

Empowering Employers Through Employee Contribution Strategies

Approaches to managing employer and employee medical benefit costs

Employers offering healthcare benefits to their employees must consider a variety of factors when developing the portion of the medical gross cost or premium to pass along to various employee or retired populations. Regardless of the premiums set by the insurer or the gross premium equivalent costs in a self-insured plan, the employer controls how much exposure the employee or retiree has to the premiums.

Employer-offered health benefits account for 55% of all health insurance enrollment and 82% of nonpublic health insurance enrollees in the United States.¹ The majority of employees enrolled in employer-sponsored health coverage pay some portion of the gross cost or

premium for their health benefits. Contribution strategies vary by employer type, size of the employer, and other factors.²

Initial considerations

An employer must first determine its philosophy toward employee contributions. For example, an employer may see very rich employer contributions to benefits as an important part of how it compensates its employees. Another employer may feel the need for employees to pay a larger share of the benefit cost in order to control costs.

Health benefits are offered for a number of reasons, but some of the most common are:

- Employee attraction and retention
- Tax advantages
- Compliance
- Collective bargaining
- Alternative form of compensation

Employee contribution strategies should align with the employer's motivation and philosophy surrounding its approach to offering health and welfare benefits. Employers who want to provide additional compensation via their health and welfare benefit offerings are more likely to subsidize a larger portion of the total benefit costs, thereby reducing the employee contribution toward the benefits.

In addition to the motivations for offering health benefits, an employer will need to consider the operational and financial impact its contribution strategy can have on the organization.

Attractiveness and affordability of benefit: Offering medical benefits will make employment with the company more appealing to employees, which will aid in retention and recruiting efforts.

The affordability of the coverage is pivotal to the value gained from the offering. Affordability of coverage will depend upon an individual's compensation package, but is also tied to competitor offerings and industry norms. Some organizations will pay 100% of the employee cost, but a lesser portion of any dependent coverage in order to address affordability.

- **Plan steerage:** Employers often offer a portfolio of plans to their employees. For example, an employer might offer a portfolio of four total plans, a narrow network health maintenance organization (HMO) plan and three wide network preferred provider organization (PPO) options:
 - A more expensive low-deductible PPO option
 - A high-deductible health plan (HDHP) with a health savings account (HSA)

- A high-deductible health plan (HDHP) with a health savings account (HSA)
- An HMO option

The employee contribution structure can help an employer steer its employees to their preferred plan design. An employer may have a preference for a particular plan in which it wants its employees to enroll based on cost or ease of administration. Even if an employer has a preference for the plan in which its employees enroll, there can still be benefits to offering multiple plan designs. They may include attractiveness, provider network adequacy, or compliance.

- **Adverse selection:** Employee contributions play a key role in helping employers avoid adverse selection scenarios. Adverse selection occurs when an unhealthy population is disproportionately drawn to a single plan offering, causing the overall cost of that plan to exceed expectations. If premiums or gross cost developments take into account selection concerns but employee contribution structures ignore these factors, adverse selection can be introduced and result in unanticipated healthcare costs for the company. The employer must take into account how its contribution strategy might be impacting selection in the plans in order to help mitigate potential adverse selection.

Employee contributions can be set to help a company match its philosophy and meet its employees' healthcare needs, but they also play an important role in the management of the employer's healthcare benefit portfolio.

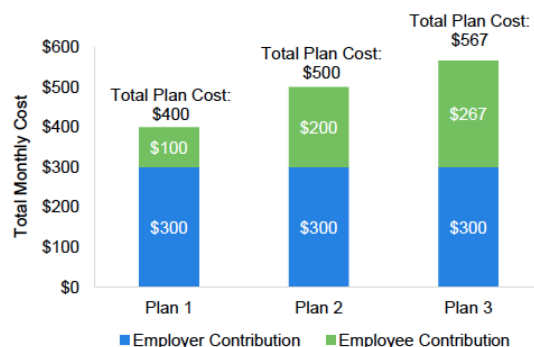
Employee contribution approaches

DEFINED CONTRIBUTION

A common approach to employee contributions is a defined contribution. In this structure, the employer opts to pay a fixed amount toward the employee's total premium, regardless of the plan chosen by the employee.

