

# THE STATE OF CONSUMER-DRIVEN HEALTH PLANS

A Workscope White Paper

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Employer-provided health care coverage has arrived at a crossroads much the way retirement planning changed course with the advent of 401(k) plans. Corporate America is shifting away from a paternalistic health benefit system and toward a defined-contribution approach in which benefits are made available as part of a partnership between employer and employee. Consumer Driven Health Plans (CDHPs) stand at the center of this movement, with technology-based employee facing solutions expected to enable CDHPs to have a significant effect on reducing health care costs, improving the overall health care system's operational efficiencies, and promoting employee health. In the pages that follow, we will examine the basics behind this exciting new concept, the reasons for offering a CDHP, and implementation challenges. Finally, we will suggest a few initial steps for organizations that are interested in learning more about CDHPs.

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## WHAT ARE CDHPS AND HOW DO THEY WORK?

The prevailing theme behind CDHPs is that overall health care costs will be reduced when employees act more as smart “consumers” of health care and less like passive recipients of a benefit program. Designed to reduce costs by combining high-deductible health insurance with an employee-controlled spending account, these plans empower employees to be more engaged in all aspects of their health care on a day-to-day basis.

Components of a Consumer Driven Health Plan can include:

- Health Reimbursement Accounts (HRA)—Employer-funded accounts that employees can use to pay out-of-pocket health expenses. Unlike an FSA (Flexible Spending Account), unused money can be rolled over at the end of the year. Employees cannot contribute and accounts are not transferable between employers.
- Health Savings Accounts (HSA)—Accounts that allow both employees and their employers to contribute tax-free money for health expenses. HSAs must be offered with an HDHP (High Deductible Health Plan). HSA funds can be rolled over, but unlike an HRA, the funds are portable to another employer or into retirement.
- Flexible Spending Accounts (FSA)—An account contributed to by employees, pre-tax, for out-of-pocket medical, dental, and child care expenses. Funds in an FSA do not roll over at the end of the year. FSAs, also known as “Section 125” plans, have been in place since 1978, but according to the US Chamber of Commerce, only 40% of eligible employees participate.

In June 2002, the U.S. Treasury Department and Internal Revenue Service paved the way for pre-tax savings from HRAs to pay routine medical expenses from employer-financed accounts and roll over unused balances year to year. Employers typically earmark \$1,000 in annual contributions or credits for the first round of medical expense reimbursements.

Employees who deplete their employer-funded HRAs are usually responsible for an out-of-pocket expense—called a “bridge” amount—before their annual deductible is met. At this point, traditional health insurance covers subsequent costs with employers usually picking up 80% of the tab capped at \$4,000.

Health Savings Accounts (HSAs), whose interest-bearing funds also can be carried forward each year, allow the co-mingling of employer and employee contributions on a pre-tax basis. Another key difference between HRAs and HSAs is that HSAs are fully portable in the event that an individual changes jobs or retires. Upon the individual's death, unused balances can be bequeathed to a surviving spouse. Under the Medicare Prescription Drug Improvement and Modernization Act of 2003, HSAs can be established only in conjunction with a high-deductible plan that's at least \$1,000 for individual coverage and \$2,000 for families. Out-of-pocket costs are typically capped at \$5,000 for individuals and \$10,000 for families.

*"Portability: The median length of service with an employer in 2000 among employees ages 35 to 39 was 4.8 years for men and 3.7 years for women, according to the U.S. Department of Labor's Bureau of Labor Statistics. The portability feature of HSAs will be a significant factor in employee acceptance and willingness to contribute."*

Workspan, May 2004

CDHPs are usually offered as an alternative to a traditional PPO or HMO plan. Often an organization adds new employee services, such as employee wellness coaching and disease management counseling, when introducing CDHPs. Employees need to feel that they are responsible for their own health care and they will gain financially from better management of their health. The overall goal for the employer and the workforce is to have healthier employees, which reduces the total health care spending and, therefore, lowers health care premiums.

The first CDHP enrollments were with start-ups such as Definity Health Corp. and Lumenos, whereas today mainstream carriers such as Aetna, Humana, United Healthcare, and CIGNA are offering such options in a roughly \$3 billion market. More than 3 million people were expected to enroll in CDHPs at the start of 2005. Key plan sponsors include BASF, Intel, Pitney Bowes, Textron, Owens Corning, Pharmacia, and the U.S. Government.

