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the challenge of funding hospital employee retirement benefits

Cost pressures are forcing healthcare employers to scale back on the benefits packages they traditionally have offered their employees. Nonetheless, many promising ideas exist for optimizing employee retirement and health programs while containing costs.

In an April 2012 Standard & Poor's report, the rating agency predicted that despite favorable overall credit quality in 2011 and a stable outlook, many U.S. not-for-profit hospitals and health systems will face increased pension funding needs in the next several years.

S&P's report highlighted the following key findings:

> The median funded status of defined-benefit (DB) pension plans increased to 78.6 percent in 2011, up from 71.7 percent a year earlier, reversing a declining trend. But other pension-related medians, such as annual pension expense to employers, worsened.

> The improvement in funded status was mainly due to an increase in asset values and curtailment gains for some sponsors who changed benefits designs.

> Due to the timing of required contribution calculations, many plan sponsors will continue to see rising contribution requirements despite an increase in funded status.

Feeling the Squeeze

For healthcare employers, cost pressures from the Affordable Care Act (ACA) and employee demographics are building to make it more challenging than ever to meet obligations in defined-benefit plans while building and sustaining financial reserves. "Many predict that the cost pressures we are facing are going to be similar to those we saw with the Balanced Budget Act of 1997," says Todd Nelson, technical director, HFMA. "With the overall reduction in payments we anticipate, it's going to be critical to stabilize expenses by finding ways to more efficiently meet obligations like retirement benefits for employees."

AT A GLANCE

> Hospitals face a difficult challenge in meeting existing benefits obligations to employees while maintaining financial reserves to invest in electronic health records, quality improvement, and more effective integration of care.

> Although they may no longer be able to afford offering employees defined-benefit plans, many forward-looking healthcare organizations are finding ways to keep their commitments without sacrificing the balance sheet.

> One such organization is Scripps Health in San Diego, whose innovative benefits packages have contributed to its being ranked 56th in *Fortune*'s "100 Best Companies to Work For" list in 2012.

Most agree that this new era of transparency and higher accountability for delivering quality clinical outcomes—value-based purchasing—will continue to gain momentum, and would have done so even if the U.S. Supreme Court had not upheld the ACA. After all, tens of thousands of Americans die because of hospital-acquired infections and medical errors annually. The sickest 10 percent of patients consume 64 percent of costs.

As of Oct. 1 of this year, the Centers for Medicare & Medicaid Services (CMS) initiated the process called for under the ACA's Value-Based-Purchasing Program of withholding a percentage of Medicare payments to allow funds to be allocated for incentive payments to top-performing hospitals. At this time, a hospital could face a 1 percent payment reduction based on its relative performance on 12 clinical process-of-care measures and eight patient experience-of-care dimensions. In FY17, the maximum potential payment reduction climbs to 2 percent.

At the same time, CMS began reducing Medicare payments up to 1 percent based on a hospital's ratio of actual to expected readmissions. (In FY14, the maximum payment reduction climbs to 2 percent, and it is capped at 3 percent for FY15 and beyond.) This action will further challenge the balance sheet. In fact, some hospitals will have more than $1 million at risk in FY12 alone.

How will hospitals meet existing benefits obligations to employees while maintaining financial reserves to invest in electronic medical records, quality improvement, and more effective integration of care?

DB Plans Not Sustainable for Healthcare Industry

For many years, DB retirement plans have been the norm for most healthcare employers. Health care is a mature industry, with many of its benefits programs—such as "one-size-fits-all" DB plans—modeled after other manufacturing industries with shift workers, such as the auto and steel industries.

But as access to care improved with Medicare reform and patient demand grew in the 1960s, the healthcare industry staffed up, and many of those same workers are still with us today. Unlike the workforces at more contemporary companies, baby boomers older than age 50 may constitute 30 to 40 percent of the workforce in hospitals and health systems today. In fact, in many communities where unemployment has risen, older nurses have reentered the workforce.

