Evaluating and Implementing a Defined Contribution Benefits Strategy Within a Total Rewards Framework

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Introduction

Under pressure from the current economic and regulatory environment, organizations are searching for better ways to manage and predict the growth in benefit costs. At the same time, they want to effectively reward a more diverse workforce and find ways to improve their employee value proposition.

Strengthening the alignment between organizational strategy, employee preferences and their benefits is at the crux of improving employee engagement and achieving financial goals. However, innovative and technically sound reward programs may not be enough. Targeted results are the distinct product of programs that support business goals and provide real value for employees.

A defined contribution benefits strategy may help organizations find the right balance between employee and employer value. This paper discusses how to evaluate the potential of this approach to become a successful part of an organization’s reward programs.

Total Rewards Evaluation

Taking the opportunity to perform a comprehensive review of an organization’s holistic benefit programs, or total rewards, often yields more useful insight than focusing solely on the advantages and disadvantages of a defined contribution strategy. When employers answer a few foundational questions, they gain a more fully informed perspective: “What is our employee value proposition?”; “What should it to be?”, and “How do we get there?”

Employers should start with a review of where they spend all their labor dollars and their competitive position in the market. How well do current reward programs support the organization’s objectives? Do employees understand these programs, and do they value them?

The first step is to think about how reward programs can be improved and better aligned. Within this context, organizations can evaluate the merits of a defined contribution strategy for benefits. If this strategy is structured well it can provide:

• Visible alignment with organizational strategy and objectives
• Flexibility for a diverse workforce
• Increased benefits cost control and sustainability
• Employee perception of program fairness
• Regulatory compliance
• Shifting of healthcare choice and responsibility to employees while providing them decision support
• Competitive advantage when incorporated into the employee value proposition and communicated
• Transparency in the total rewards program

A defined contribution benefits strategy can strongly improve employers’ total rewards programs.
Employers will be able to make a more informed and confident decision about a defined contribution approach if they consider the organization’s culture and employee preferences. As part of this exercise, they should anticipate outcomes for both the organization and its talent.

- Does an increase in employee benefits consumerism appeal to the organization? Will employees embrace the opportunity to make their own choices?
- Will a defined contribution opportunity and experience change employees’ use of their available benefits? Will they buy up or buy down benefits based upon their individual needs?
- What is the anticipated impact on employee engagement, retention, recruitment, labor costs, and overall business strategy and objectives?

In the end, the decision to implement a defined contribution approach should be based on the potential to gain a competitive advantage. In other words, it needs to improve the employee value proposition.

**Defined Contribution Program Design**

When an employer decides to pursue a defined contribution strategy for benefits, there are a number of decisions to be made about the program structure... the most logical method for delivering defined contribution opportunities to employees is a private exchange.

Some considerations include:

- Technology
- User experience
- Decision support and user education
- Available carriers and plans
- Collaboration between the exchange and the organization

Once a partner is selected, employers need to determine how to structure the exchange. A good partner provides guidance in thinking through all aspects of this structure, and can share what has worked for others.

Structuring a defined contribution strategy requires several core considerations:

**Contribution Amounts**

- What’s the best way to determine how many dollars to give employees? Employers may want to partner with a consulting firm to conduct a custom survey of organizations that have implemented a defined contribution benefits strategy. With this comparison data at hand, they can review the current employer and employee premium spend for the various plans and tiers. This provides a great reference point for how to stay close to this spend.
• **How should contribution amounts be allocated?**

Employers will need to decide if they want to provide one total dollar amount for medical, dental, vision, etc., or a set amount for each program. Next, they'll want to determine if they will provide a different contribution for the various tiers.

If an organization currently provides or is thinking about offering benefits for retirees, these employees should also factor into the planning process.

Finally, for employers that operate in diverse geographic areas nationally, there’s the question of whether or not to provide a different contribution for higher cost areas (e.g., New York, California) vs. lower cost areas (e.g., Kentucky, Oklahoma). The premiums on the exchange could differ quite a bit between geographic locations.

Regardless of how organizations structure their contribution amount, the program must be sustainable. It should help to both control and manage benefit costs.

**Leftover Contributions**

The “gift card” approach provides a set amount of funds for each employee to use across various programs. If any funds are leftover, employers need to decide how to treat them. Will they be contributed to a Health Savings Account (HSA), Health Reimbursement Account (HRA), paid in cash compensation, or forfeited? It’s important to determine the practical and tax implications of using an HSA, HRA and/or a flexible savings account.