Consider the example in Figure 1 that illustrates a benefit portfolio with three plan options and a defined contribution of \$300 per employee per month.

FIGURE 1: DEFINED CONTRIBUTION EXAMPLE



As shown in Figure 1, an employee is given the option of a \$100 monthly premium if that person selects Plan 1 or a “buy up” option may be offered to more expensive plans with more comprehensive benefits.

Additionally, an employer may consider a tiered approach to a defined contribution structure. Under this structure, the employer may contribute additional defined amounts for dependents or dependent tiers. Figure 2 shows an example of this strategy where the employer varies the defined contribution by tier. The employer continues to contribute \$300 per employee as well as an additional \$100 for the employee (EE) plus spouse and employee plus child(ren) tiers and an additional \$200 for the family tier.

FIGURE 2: TIERED EMPLOYER DEFINED CONTRIBUTION EXAMPLE

Plan Option	Tier	Total Monthly Cost	Employer Contribution	Employee Contribution
Plan 1	Single	\$400	\$300	\$100
Plan 1	EE + Sp	\$840	\$400	\$440
Plan 1	EE +Child(ren)	\$680	\$400	\$280
Plan 1	Family	\$1,200	\$500	\$700
Plan 2	Single	\$500	\$300	\$200
Plan 2	EE + Sp	\$1,050	\$400	\$650
Plan 2	EE +Child(ren)	\$850	\$400	\$450
Plan 2	Family	\$1,500	\$500	\$1,000
Plan 3	Single	\$567	\$300	\$267
Plan 3	EE + Sp	\$1,190	\$400	\$790
Plan 3	EE +Child(ren)	\$963	\$400	\$563
Plan 3	Family	\$1,700	\$500	\$1,200

Advantages of defined contribution approach

A few advantages to the defined contribution approach make it the preferred structure for many firms.

1. Maintains levels of fairness to employees regardless of plan chosen.
2. Protects the employer against high year-to-year trends in medical costs.
3. Offers ease of forecasting employer costs.
4. Provides ease of communication to participants.
5. Reduces adverse selection concerns because the employer contributes the same amount independent of the plan.

Disadvantages of defined contribution approach

1. May create unintended steerage to a given plan.
2. Places burden of trend solely on employee, if no adjustments are made to contribution amount. This impact can be quite onerous to employees due to trend leveraging as shown in the illustration in Figure 3. As seen below, the total cost for the medical plans offered by the employer only increases by 5% in year 2. However, because the employer contribution stays flat, the employee contribution trend exceeds the total cost trend for every tier.

FIGURE 3: YEAR 2 OF DEFINED CONTRIBUTION (5% TREND ON TOTAL COST)

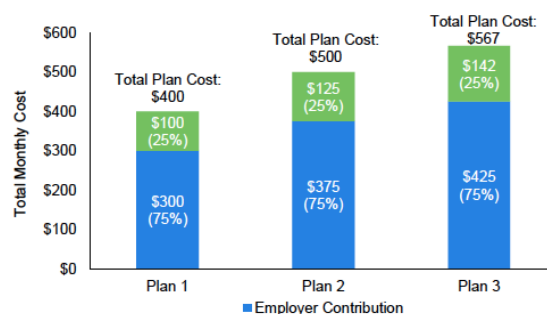
Plan Option	Tier	Total Monthly Cost	Employer Contribution	Employee Contribution	ER Trend	EE Trend
Plan 1	Single	\$420	\$300	\$120	0%	20%
Plan 1	EE + Sp	\$882	\$400	\$482	0%	10%
Plan 1	EE +Child(ren)	\$714	\$400	\$314	0%	12%
Plan 1	Family	\$1,260	\$500	\$760	0%	9%
Plan 2	Single	\$525	\$300	\$225	0%	13%
Plan 2	EE + Sp	\$1,103	\$400	\$703	0%	8%
Plan 2	EE +Child(ren)	\$893	\$400	\$493	0%	9%
Plan 2	Family	\$1,575	\$500	\$1,075	0%	8%
Plan 3	Single	\$595	\$300	\$295	0%	11%
Plan 3	EE + Sp	\$1,250	\$400	\$850	0%	8%
Plan 3	EE +Child(ren)	\$1,012	\$400	\$612	0%	9%
Plan 3	Family	\$1,785	\$500	\$1,285	0%	7%

