

Background

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Utah's Defined-Contribution Option: Patient-Centered Health Care

Gregg Girvan

Abstract: Americans who receive health insurance through their jobs generally have little flexibility: 86 percent of employers in the country offer only one plan. This system of “defined benefits” has worked well for expanding group coverage, but severely limits options for individuals, and has not kept costs from skyrocketing. Recipients of employer-sponsored health insurance also lose their current coverage when they leave or switch jobs. In Utah, state policymakers have taken a different approach, giving businesses and their workers the option of “defined contribution” health benefits—where participating workers choose coverage from a wide variety of plans offered by competing insurers through Utah’s health insurance exchange. Utah’s state leaders are innovators who are doing precisely what they should be doing—using their authority to resist concentrated power in Washington, and working to provide more and better choices for their citizens.

Serious state health insurance reformers have one thing in common: They must all cope with the limitations, restrictions, and obstacles of federal tax policy.

Federal tax policy treats the value of employer-sponsored health benefits as tax-free income to workers, and has encouraged an almost exclusive dependence of most American workers and their families on employer-sponsored health insurance. But employment-based health care coverage is almost always offered on a “defined benefit” basis—meaning that the employer specifies the package of benefits offered to its workers and determines the share of premiums its

Talking Points

- Federal tax policy treats employer-sponsored health benefits as tax-free income to workers, and has encouraged an almost exclusive dependence of most American workers and their families on employer-sponsored health insurance.
- Employment-based health insurance is almost always offered on a “defined benefit” basis—meaning that the employer determines the benefits available to employees and the premiums they must pay, leaving little or no flexibility in tailoring insurance to meet individual needs.
- The state of Utah has created a defined-contribution option for employer-sponsored health insurance. Under this option, the employer offers workers a tax-free contribution toward the health plan of their choice. Each worker chooses from a menu of plans with different benefits offered by competing insurers through Utah’s health insurance exchange.
- Enabling employers to offer health insurance on a defined-contribution basis creates new paths for more employers to offer coverage and for more workers to obtain the coverage they prefer and can afford.

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(202) 546-4400 • heritage.org

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workers must pay, as well as the schedule of patient co-payments, regardless of the personal preferences of the workers.

While this federal policy has directly contributed to providing health insurance coverage for millions of Americans, its drawbacks are also becoming increasingly clear: little or no personal choice; little or no portability of coverage in a rapidly changing economy where workers are changing jobs and careers; and little or no flexibility in tailoring insurance coverage to meet individual and family needs.

The state of Utah has addressed these issues through its creation of a defined-contribution option for employer-sponsored health insurance administered by a state health insurance exchange. Utah's leaders have become innovators in the crucial area of health insurance market reform.

The Problems with Defined Benefits

Since World War II, the tax policy that promotes “defined benefit” health insurance has worked well in expanding group coverage at the workplace, but over time, its disadvantages have also become increasingly apparent, especially given the higher mobility of the workforce, where job and even career changes have become increasingly common.

Little Choice, No Portability. For many workers, defined benefit means little or no choice of health plans. Employer surveys find that among businesses offering health care coverage to their employees, 86 percent of firms offer only one plan.¹ Workers in those firms are offered health benefits by their employer on a “take it or leave it” basis. Also, because employer-sponsored health insurance—unlike auto, property, or life insurance—is owned by the employer, not the worker, when changing jobs a worker must factor into his decision the coverage offered by prospective employers and any changes in benefits or access to physicians that might result.

Higher Costs and Cost-Shifting. For employers, the inflexibility of defined-benefit insurance means that they are the ones who must deal with the growth in health care costs. Faced with higher costs, a company that offers workers defined-benefit health care coverage has the following options, none of which are optimal: (a) pay the extra costs directly, out of funds that would otherwise be allocated to increased cash wages; (b) require its employees to pay a larger share of the premiums; (c) increase patient co-pays; (d) reduce plan benefits; or (e) discontinue coverage.

Not surprisingly, the expense and hassles associated with offering and administering traditional defined-benefit group health insurance has increasingly become an obstacle to employers—particularly smaller firms—that provide their workers with tax-favored health benefits. Nationally, only 41 percent of private firms with fewer than 50 employees offered their workers health insurance in 2009.²

Patient-Centered vs. Government-Centered Responses

The congressional response to these problems, in its enactment of the massive Patient Protection and Affordable Care Act (PPACA), is to impose new federal regulations and uniform benefit designs on all health insurance plans, along with mandates on employers to offer coverage and on individuals to buy coverage, starting in 2014.