## WHY SHOULD EMPLOYERS CARE?

All major corporations have dealt with the spiraling cost of health care in recent years—unable to escape high medical inflation and several consecutive years of double-digit annual health insurance cost increases. The crisis is so bad that 92% of employers responding to a 2004 Towers Perrin survey say senior managers now view health care costs as a serious business issue that must be addressed. A growing body of research suggests that CDHPs generally lower an employer's health care tab, containing annual cost hikes to single digits if not an outright reduction in cost.

*"CDHP could reduce the average worker's medical care 5-10% over the long term."*

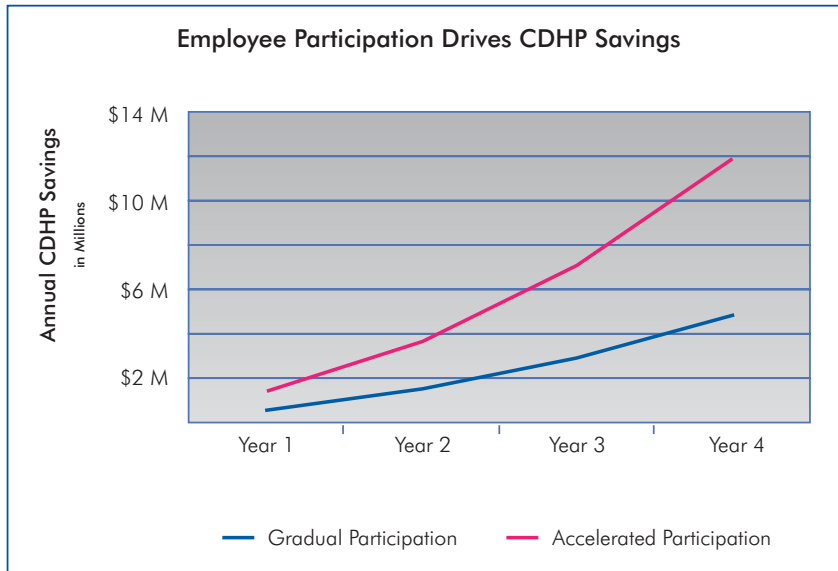
Kenneth Thorpe, economist, Emory University

While earmarking a set dollar amount each year for every employee's HRA and offering a high-deductible plan will make employer costs more predictable, the only way to significantly reduce health insurance premiums is to change the behavior of employees who have thus far lacked the financial incentive to choose care more wisely. With CDHPs, employees have a financial incentive to shop for their providers and prescriptions versus just accepting the initial recommendation and paying the co-pay. Employees may think twice about getting an MRI when an X-ray may be sufficient or purchasing brand-name drugs instead of less costly generics that may be just as effective.

For the employee, participation in a CDHP goes beyond simply signing up for the plan during open enrollment. Employees need to be engaged in the management of their own health on an ongoing basis and the employer needs to help the employee by making the proper resources readily available. In many cases, employers have special resources for those with high cost illnesses. Plan enrollees can leverage the expert advice of health care coaches who help them use diet and exercise to reduce the effect of leading chronic illnesses such as heart disease, hypertension, diabetes, asthma, and depression.

Expectations for CDHPs surely are running high. About \$88 billion of premium-equivalent dollars are expected to flow through the CDHP model by 2007, according to a Forrester Research study released in October 2003. In addition, The Segal Co. forecasts that 32 million Americans, or 20% of those insured by employers, will choose CDHPs during the next five years. But make no mistake about CDHP: It is not the holy grail of health care cost savings for employers, nor should employee benefit managers delude themselves into thinking that embracing this approach will automatically cut costs. It's important to manage expectations. The old adage, "knowledge is power", applies to CDHPs and employees need to know the value of preventive care as well as their medical history so that they can take meaningful action to break negative patterns. The proposition takes on tremendous importance considering health experts estimate that 75% of health claims can be traced to lifestyle.

