

Defined Benefit vs. Defined Contributions

A smart new way to look at health insurance for small business.

It's not your father's employer group health plan anymore.

Healthcare reform is driving a whole new way to handle health insurance for small business under 50 employees. Here-to-fore, owners of small business might not offer health insurance or they faced outlandishly high rates because of medical risk over a limited number of employees and because of guaranteed issue despite the employee's and spouses health history. Now with the opening of guaranteed issue health insurance exchanges, employers can offer a Defined Contribution Health Plan instead of a Defined Benefit Health Plan.

Defined Benefit vs. Defined Contribution

First, let's start with a familiar concept. In the retirement space, *defined contribution* is a type of retirement savings plan in which the amount of this employer's annual contribution is specified, such as with a 401K. Compare this to a pension plan where the employer specifies the benefit (a *defined benefit*).

The same logic is followed in health care. A *defined contribution health plan* is a type of health plan in which the amount of the employer's annual contribution to employees health care (and individual health insurance policies) is specified. Compare this to a group health plan where the employer specifies the group health insurance plan (again, a *defined benefit*).

How Defined Contribution Health Plans Work

Defined Contribution Health Plans offer a new alternative to the Defined Benefit Group Health Insurance Plan. Just as employers realized the savings associated with moving away from defined benefit retirement pensions and toward 401K's, many businesses are applying this model to their health benefits programs. The general strategy of a Defined Contribution Health Plan is that:

- The employer implements a stand-alone Health Reimbursement Arrangement (HRA) to give each employee a fixed dollar amount. In setting up the HRA, the employer determines.....(1)how much to contribute to health benefits, and (2)what expenses are eligible, such as individual health insurance premiums, doctor visits, dental, prescriptions, etc.
- Employees choose how to spend the funds, within the parameters of the employer's plan. For example, employees purchase their own individual policy directly from any health insurance company, or from the new state health insurance marketplaces starting in 2014.
- The employer reimburses employees tax-free, up to the amount of their defined contribution allowance.

Defined Contribution Health Plans by themselves are not health insurance plans, rather they are a health benefits strategy that allows the employer to realize cost savings.

Why Defined Contribution Health Plans Work

Defined Contribution Health Plans work for employers and employees because:

- The contributions are tax-free to the employer, and employees receive pre-tax dollars.
- The employer gains fiscal control and predictability over their health benefits budget.
- There are no minimum or maximum contribution amounts and no minimum participation requirements.
- Employees have *choice* in health insurance plans and make consumer-driven choices.
- No annual bidding, comparing and contracting each year.

Bottom line ? With individual and family guaranteed-issue policies starting in 2014, Defined Contribution Health Plans will have all the same benefits of a Defined Benefit (group health insurance plan), often at a much lower net cost for the business and employees.

For more information and specific details on Defined Contribution Health Plans, we welcome the opportunity to assist you. Please contact us through the Contact Us page of this website.