In sharp contrast to the official Washington agenda of increased regulation, standardization, and coercion, the state of Utah is implementing a set of health insurance reforms designed to provide employers and workers with new coverage options and greater choice, competition, and diversity in health insurance plans.

The Defined-Contribution Option. A key component of Utah's health care reform is the creation of a “defined contribution” option for employer-sponsored health insurance. Under this option, the

1. Kaiser Family Foundation and Health Research & Educational Trust, “Employer Health Benefits 2009 Annual Survey,” September 15, 2009, Exhibit 4.1 (“Among Firms Offering Health Benefits, Percentage of Firms that Offer One, Two, or Three or More Plan Types, by Firm Size, 2009”), at <http://ehbs.kff.org/?page=charts&id=2&sn=19&ch=1048> (July 21, 2010).
2. Kaiser Family Foundation, “Percent of Private Sector Establishments that Offer Health Insurance to Employees, by Firm Size, 2009,” StateHealthFacts.org, at <http://www.statehealthfacts.org/comparemaptable.jsp?ind=176&cat=3> (July 14, 2010).

employer offers its workers a tax-free contribution toward the health plan of their choice. Each worker then chooses the coverage he or she prefers from a menu of plans with different benefits offered by competing insurers through Utah's health insurance exchange.³ The state ensures that all plans offered through the exchange qualify as employer-sponsored coverage under state and federal law so that premiums can be paid on a pre-tax basis.

Utah also included other features that complement the defined-contribution option. These include: (1) a "premium aggregator" function that will allow individuals and families to combine contributions from more than one employer; (2) a "risk adjustment" system that is designed and managed by the insurers themselves to compensate for any selection effects that might occur, such as individuals in poorer health choosing certain plans in disproportionate numbers; and (3) paying commissions to brokers for their services helping employers participate in the system and helping workers evaluate competing plans to choose the one that best meets their needs and preferences.

Meeting Utah's Needs. The creation of a defined-contribution option was one of the solutions that Utah developed through a multi-year health reform process involving the state's lawmakers and stakeholders. Those solutions were based on their assessment of the particular needs of individuals and businesses in their state, given Utah's demographics and existing health system.

For example, Utah has a greater share of part-time workers in its labor force than any state except

Minnesota and, relative to other states, an above average share of workers with more than one job.⁴ Utah's workforce is also younger than the national average. Among the adult population, the largest age cohort in Utah consists of those ages 25 to 29, while for the nation as a whole, the largest adult-age cohort are those between the ages of 40 and 45.⁵ While younger workers are generally healthier, they also generally earn less than older, more experienced workers.

Given these demographic factors, it is not surprising that the 2008 Utah Healthcare Access Survey found that, of the state's uninsured population, 45.9 percent are between the ages of 18 and 34.⁶ The survey also found that among uninsured adults 46.3 percent worked full time, another 20.2 percent worked part time, and a further 12.1 percent were non-working spouses.⁷

Utah is also below the national average when it comes to the share of small businesses that offer health coverage to their workers. Only 31.4 percent of Utah firms with 50 or fewer employees offer coverage—a rate lower than that of 41 other states.⁸

Thus, the profile of Utah's uninsured signaled to policymakers a need to focus on providing better options for younger adults, non-traditional workers, and those employed by small businesses. Creating the opportunity for businesses to offer tax-advantaged employee health coverage on a defined-contribution basis is one way of meeting the need.