Employers need to put employees in charge of their own health care and health care finances. The ability to carry over HRA and HSA funds from one year to the next provides employees a powerful incentive to budget more carefully for annual health care expenses. Having access to these corporate contributions will help employees have a more favorable perception that they're part of a partnership approach rather than paying for everything out-of-pocket.



Employee Participation drives CDHP savings. As an example, these are the potential cost savings for a 10,000-employee company

**Assumptions:**

- Company has 10,000 enrolled employees
- Baseline costs for health benefits is \$8,000 per employee per year
- Employer/employee split insurance premium 80/20
- Costs increase at 12%/year without CDHP
- Costs increase at 6%/year for employees with CDHP
- This model does not include effect of tax savings for employer or employee

**Results:**

	Base Year	Year 1	Year 2	Year 3	Year 4
<b>No CDHP</b>					
Employer Health Benefit Cost	\$64,000,000	\$71,680,000	\$80,281,600	\$89,915,392	\$100,705,239
Employee Health Benefit Cost	\$16,000,000	\$17,920,000	\$20,070,400	\$22,478,848	\$25,176,310
<b>CDHP Gradual Participation</b>					
Participation rate		15%	20%	25%	30%
Employer Health Benefit Cost	\$64,000,000	\$71,104,000	\$78,783,232	\$87,055,471	\$95,935,129
Employer Savings		\$576,000	\$1,498,368	\$2,859,921	\$4,770,110
<b>CDHP Accelerated Participation</b>					
Participation rate		35%	50%	65%	80%
Employer Health Benefit Cost	\$64,000,000	\$70,336,000	\$76,666,240	\$82,876,205	\$88,843,292
Employer Savings		\$1,344,000	\$3,615,360	\$7,039,187	\$11,861,947
<b>Financial benefit of accelerating CDHP participation</b>		\$768,000	\$2,116,992	\$4,179,266	\$7,091,837
<b>Cumulative financial benefit</b>		\$768,000	\$2,884,992	\$7,064,258	\$14,156,095

## IMPLEMENTATION CHALLENGES

While CDHPs have significant potential to lower health care costs, several obstacles stand in the way of successful CDHP implementation. The primary challenge is to overcome employees' reluctance to change. HR must educate employees on the benefits of the CDHP, provide the decision support tools they need to confidently select the CDHP, and change the corporate culture with respect to health care. The important areas are:

- **Communication**—Communication efforts should begin at least three months before enrollment so that employee populations have ample time to absorb all this new information. Placing CDHPs in a larger context by casting a bright light on market forces and high medical inflation will bolster employees' understanding of the new offering. It also helps to arm employees with newspaper or magazine articles on CDHPs and to distribute these materials to employees via mail or email.

One way to heighten understanding in communication campaigns is to make relevant analogies. For example, CDHPs can be compared to buying automobile insurance in that accepting a higher deductible will result in a lower premium—thus providing an incentive to drive safely in order to avoid higher costs. Since CDHPs can only be offered alongside high deductibles, the comparison is a natural.

As with any HR-to-employee communication campaign, a coordinated multi-channel approach works best: posters, intranet, email, employee briefings, etc. The theme should not be just a new health plan being available but an initiative aimed at creating a healthier workforce with the employees sharing in the financial rewards of lower health insurance premiums.

- **Decision Support**—Achieving a high level of employee participation in CDHPs requires a level of decision support beyond that of HMOs and PPOs. A Web page that gives a side-by-side comparison of the plans is a good start, but employees will need more to be able to confidently choose the CDHP option. An online medical-cost calculator is needed to help each employee compare the health plan options based on their specific personal situation: family size, health status, history of provider usage, prescription usage, etc. A fairly simple interface is needed with pull-down menus that estimate typical premium, deductible, and co-pay costs—enabling consumers to conduct what-if scenarios.

Medical Cost Calculator

Below is a list of commonly used medical services, with an average cost estimate for each (actual cost of the service may vary).

For each person to be covered by the plan

- Indicate the estimated number of times each service will be used in the plan year.
- To see a definition of the service, click on the term.
- To reset the form to all "0's", click the **Clear** button.
- When you are finished estimating usage, click the **Next** button to see a plan comparison of costs.