**Annual Contribution Increase Determination**

Once employers set the contribution strategy, they have to begin thinking about how they’ll determine any employee contribution increases in the future. For example, they could stick with a similar contribution percentage, or continue with the same dollar amounts. If they’ve created a sustainable contribution strategy, they will be able to maintain manageable and predictable contribution increases.

**Wellness**

If employers have a wellness program or plan to implement one, it should be integrated in their defined contribution planning. Will they offer incentives for wellness participation? At a minimum, they should be sure to integrate the communications for their benefit and wellness programs.

**Compliance**

While making decisions about contributions, employers also have to keep in mind the Patient Protection and Affordable Care Act and the Cadillac Tax, as well as COBRA and any other applicable laws and regulations.
When employers have made their decisions about the program’s structure, or have a few scenarios they would like to test, it’s time to create impact models. If possible, these models should not just be created for the defined contribution strategy, but also be included as part of their total rewards program.

Modeling

When employers have made their decisions about the program’s structure, or have a few scenarios they would like to test, it’s time to create impact models. If possible, these models should not just be created for the defined contribution strategy, but also be included as part of their total rewards program.

Overall, what will be the impact to employees? It’s important for the organization to know how its total rewards spend per employee is changing. If employers are able to access the required information, they can also anticipate the impact on employee discretionary income. With healthcare claim history, they can model out the full impact on an employee assuming that claims remain relatively steady. Of course, part of the allure of a defined contribution strategy is its ability to help alter employee health behaviors. An employee that was over-insured in the past may select a lower level plan.

As part of the modeling process, it’s important to estimate the number of employees that would fall below 400% of the federal poverty guidelines. Employers could be exposed to penalties if employee-only coverage costs more than 9.5% of an employee’s income.

Finally, organizations should consider the implementation and ongoing costs if they choose to join a private exchange.

If possible, employers should include other reward programs in the modeling. For example, they could include employee compensation and the effects of a change in their merit program or short-term incentives. The more they can include in this model, the better idea they’ll get of the true effect on employees and how the change to a defined contribution benefits strategy will fit into their current and future total rewards program.

After the models have been reviewed, organizations should tweak their recommendations as needed. Once they have a recommendation and model or a few different options, they are ready to state their case and seek approval from leadership.

Leadership Approval

As with any other organizational initiative, a defined contribution benefits strategy will likely fail without leadership buy-in. Leaders must champion this change both publicly and privately. They need to understand the basics of the defined contribution strategy and provide additional direction where needed.

To help pave the way for their leaders to approve this change, employers can calculate the estimated savings from this approach and also any anticipated qualitative improvements.
Implementation

Once leadership has approved the final recommendations, it becomes vital to think critically about implementation process requirements. This is the time to create a detailed project plan to meet these needs.

Employers should communicate to employees throughout the implementation. The best practice is to use a mixture of mediums and make sure management and supervisors understand and champion the change. It’s important to explain why the organization is making the change and how the employees will gain from it. The employees will likely see great benefits from the move to this approach and will also have an increased stake in their own health.

As part of this communication campaign, employers should also consider providing employees with total reward statements. These statements display all reward dollars received by the employee and can qualitatively explain the value of benefits that can’t be expressed in numbers. This changes the employee perspective, for example, from an $85,000 base salary to a $130,000 total rewards package.

Employers will benefit from partnering with their Information Technology department throughout implementation. They’ll want to make sure employees can easily access the new private exchange site and investigate if there are any opportunities for integration with technology currently used by the organization.

Finally, although it’s not technically part of the implementation process, organizations will want to annually revisit not only the defined contribution benefits program, but also their total rewards program as a whole. A lot can change in a year, and regardless, there may be a need to refine the program to optimize its performance value. Staying proactive supports this outcome more efficiently and effectively than reacting to change as it happens.

Conclusion

A defined contribution benefits strategy can strongly improve employers’ total rewards programs. This strategy helps recruit and retain a diverse workforce, shifts responsibility for individual health to employees, frees up organizational resources and if structured well, provides sustainability and ensures compliance.

Organizations may consider selecting an experience and expert partner to help guide them through the this evaluation and implementation process. The right partner to help organizations evaluate a defined contribution strategy for employee benefits not only gives advice, but also brings value while making it easier to do business together.

A well designed defined contribution benefit plan is likely to provide a strong competitive advantage in a war for talent that will continue in the foreseeable future.
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About the Authors

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