Meanwhile, as unions have declined in the private sector over the past 20 years, they have expanded in health care. Unions support the interests of employees who are nearing retirement and expect that organizations will reward them for long-term loyalty by providing DB programs for retirement.

The problem is that investment returns have not kept pace with financial models for these plans. In recent decades, it's become clear to most healthcare employers that continuing to offer a DB plan for employees is just not sustainable if the organization is to build the long-term reserves it needs to meet the future. At hospitals where board members and senior executives are fighting to keep those plans, leaders frequently answer tough questions from rating agencies during bond offerings about their lack of reserves and unfunded liabilities as a result of these DB plans.

Moving Forward with DC Plans

Shortfalls and rising liabilities on the balance sheet are causing healthcare organizations to move from DB to defined-contribution (DC) plans, according to Larry Hughes, CPA, partner-in-charge, healthcare services, at Dixon Hughes Goodman in Winston-Salem, N.C. "Unfortunately, all the assumptions that existed in the early years of funding DB plans are no longer valid as longevity rises and inflation rates are lower than predicted," says Hughes.

Would most healthcare organizations like to retain their DB plans for employees? Absolutely. Most Americans are notoriously poor at saving adequately for retirement—and most don't recognize the importance of saving aggressively for healthcare costs as well. In fact, when a group of the nation's biggest thinkers on retirement (representatives from unions, employers, financial services providers, government agencies, and consumer groups) gathered last year in a Senate hearing room, they all expressed grave concerns about shortcomings of the 401(k).

As they see it, the plans have two significant problems. First, they aren't powerful enough to secure the retirements of low-income workers who can't afford to maximize contributions; and second, many such plans leave account holders to manage risks alone. Without being able to pool risk, participants must settle for lower returns and lower withdrawals.

Even though hospitals cannot afford to continue their DB plans, forward-looking organizations are finding ways to keep their commitments without sacrificing the balance sheet. For example, some organizations are communicating with their employees—particularly those in unions—with transparency about costs to keep the organization viable for the future. Given available dollars for labor costs, what do unions prefer—a richer healthcare plan, better retirement plan, or higher hourly and salary compensation? Would they rather have a $20-per-hour wage with a DB plan for shift workers or a $25-per-hour wage with a DC plan?

Leading healthcare employers are also moving to more flexible compensation and benefit packages to attract and retain top talent by optimizing benefits for a diverse workforce. Employers are placing less emphasis on healthcare benefits for younger, more mobile employees and promoting better savings opportunities for veteran workers.

Case Study: Scripps Health

Hospitals and health systems can take a lesson from Scripps Health, a not-for-profit integrated health system in San Diego. Scripps was ranked 56th in *Fortune*'s "100 Best Companies to Work For" list in 2012, and also was ranked as the top employer in the American Association of Retired Persons' 2012 list of the 50 Best Employers for Workers Over 50.

"Like so many employers, we've had to revise our assumptions for returns down based on market performance," says Victor Buzachero, corporate senior vice president for innovation, human resources, and performance management at Scripps. "We've designed new programs to ensure we can continue to offer world-class benefits packages to employees for retirement planning."

Scripps automatically enrolls all new employees in its health 401(a) retirement savings plan at a match rate of 1 percent of pay. Employees may increase, decrease, or stop their contributions at any time. Scripps matches employee contributions dollar for dollar up to 3 percent and incentivizes retention by increasing its match at 10 years of service, including a two-to-one match for employees with 20 years of service.

A 403(b) plan supplements the company's 401(a) retirement savings plan for employees who want to make additional pretax or Roth contributions up to the limit set by the IRS. (Scripps also makes an annual employer contribution of 1 percent of pay for all eligible employees, even if they elect not to contribute to the retirement plan. In 2010, 12,479 employees received a collective $7.2 million.)

Scripps offers various lifestyle funds through a third-party administrator, which enables employees to choose their own risk tolerance and enjoy solid returns without taking an active role in managing individual index funds. "One of the benefits of the DC funds is that employees own that money forever, unlike DB plans, where benefits can be terminated if an organization goes bankrupt," says Buzachero. "We've seen that occur in the airline and auto industries. It's important to communicate that benefit to employees."