The disadvantages to the defined contribution approach often lead employers to increase the employee contributions by a fixed percentage upon renewal. Over time, this approach distorts the defined contribution amount and creates a structure that is no longer well defined. This distortion can lead to misperceptions of value to employees. It also creates misunderstandings regarding the goals of the benefit plans among management when contribution approaches are not viewed with historical context.

DEFINED PERCENTAGE

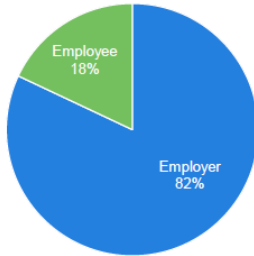
Another common approach to employee contributions is a defined percentage. In this structure, the employer opts to pay a fixed percentage toward the employee's total premium, regardless of the plan chosen by the employee.

FIGURE 4: DEFINED PERCENTAGE EXAMPLE



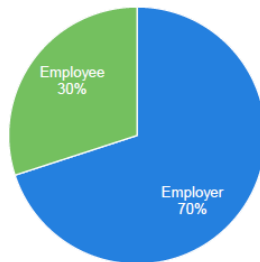
The defined percentage approach will often use a different percentage for the employer share for dependent costs.

FIGURE 5: AVERAGE EMPLOYER CONTRIBUTION PERCENTAGE – SINGLE TIER



SOURCE: KFF Employer Health Benefits Survey, 2019

FIGURE 6: AVERAGE EMPLOYER CONTRIBUTION PERCENTAGE – FAMILY TIER



SOURCE: KFF Employer Health Benefits Survey, 2019

Advantages of defined percentage approach

The advantages to the defined percentage approach make it the preferred structure for many firms.

1. Creates a proportional “partnership” between employees and employer that is maintained over time with trend changes. This is because any percentage increases to the total cost will be the same percentage increase to the employer and employee share.
2. Provides ease of communication to participants.

Disadvantages of defined percentage approach

1. Can create steerage concerns and potential adverse selection.
2. Poses equitability concerns among employees who select different plans.
3. Cost forecasting is dependent upon medical trend.

Other considerations

DISABILITY

Employers will often create reduced premium structures for participants who become disabled. Some employers offer a full medical premium waiver for some portion of the duration of the disability. Estimates of these costs should be carefully considered before implementing this type of benefit. While disability rates for many industries are low frequency, the high cost for a long-term medical premium waiver can still create large liabilities to the plan.

RETIREES

Employers offering medical benefits to retirees is becoming increasingly rare. In 2019, only 28% of large firms that offer health benefits were offering some form of health benefits to retirees.³ Alternative solutions to retiree medical coverage, such as employer-funded health reimbursement arrangements (HRAs) in lieu of medical benefits, may remove the need for employers to develop contribution strategies for this population. In order to avoid the long-term medical trend risk, an increasing number of employers are no longer providing coverage to retirees, but dollars or credits that can be used to purchase medical coverage.⁴

Pre-65 retirees

Pre-65 retiree costs per enrollee far outpace those of their active counterparts. This should be taken into consideration when a group includes retirees. If the pre-65 retiree experience is pooled with the active experience, a determination will be made by the insurer or self-insured employer whether the extra costs will be reflected in separate active and pre-65 premiums. If the active and pre-65 premiums are pooled together, there is an implicit subsidy to the retired population borne by the active population.

Insurers usually vary premiums by coverage tier and plan. Similarly, insurers or plan sponsors will

often reflect the additional retiree costs when setting those premiums.

This approach allows for the insurer or plan sponsor to more closely reflect actual claims experience.

The employer ultimately determines how its population is exposed to the rates via the contributions it sets.

