

Defined Contribution: Overview and Resources

To open the new year, we present an overview of defined contribution, a marketplace phenomenon garnering a good deal of attention. Defined contribution is a new approach to employer-based health insurance coverage that could change in major ways the roles and relationships among consumers, health plans, purchasers and providers.

For several decades we have grown accustomed to a health care financing system in which employers purchase and help administer insurance on behalf of their employees, and employees select from the limited number of plans offered by their employers. Defined contribution shifts the dynamic: while employers continue to contribute their share of the costs, employees now assume more of the decision-making as to plan, benefits, and level of expenditure. The model for this arrangement is the 401(k) pension, in which employees are given a fixed amount of money, a series of investment options, and the flexibility to manage their own retirement portfolios.

Defined contribution is one manifestation of the consumerism that we see in many sectors of our society. It stems from the notion that increasing flexibility and choice also increases buyer satisfaction. But to be most effective it requires educated consumers. People need good information in order to choose wisely to meet their specific needs and desires. As they compare and evaluate their options, consumers will learn more about health care and the relationships and trade-offs between price, choice and access-issues that managed care has introduced to the marketplace. With a clearer sense of the financial implications,

many consumers may be more accepting of cost control tools and techniques such as formularies, referral management and practice guidelines.

Employer Issues

Why would employers consider defined contribution plans? One key impetus is their frustration with the current system and the rising costs of insurance; employers are looking for alternatives that might save them money over time. A related reason is to relieve themselves of the administrative hassles and expenses of managing benefits and dealing with health plans. They may view this as a way of offering more choices of health plans to their employees. The success of pension plans provides a precedent for shifting control to employees. The precise level of employers' interest in defined contribution plans is difficult to measure, as different surveys have yielded different findings. But expert observers expect the approach to take hold over the next few years.

Implementation Models

There are various models of how defined contribution would work in practice. At one end of the spectrum is a pure individual, nongroup market model, where employees are given money and left to their own devices to find insurance. Moving along the spectrum, there are models where employees are given a menu of choices assembled by the employer or an intermediary broker. These choices could include several benefit packages from a small number of health plans, such as closed-panel HMO or PPO products, high premium / low deductible packages or the reverse, and catastrophic care or comprehensive care. The goal here is to allow the enrollee to customize

his or her individual or family coverage, based on personalized considerations of value, quality and price. This system has much in common with the "managed competition" model advocated in the 1980s and 1990s as a way of controlling health care costs.

In all descriptions of defined contribution, the internet plays an important role. Through the web, employees will access information about their options, make their choices, administer their benefits, and monitor their spending. Companies that can manage these e-commerce functions will emerge as a new player in the health care financing system.

Obstacles and Challenges

There are a number of outstanding questions and concerns that will impact the development of defined contribution. One major issue is how regulations and tax laws now governing employer-based coverage would apply to this new system in which individuals are in effect given money instead of benefits; will employers and employees have the same tax advantages under defined contribution plans as they currently have under defined benefit plans? Another concern is the complexity of the information requirements and how to make the system work for consumers; compared to pension plans and their investment options, health insurance coverage has many more variables, such as provider panels, benefit options, needs of family members, and quality data.

Perhaps the most fundamental concern has to do with risk pools and adverse selection. As individuals are free to construct their own benefit packages based on their self-perceived needs, healthy individuals are likely to select the least expensive, highest deductible plans. This conflicts with the needs of insurance underwriters for a balance of sick and healthy enrollees to make the plan financially viable.

Suggested solutions include the use of purchasing pools, regulatory changes, or keeping the employer as the risk pool entity.

Provider Implications

What will defined contribution mean for physicians, hospitals and other providers? The prevailing wisdom is that the choices that individuals make regarding how they spend their contribution will include not only insurer and benefits, but also physicians and hospitals. While managed care enrollees now select their personal physician primarily from printed lists, in the future they will be provided much more detailed profile information online at their designated website. Employees are likely to be very quality-conscious, and they will consider provider-related items such as convenient locations, short waiting times, attractive facilities, adequate face-to-face physician time, reasonable charges, access to educational information, and physician's internet access. Physicians will need to adapt to this increasingly competitive marketplace.

A related dramatic development for both providers and health plans is the emergence of companies that enable consumers to use their defined contribution to customize their benefits and choose their providers, without enrolling in an established health plan. These new entities seek to sign on providers who constitute their participating panel, but without the involved arrangements and controls imposed by managed care organizations. One example is Vivius Inc. (<http://www.vivius.com/>), which calls itself a "personalized health care system" in which participating physicians, hospitals, and other providers set their own payment rates, and each employee chooses a personal physician, hospital, pharmacy network, medical lab and radiology clinic, and about fifteen specialty physicians, as well as their

own level of co-payment for these providers. Another new company promising to restore physician autonomy and remove external controls, while enabling consumers to exercise greater choice and control, is Definity Health (<http://www.definityhealth.com>).

A year from now, perhaps longer, many Americans may be obtaining their health insurance and arranging their medical services in very different ways than our current practices. Health care professionals will want to follow these developments to make sure they work to the benefit of our patients and enrollees.

Sites providing lists of and links to online reports and articles:

- Defined Care Resource Center and Article Library <http://www.definedcare.com/>
- MyHealthBank, Industry Trends <http://www.myhealthbank.com/>

Selected articles and reports:

- Aquilina D. Will Consumer-Driven E-Health Plans Reward Physicians for Quality? The Quality Indicator Physician Resource. December 2000. <http://www.qiphysician.com/>
- Costello MA. New voucher-type coverage plans make their way into health care scene. AHA News, May 22, 2000. <http://www.ahanews.com/> (Article Archive)
- Jacob J. Defined benefits: multiple choice. American Medical News, May 1, 2000. http://www.ama-assn.org/sci-pubs/amnews/pick_00/bisa0501.htm

- New directions in employer -sponsored health care. Healthcare Business. May 2000. Supplement: Roundtable. <http://www.healthcarebusiness.com/archives/healthcarebusiness/0500/index.html>
- Press C. A future with defined contribution health plans. Health care Forum Journal. November/December 2000;43(6). <http://www.healthforumjournal.com> (Article Archive)
- Reinventing health care benefits: understanding defined contribution models, self-directed health plans and online benefits management. Health care Business. November/December 2000. Supplement: Roundtable. <http://www.healthcarebusiness.com/archives/healthcarebusiness/current/rt-feature.html>
- Roniger LR. Emerging markets: E-benefits: beyond managed care. Health care Business. September 2000. <http://www.healthcarebusiness.com/archives/healthcarebusiness/0900/dept-emerging.html>
- Scandlen G. Defined contribution health insurance. National Center for Policy Analysis. Policy Backgrounder No. 154, October 26, 2000. <http://www.ncpa.org/bg/bg154/bg154.html>