Advantages of Defined-Contribution. The defined-contribution option makes it easier for businesses to offer health benefits because the busi-

3. For a further discussion of the purpose and functions of a state health insurance exchange, see Robert E. Moffit, "The Rationale for a Statewide Health Insurance Exchange," Heritage Foundation *WebMemo* No. 1230, October 5, 2006, at <http://www.heritage.org/research/healthcare/wm1230.cfm>.
4. Laura Summers, "Is Utah Really a Low-Wage State?" Utah Foundation *Research Brief*, June 5, 2008, at http://www.utahfoundation.org/reports/?page_id=298#_edn2 (July 21, 2010).
5. *Ibid.*
6. Utah Department of Health, Office of Public Health Assessment, "2008 Utah Healthcare Access Survey Overview Tables," December 2009, Table 3a ("Health Insurance: Percentage of Persons with No Health Insurance Coverage, by Selected Demographic Characteristics, Utah Residents, 2008"), at http://health.utah.gov/opha/publications/2008uhas/Overview_State_2008.pdf (July 21, 2010).
7. *Ibid.*
8. Kaiser Family Foundation, "Percent of Private Sector Establishments that Offer Health Insurance to Employees, by Firm Size, 2009."

ness is not required to find and manage the coverage. Thus, by reducing the level of effort and risk to employers in offering health benefits, it creates a path for more firms, particularly smaller ones, to begin offering their workers coverage.

Because each worker can choose the coverage he or she prefers from a wide and varied menu of plans under the defined-contribution option, it also increases the likelihood that younger workers, who generally have lower earnings, will be able to find a plan that they like and can afford.

In addition, the defined-contribution option makes it practical for employers to offer their part-time or seasonal workers prorated coverage contributions, with a reasonable expectation that those workers can then obtain coverage by combining that employer's contribution with funds from other sources.

It should be noted that, unlike the shapers of the federal health care legislation, Utah policymakers have taken care to preserve existing options while creating new alternatives. Thus, Utah employers will still be able to offer traditional defined-benefit coverage if they so choose. Furthermore, unlike Congress and the Administration, Utah lawmakers did not impose any new coverage mandates, and actually reduced coverage requirements in some cases, giving insurers wide latitude to tailor their product offerings to respond to consumer preferences. Nor did Utah—again, in sharp contrast to Congress and the Administration—create any new bureaucracies. Rather, the state contracted with private companies that have expertise in health insurance and employee benefits to develop and operate an Internet-based health insurance exchange funded by nominal user fees.⁹

Indeed, the overarching goal of Utah's health reforms—with respect not only to insurance markets but also to health care providers—is to empower consumers and patients, not government bureaucrats, to be the key decision makers in the new system.

Utah's Experience

In fall 2009, Utah's Office of Consumer Health Services conducted a limited launch of the defined-contribution option and the Utah Health Exchange in order to identify problems before a market-wide rollout. In fewer than eight business days, 136 businesses representing 2,333 employees volunteered to join. Of those 136 businesses, 99 qualified as a small-employer group and met eligibility requirements to continue the enrollment process.¹⁰

At the time of the launch, employees had the choice of 66 plans among three insurance carriers. In a report on the limited launch results, officials stated that, "The most significant issue was the difference in premiums quoted in the defined benefit and defined contribution markets. Approximately 60 percent of the eligible groups that opted out reported the difference in premiums as a contributing factor."¹¹

Officials found that the differences in premium quotes were attributable to how carriers applied the state's existing rating rules to the two market segments. In response, the Utah legislature further clarified insurance-rating rules as part of a package of health reform amendments signed into law by Governor Gary Herbert in March 2010.¹² In general, the legislation requires insurers to use the same risk rating practices in both the defined-contribution and defined-benefit markets, and requires them to treat employers who elect to move from defined-

9. Press release, "BSwift Selected as Technology Provider for Utah Health Exchange," BSwift, July 22, 2009, at http://www.bswift.com/about/news/news_2009-07-23.html (July 21, 2010). The state also contracted with HealthEquity (<http://www.healthequity.com>) to provide the premium aggregation functions, and FirstWest Benefit Solutions (<http://www.fwbs.com>) provided the state with expertise in developing the details of the defined-contribution option.

10. Press release, "Health Exchange Update," Utah Health Exchange, January 12, 2010, at <http://www.exchange.utah.gov/report1.html> (July 21, 2010).