Post-65 retirees

If an employer opts to offer post-65 coverage under the active plans, then an insurer or plan sponsor will need to determine whether the rates will reflect coordination of benefits with Medicare coverage. Care should be taken that any type of rate adjustment due to coordination of benefits for a post-65 enrollee requires confirmation of Medicare enrollment.

When an employer sets the contributions for retirees they will need to consider:

- **Retiree agreements in place:** Retiree contributions may need to be set in accordance with any contractual retiree labor agreements in place. These agreements will need to be reviewed over time to make sure they reflect the current healthcare environment.
- **Purpose of the plan:** Contributions should align with the purpose of the plan. If the purpose is to encourage early retirement, modest retiree contributions may be appropriate.
- **Anticipated future of the plan:** If the plan is expected to be terminated in the near future, it may be appropriate to steer people out of it.

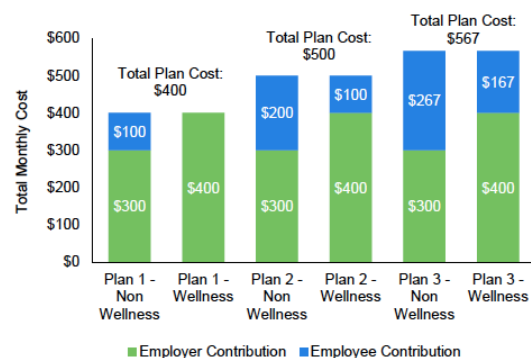
WELLNESS

Oftentimes, a healthcare benefit is accompanied by a wellness program. Employers seek to improve productivity and reduce absenteeism and medical claims among their workforces through the use of wellness programs.⁵

An employer may use a reduced employee contribution schedule as an incentive for participation in a wellness program. Should the employer decide to provide the incentive via reduced employee contributions, consideration must be given to how this affects the overall contribution strategy.

Figure 7 builds upon the example in Figure 1 above but illustrates the addition of a wellness incentive. Each plan now has two sets of employee contribution options—one for those who participate in the wellness program and one for those who decline to participate.

FIGURE 7: DEFINED CONTRIBUTION EXAMPLE WITH WELLNESS INCENTIVE



Employer control of employee rates

Ultimately the employer controls the rates that are charged to its employees. If an employer's medical benefit portfolio is composed of fully insured plans or a combination of self-insured and fully insured benefit options, the employer can determine what costs will be passed along to its employees.

For a variety of reasons, the tier or plan factors an employer chooses to use in the employee rate subsidization may differ from those used in the insurer's quoted premiums. We present two examples where an employer may want to charge out premiums differently to its population.

EXAMPLE A

In this example, an employer offers two HMO options along with a PPO option. Each plan is fully insured. The employer has a strong preference for its employees to use the HMO options in an attempt to capture network savings, but has opted to also offer a PPO option to enhance its medical benefit portfolio.

The employer has traditionally used a defined contribution approach, but now chooses to use an employee contribution strategy that will steer employees toward the HMO options.

Figure 8 outlines the insurer's premiums, the traditional defined contributions, and the employer's elected contribution strategy for a single tier.

FIGURE 8: EMPLOYER CONTROL SCENARIO (SINGLE TIER ONLY)

Plan	Monthly Premium	Defined Contribution Approach		Alternative Contribution Approach	
		Employer Cost	Employee Contribution	Employer Cost	Employee Contribution
PPO	\$550	\$300	\$250	\$200	\$350
HMO 1	\$425	\$300	\$125	\$300	\$125
HMO 2	\$450	\$300	\$150	\$300	\$150

In these situations some employees will still opt for the less subsidized option due to network preference or perceived value differences, but the employer can use the employee contributions to steer employees to a preferred plan or protect itself against potential cost shifts that it believes are not accounted for in the insurer rate factors.

EXAMPLE B

This example illustrates how an employer can choose to allow its active population to subsidize its retiree population even if the insurer has rated the groups separately. Figures 9 and 10 illustrate the charges to active and retired participants under a traditional defined contribution approach with a defined contribution amount of \$300.

