Although the increases have slowed recently, health care costs have been increasing much more rapidly than the economy as a whole over the last several decades:

- health care costs per capita have grown an average 2.4 percentage points faster than the Gross Domestic Product (GDP) since 1970, and in 2010 averaged just over $8,400 per person[8];
- the share of GDP devoted to health care has increased from 7% in 1970 to nearly 18% in 2009 and 2010[8];
- U.S. employers' expenditures in 2011 for providing employee medical coverage averaged 12.1% of payroll costs[9].

According to the Kaiser Foundation's Employer Health Benefits 2013 Annual Survey, average annual premiums for employer-sponsored health insurance in 2013 were $5,884 for single coverage and $16,351 for family coverage, with employers contributing $4,885 and $11,786, respectively. Using family coverage as an example, total premiums have increased from $9,068 in 2003 to $16,351 in 2013 (80% increase), and employer contributions have increased from $6,657 in 2003 to $11,786 in 2013 (a 77% increase).

Average Annual Premium for Employer Provided Family Plan



As a result of the rapid increase in the costs of providing health care benefits, many employers generally reacted by shifting more of the costs to their employees. This cost shifting has come in the form of higher co-payments, higher coinsurance amounts, higher deductibles, higher share of premiums, reductions in coverage, and adding higher co-payment tiers to prescription drug plans. More recently, the move towards more of a defined contribution feel to the health plan has gained momentum as more employers are offering high deductible health plans combined with a health savings account (HSA) or a health reimbursement arrangement (HRA). For example, the number of participants with health savings accounts has grown from approximately 4.5 million in 2007 to approximately 15.5 million in 2013[10]. As a result of these moves, employees are required to take more control of and responsibility for their health care costs. This is not necessarily a negative, because in order to break the trends of rising health care costs, we need to change employee behavior.

Many pre-retirees are concerned about their ability to fund their retirement health care costs, as highlighted by the following statistics:

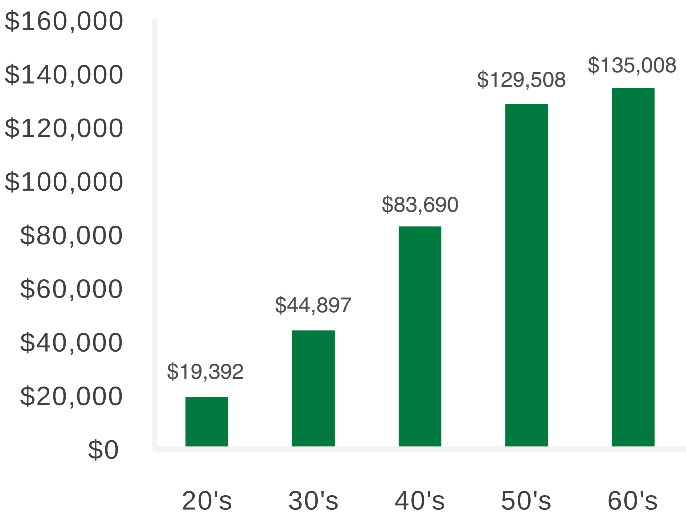
- 80% of Baby Boomers cite uncovered health care expenses as their top concern in retirement[11].
- only 12% of workers have a financial plan for retirement that factors in health care costs[12].

The rising cost of health care is an ongoing issue for employers. Along with cost concerns, legislative changes, including the Patient Protection and Affordable Care Act (PPACA), continue to challenge employers with increasingly complex coverage, administrative, and compliance rules.

Retirement Savings Trends

Increasingly over the last several decades, employers have switched from defined benefit pension plans to defined contribution plans (e.g., 401(k) plans), requiring employees to accept greater responsibility for securing their retirement spending needs. However, the reality is that defined contribution plan participants as a whole are undercapitalized, meaning that in general, they have not saved sufficient amounts to meet their retirement goals. The chart on the following page depicts the average balance for various participant age cohorts for a group of consistent 401(k) participants as of 12/31/2011[13].

Average 401(k) Balance



Unfortunately, participant engagement in defined contribution plans is lower than needed for many participants to meet their retirement savings goals.

- 52% of 401(k) participants did not have the time, interest, or knowledge to manage their retirement portfolio
- Approximately 56% of participants do not read plan educational materials[14].
- More than half of workers (56%) report that they have not taken the time to calculate the amount of savings that they need to meet their retirement goals[15].

The magnitude and complexity of the decisions that a participant has to make in securing their retirement under the defined contribution system (e.g., when to start saving, how much to save, where to invest, how to adjust investments as they age, when to retire, how much to target for withdrawal, etc.) has no doubt contributed to this lack of participant engagement. The good news is that employers, 401(k) service providers, and legislators have all recognized the challenges participants are facing and the 401(k) plan continues to evolve.

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[4]"It's Time to Create a Financially Literate Workforce to Improve the Bottom Line", Aimee D. Prawitz and E. Thomas Garman, Personal Finance Employee Education Foundation.
[5]"The Aging Workforce: Challenge or Opportunity?", World at Work Journal, 3rd quarter 2006
[6]"The Health & Economic Implications of Worksite Wellness Programs", American Institute for Preventive Medicine, 2008. "Preventive Care and Services in Workplace Health Plans", Benefits & Compensation Digest, December 2004. Employee Benefit Plan Review, December 2007.
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[8]"Health Care Costs A Primer", The Henry J. Kaiser family Foundation, May 2012.
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[11]"Middle Income Boomers, Financial Security and the New Retirement", Banker's Life and Casualty Company Center for a Secure Retirement, May 2011
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[14]"401(k) Participant Survey", Charles Schwab, May 7, 2012
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