11. *Ibid.*

12. State of Utah, "H.B. 294 Enrolled: Health System Reform Amendments," 2010 General Session, at <http://le.utah.gov/~2010/bills/hbillenr/hb0294.htm> (July 21, 2010).

benefit coverage to defined-contribution coverage as “renewal” business, not “new” business.¹³

As a result of the limited launch, 433 employees have so far received health benefits in the defined-contribution market.¹⁴ With the exchange re-opening enrollment for all Utah small businesses this fall, the number of covered employees is expected to grow quickly into the thousands, with 400 to 500 businesses anticipated to enroll monthly.¹⁵ While Utah’s health reform measures were initially geared to the small-group market, the 2009 reform legislation authorized the extension of the defined-contribution option to large employers beginning in 2012. However, at the request of several of the state’s large employers, Utah officials decided to pilot the defined-contribution option with a group of eight large employers one year earlier than originally anticipated. That pilot program is now underway and when it is ready to enroll employees of the participating firms, it could add as many as 50,000 individuals to the program.

While the defined-contribution option is currently limited to full-time workers, officials anticipate that one of the next steps in their phased rollout will be to allow employers to make defined-contribution coverage available to their part-time employees as well.

Lessons for Other States

Many of the new federal requirements in the Patient Protection and Affordable Care Act of 2010 do not take effect until 2014. Actions in the intervening years by a new Congress or federal courts could result in a very different situation four years from now. The key issue for state lawmakers is whether they will be proactive or passive in the continuing national health care debate.¹⁶ The right

response is to be proactive; that is the best way that state lawmakers can change the facts on the ground on behalf of their citizens, and exercise their rightful constitutional authority. Specifically, state policy-makers should:

- **Assess their State’s Needs.** Every state has a set of factors—including demographics, insurance markets, provider networks, and financing arrangements—that must be considered when developing a health reform strategy. Within each of those factors, any given state will find similarities and differences between it and other states. However, in each state the combination will be unique.

Thus, the first step for lawmakers in any state is to take stock of their state’s particular circumstances as a guide to finding solutions that will be a good fit for their constituents. Where they find similarities, they can learn from the experiences of other states. Where they find differences, they can modify approaches used by other states or develop their own solutions.

- **Provide Real Alternatives.** States looking for ways to counter the threats that Obamacare poses to coverage and choice in their insurance markets should consider Utah’s experience with creating a defined-contribution option. Enabling a state’s employers to offer health insurance on a defined-contribution basis creates new paths for more employers to offer coverage and for more workers to obtain the coverage they prefer and can afford. Defined contribution also frees employers from much of the risk and hassles associated with offering health benefits to their workers, allowing them to focus more on their businesses. Eventually, as enrollment expands,

13. For a further discussion, see Edmund F. Haislmaier, “State Health Care Reform: An Update on Utah’s Reform,” Heritage Foundation *Background* No. 2399, April 9, 2010, at <http://www.heritage.org/Research/Reports/2010/04/State-Health-Care-Reform-An-Update-on-Utahs-Reform>.

14. Press release, “Health Exchange Update.”

15. *Ibid.*

16. To be sure, there are profound constitutional issues at stake in the national health care debate, including the future of federalism itself. For a more detailed discussion of these challenges, see Robert E. Moffit, “Revitalizing Federalism: The High Road Back to Health Care Independence,” Heritage Foundation *Background* No. 2432, June 30, 2010, at <http://www.heritage.org/research/reports/2010/06/revitalizing-federalism-the-high-road-back-to-health-care-independence>.

the defined contribution option also offers the possibility that more and more workers will be able to keep their preferred health plan when changing jobs. In addition, Utah's reforms were designed to allow insurance carriers—both existing and new—to compete on a level playing field driven by consumer demand.

- **Take the Initiative.** Faced with the federal government's impending moves to limit insurance competition and coverage choices, states should instead quickly enact health reforms that counter that threat by expanding health insurance choices and coverage options for their citizens and businesses. Considering a defined-contribution option for employer-sponsored coverage that offers a robust variety of plan designs and benefit packages is a good place to start.

Conclusion

Utah is an innovator in health insurance market reform. Utah also demonstrates that state lawmakers with vision, skill, and the political will to effect consequential change can make a real difference in the lives of their citizens. Moreover, Utah's initiatives validate the premise of the founders of the American republic. The states can and should be laboratories of democracy, the mainspring of imaginative social and economic policies. But they can also serve another important function that the founders explicitly intended—to be a source of institutional resistance against the concentration of power in Washington, and true guardians of their citizens' liberty.

—*Gregg Girvan is a Graduate Health Policy Fellow in the Center for Health Policy Studies at The Heritage Foundation.*