FIGURE 9: TRADITIONAL ACTIVE CONTRIBUTIONS (SINGLE TIER ONLY)

Plan	Monthly Premium	Active Employee Enrollment	Employer Cost	Employee Contribution
Plan 1	\$400	8	\$300	\$100
Plan 2	\$500	6	\$300	\$200
Plan 3	\$567	17	\$300	\$267

FIGURE 10: TRADITIONAL RETIREE CONTRIBUTIONS (SINGLE TIER ONLY)

Plan	Monthly Premium	Retiree Enrollment	Employer Cost	Retiree Contribution
Plan 1	\$580	0	\$300	\$280
Plan 2	\$725	2	\$300	\$425
Plan 3	\$822	1	\$300	\$522

Total Monthly Premium: \$18,111

Total Monthly Employer Cost: \$10,200

The employer has decided that it would prefer to shield its retirees from the larger rates, so it designs a contribution strategy with equivalent active and retiree rates. Based on its enrollment, it redistributes the total premium across the population. Because the total monthly premium is \$18,111 based on its current enrollment, it redistributes the premium as shown in Figures 11 and 12.

FIGURE 11: ALTERNATIVE ACTIVE CONTRIBUTIONS (SINGLE TIER ONLY)

Plan	Monthly Premium	Active Employee Enrollment	Employer Cost	Employee Contribution
Plan 1	\$400	8	\$279	\$121
Plan 2	\$500	6	\$279	\$221
Plan 3	\$567	17	\$279	\$288

FIGURE 12: ALTERNATIVE RETIREE CONTRIBUTIONS (SINGLE TIER ONLY)

Plan	Monthly Premium	Retiree Enrollment	Employer Cost	Retiree Contribution
Plan 1	\$580	0	\$459	\$121
Plan 2	\$725	2	\$504	\$221
Plan 3	\$822	1	\$534	\$288

This approach allows the employer to adopt its preference of charging employees and retirees similar amounts without adjusting how much premium it pays to the insurer, despite the insurer billing premiums reflecting cost differences between the active and retired groups.

Conclusions

Contributions charged to employees and retirees are an important aspect of an employer's health and welfare benefit strategy. Through its selected employee contribution approach, an employer can help control health and welfare costs, increase competitiveness and retention among potential and existing employees, and meet government compliance requirements.

Often the employee contribution approach adopted by an employer evolves over time. Strategic planning can help an employer maximize the value of its health benefit offerings, thus providing attractive employee benefits while meeting the company's goals in offering medical coverage.

Caveats

The results presented here are based on common employee benefit strategies. Employers engage in a wide variety of employee contribution strategies for their medically covered populations. The strategy employed by any particular employer may vary substantially from those presented here. All of the examples used in this paper are hypothetical examples based on approaches that the authors have encountered in consulting employer clients with regard to employee contribution strategies.

Les Kartchner is a member of the American Academy of Actuaries and meets its qualification requirements to issue this report.

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Endnotes

- ¹ Berchick, E.R., Barnett, J.C., & Upton, R.D. (November 2019). Health Insurance Coverage in the United States: 2018. U.S. Census Bureau. Retrieved April 15, 2020, from <https://www.census.gov/content/dam/Census/library/publications/2019/demo/p60-267.pdf>. See Table 1 on page 3. Employment-based is 55.4% out of the 67.7% that represents all private plans.
- ² Kaiser Family Foundation (September 25, 2019). 2019 Employer Health Benefits Survey. Retrieved April 15, 2020, from <https://www.kff.org/health-costs/report/2019-employer-health-benefits-survey/>.
- ³ Kaiser Family Foundation (September 25, 2019). 2019 Employer Health Benefits Survey. Retrieved April 15, 2020, from <https://www.kff.org/report-section/ehbs-2019-section-11-retiree-health-benefits/>.
- ⁴ Ehrhardt, J.W. (May 1, 2006). Demystifying the Hybrid Pension Plan. Retrieved April 15, 2020, from <https://us.milliman.com/en/Insight/demystifying-the-hybrid-pension-plan>.
- ⁵ Baveja, L. et al. (January 6, 2020). How to Implement a Wellness Programme. Milliman Report. Retrieved April 15, 2020, from <https://www.milliman.com/en/Insight/how-to-implement-a-wellness-programme>.

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