Type of Medical Service	Estimated 2006 Cost Per Medical Service	2006 Estimated Usage Per Person			Estimated Subtotal (Usage times Cost)
		Self	Spouse	Child 1	
<a href="#">Routine physical exam</a>	\$80	1	1	2	= \$ 320
<a href="#">Office visit for established patient</a>	\$60	0	0	0	= \$ 0
<a href="#">Specialist visit</a>	\$125	0	0	1	= \$ 125
<a href="#">In-patient hospitalization</a>	\$7800	0	0	0	= \$ 0
<a href="#">Outpatient surgery</a>	\$375	0	1	0	= \$ 375
<a href="#">Emergency room visit</a>	\$285	0	0	0	= \$ 0
<a href="#">Retail prescription drug (brand)</a>	\$66	3	0	0	= \$ 198
<a href="#">Retail prescription drug (generic)</a>	\$24	0	2	2	= \$ 96
<b>Estimated Cost of Medical Services</b>					<b>= \$ 1114</b>

Clear Next

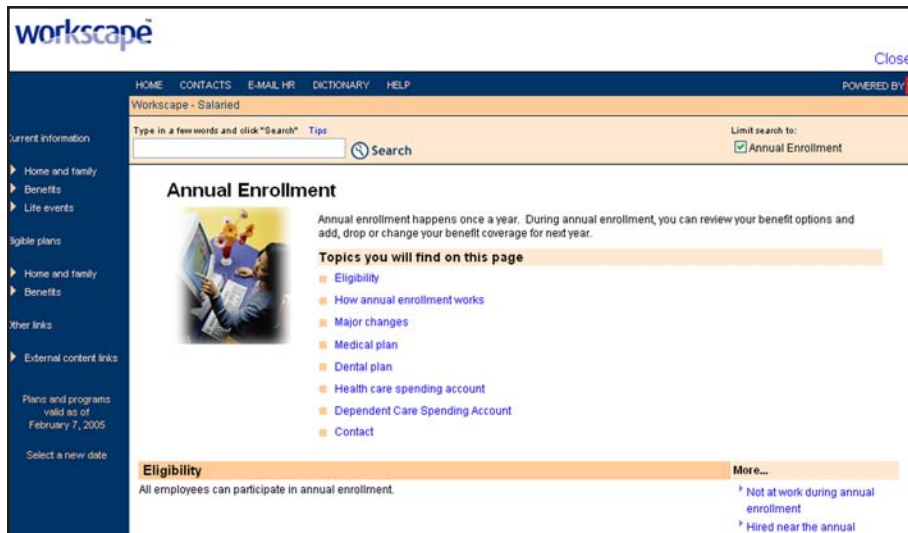
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Example of an online medical-cost calculator.

As they consider CDHPs, employees and dependents need access to a knowledgebase, preferably one embedded in the enrollment system, that provides information on the plans, the enrollment process, terminology definitions, treatment alternatives, etc. Employees will also need information on the cost and quality of health care providers: patient satisfaction, readmission rates, complication rates, waiting times, etc. These helpful resources play a huge role in improving quality care if employees are comfortable with the information they receive and apply the knowledge they acquire.

Along with an online enrollment system and a knowledgebase, employees should be able to email or call an HR service center representative who can instantly call up the same screen the employee sees and answer questions on the spot or walk employees through the rest of their enrollment. These specialists are trained to spot common pitfalls so that they can help people troubleshoot their way through enrollment and generally provide the personalized attention the employee needs to make informed decisions. The bottom line is that combining a Web-based interface with human assistance can increase CDHP participation rates, while offering employers reduced administration costs and continuous quality improvement throughout the enrollment process.



A knowledgebase provides employees with information on the plans, the enrollment process, terminology definitions, treatment alternatives, and more.

- **Culture**—For many organizations, the biggest challenge will be to institute a fundamental change in corporate culture built around getting employees to take more responsibility for their health care habits and spending. The offering of a CDHP is only one part of cultural change. For example, one large casino operator has blazed a path to innovation by providing a free daily lunch in the corporate cafeteria to employees who eat healthy fare while charging those who select unhealthy meals. The same company also offers employees a monetary incentive to lose weight—a program that many others have started to implement as the nation’s obesity epidemic worsens.