As an early adopter of 401(h) health insurance savings accounts, Scripps also offers employees the opportunity to save for health costs after retirement with tax-free withdrawals to pay for post-retirement health insurance premiums. Employer matches similar to the 401(a) program apply. (Scripps also subsidizes health insurance significantly for low-wage employees and reduces the subsidy as hourly wages rise.)

"Because we work in an industry that still needs a lot of skilled labor, it's important to offer retirement plans that don't necessarily encourage people to retire," explains Buzachero. "We offer a staged retirement plan that allows people to work part-time and still accrue full-time benefits, take partial withdrawals from their retirement plan, and pay into their plan." Employees are eligible with 20 years of service at age 55 or at 10 years of service for fewer benefits.

On reviewing the types of employees that took advantage of the staged plan, Scripps found that 60 percent were in hard-to-fill jobs, such as registered nurses and pharmacists. "The cost of offering full-time benefits is minor compared with the cost of replacing these employees who might otherwise take full-time retirement benefits and perhaps go to work part-time for a competitor," Buzachero says. Instead, employees in their late 50s or early 60s tend to stay with Scripps an additional three to five years before retiring, he says.

Buzachero says the key to minimizing labor costs, maintaining staffing levels, and supporting employees is offering flexible retirement options. "Some individuals will work past age 65 or use Medicare as a primary benefit so they won't need retiree health. Others may have access to it through a spouse, while yet others may want to retire early," he notes. Are employees happy? On its annual employee satisfaction survey administered by the Great Places to Work Institute, 87 percent of employees responded favorably to the question "We have special and unique benefits," exceeding the benchmark of *Fortune's* list of 100 best companies.

Employer Wellness Programs Deliver Positive Results

Controlling healthcare costs will continue to be a challenge for providers. However, wellness programs—where employees receive financial incentives to complete health assessments with biometric screenings and participate in targeted wellness programs—are showing some promise as a step in the right direction.

"We're seeing positive results with strong support by employers and high interest by employees," explains Hughes of Dixon Hughes Goodman. "Increasingly, organizations are considering these factors in the hiring decision itself—like whether a job applicant is a smoker or has a high body mass index. They're asking, 'Is this person a health risk for the organization?' In the past, it may have been a more subconscious consideration, but some employers are now overtly precluding individuals from employment or making their employment contingent on participation in a smoking cessation or weight loss program."

"As healthcare employers, we want to incentivize healthy behaviors, whether we work through a payer or wellness program in our own hospitals," adds Nelson of HFMA. "While we know what the healthy behaviors are, we're still working as an industry on determining the right dollar amount for payback on the investment."

By performing an actuarial analysis on healthcare costs of the current population and evaluating it against future costs, organizations can begin to determine returns. In 2010, for example, 8,144 employees at Scripps each earned $30 by voluntarily undergoing biometric screenings (with a 64 percent participation rate). By participating in directed-activity challenges to reduce health risks, 5,583 of those employees earned additional discounts equal to receiving free health insurance for one year.

From the screening, participants received a personalized health assessment highlighting key risk factors. (The top medical risk factors facing healthcare workers are lack of physical activity, high blood pressure, weight, proper diet, stress, and high cholesterol.) By using a combination of web-based education modules, health intervention programs, on-site services (including fitness classes), and partnering with the Scripps employee assistance program, Scripps saved $2.1 million in health plan expenses, with an average risk reduction of 12.4 percent for participating employees over the past three years.

Transparency in the Future

Although healthcare employers face many challenges, promising ideas for optimizing employee retirement and health programs abound. Organizations that optimize their DC plans for a diverse workforce and offer education, guidance, and behavioral incentives with layered longevity plans are rewarded with high marks and high participation from employees. Employers that commit to a transparent, honest dialogue with employees about the challenges they face in funding retirement and health programs, and that openly demonstrate a continued strong commitment to employee well-being, will be rewarded with a skilled and loyal workforce that will help them meet the challenges ahead. ●

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