Any financial incentive that reduces the employee’s out-of-pocket costs helps to keep employee populations engaged in the process and motivated to improve their health. Moreover, the rollovers of unused dollars from HRAs and HSAs will help seal their interest in long-term participation and better prepare them for financing post-retirement medical expenses.

*“62% of employers offering CDHPs have a less than 20% employee participation rate.”*

Deloitte Survey, April 2004



Another CDHP challenge is making the concept more responsive to the needs of employees and dependents that suffer from chronic diseases and run the risk of depleting their HRA allowances in a matter of weeks or months. In some cases, it may not make sense for certain individuals to enroll in CDHPs given their health status. But for all others, employers will need to step up campaigns to educate and motivate this segment of the population to help achieve meaningful results.

The key to unlocking their involvement may be creative plan design. For example, employers can create a separate prescription drug tier just for this population to help ensure that diabetics, asthmatics, and others suffering from a host of chronic illnesses take their medication and refill prescriptions. Similarly, co-pays can be tied to behavior so that those who follow a doctor's orders or listen to their disease management "coach" pay less for refills while those who are in non-compliance pay higher costs. These steps will go a long way toward helping people suffering from chronic diseases take more responsibility for their health care and better manage their condition.

*"Whether offering a CDHP as an option or as total replacement for existing health plans, the initial key to success is educating employees on how the model works and how members benefit through CDHPs. Ultimately, long-term success hinges on the employees' willingness to modify behavior. We believe the use of positive incentives for employee motivation is very important."*

Jay Power, hr consultant, benefitsContinuum

For CDHP program administrators, the data collected by an automated enrollment system and employee surveys helps significantly in measuring the effectiveness of CDHP initiatives—knowing, for instance, how many employees and dependents have signed up for CDHPs, are considering the plans, or are switching their options. Business intelligence or analytics will allow employers to get these reports to the right people at just the right time, serving as a tremendous opportunity for HR professionals to show how CDHPs can save the company money and improve employee satisfaction about their CDHP enrollment and health care purchasing experience.

## GETTING STARTED

Now that we've covered the basics behind CDHPs, what is the next step for employers that are interested in learning more about this concept? It is important to lay the groundwork for a cost-benefit analysis by conducting an internal audit of the true cost of providing and administering company-provided health benefits. Only then will the organization be able to determine how offering a CDHP option to its workforce can reduce costs.

It's also important to leverage the many valuable resources in the marketplace in order to benchmark CDHPs against emerging industry standards. Employers should offer a broad array of plan options that tailor benefits coverage to employee populations. While early adopters of CDHPs built networks around referral-free PPOs, newer designs include open-access point-of-service plans and exclusive provider organizations as well as integrated pharmacy and dental plans. Having access to a broad, national provider network will help employers negotiate favorable pricing and maximize freedom of choice.

*"The combination of three key factors—four consecutive years of double-digit rate hikes for health coverage, the IRS' 2002 landmark ruling regarding the tax treatment of employer-funded HRAs, and the HSA provision of last year's Medicare reform law—have contributed to what can best be described as a "perfect storm" in the health care industry. That environment has created a tidal wave of interest in these account-based plans."*

Steve Davis, editor, Inside Consumer-Directed Care. ([www.aishealth.com](http://www.aishealth.com))

In the end, a CDHP has to lower the health care costs for both the employer and the employee. The cost reduction comes as much from employees managing their health care as it does from their acting as educated consumers of health care services. CDHPs should be thought of as a cornerstone in a new type of employer/employee health care relationship. As with most significant changes, CDHPs require a few years of dedicated implementation to show their complete value.

## ADDITIONAL RESOURCES:

- HSA Insider: [www.hsainsider.com](http://www.hsainsider.com)
- National Association of Health Underwriters: <http://www.nahu.org/consumer/HSAGuide.htm>
- National Center for Policy Analysis: [http://cdhc.ncpa.org/issues/Need\\_for\\_CDHC](http://cdhc.ncpa.org/issues/Need_for_CDHC)
- Health Care Financing & Organization: <http://www.hcfo.net>
- America's Health Insurance Plans (AHIP): [www.hsadecisions.org](http://www.hsadecisions.org)

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