Evidence on Defined Contribution Health and Retirement: The Road Ahead

EBRI–ERF Policy Forum #76
Thursday, May 14, 2015

Wireless Password: innovation
Panel 1: Private Health Insurance Exchanges and “Defined Contributions”

EBRI–ERF Policy Forum #76
Thursday, May 14, 2015
Private Health Insurance Exchanges and “Defined Contributions”

Paul Fronstin, Ph.D.
Director, Health Research and Education Program
Employee Benefit Research Institute
Washington, DC
Headline from Bloomberg News: “Workers to Shop for Health Plans as Employers Quit Benefits”

“A growing number of Americans are no longer getting health insurance directly from work as companies quit administering benefits…”

Headline from Forbes:
“Private Insurance Exchanges Thrive While Obamacare's Falter”

“Private exchange enrollment has reached 6 million customers…”

Source:
Private Health Insurance Exchanges

• A private business – typically operated by insurance brokers, benefit consultants, or insurers – that sells insurance products to consumers through web-based portals

• Private exchanges offer:
  • The use of defined contribution health plans
  • Expanded “employee choice”
  • Decision support (e.g., “recommendation technology”)
  • End-to-end transactional services

• Single-carrier or multiple-carrier
• Single-employer or multi-employer
• Can also provide dental, vision, and other voluntary benefits
Goals

• Create a competitive marketplace at the consumer level
• Facilitate movement to fixed-contributions or defined-contributions
• Expand choice
• Provide an alternative to state-based exchanges
• Offers a solution for retiree health
• Reduces administrative costs and burden
Is It Déjà Vu All Over Again?
Technology “Caught-Up” to the Concept

SPECIAL ARTICLE
Consumer-Choice Health Plan — Inflation and Inequity in Health Care Today: Alternatives for Cost Control and an Analysis of Proposals for National Health Insurance
Alain C. Enthoven, Ph.D.
March 23, 1978
The Largest Employer with a Private Exchange

- Federal Employee Health Benefits Program (FEHBP)
- About 3 million workers
New Model Uncertainties

- Are expenses more predictable?
- Will it increase competition?
- Will increase choice be positive for consumer?
- Will employees shop intelligently and choose highest value plan?
- What happens to wellness programs?
- Will it reduce administrative costs?
- Do lessons learned from retirement benefits apply?
- How does moving to fully-insured model save money?
- If plans are standardized, how do they compete?
- Does risk-adjustment mitigate need to compete?
- Why would insurers invest in people if they can easily move to another plan during open enrollment?
- If employers aren’t pooled, what does it mean to be in an exchange?
- If employers self-insure, what does it mean to be in an exchange?
Interest in Private Exchanges is High; Adoption is Low

## Trends Start with Small Numbers: Private Exchanges for Large Employer Active Market

<table>
<thead>
<tr>
<th>Year</th>
<th>Aon Hewitt</th>
<th>Buck</th>
<th>Mercer</th>
<th>Towers Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>Darden &amp; Sears</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014 (1.3 mil.)</td>
<td>600,000 lives</td>
<td>400,000 lives</td>
<td>165,000 lives</td>
<td>127,000 lives</td>
</tr>
<tr>
<td>2015 (2.9 mil.)</td>
<td>850,000 lives 30 employers</td>
<td>610,000 lives 16 employers</td>
<td>975,000 lives 170 employers</td>
<td>450,000 lives</td>
</tr>
</tbody>
</table>

Select Employers:
- Aon
- Apollo Education Group
- AXA
- Aramark
- Darden
- Hallmark
- Hilton Worldwide
- Sears
- Tesla Motors
- Walgreens
- AMN Healthcare
- Arby’s Restaurants
- Bob Evans
- Church & Dwight
- Domino’s Pizza
- Ovation Brands
- Xerox Corp.
- ABHOW
- Addison Group
- Avago Technologies
- Cosentry
- DineEquity
- Kinder Morgan
- Kraus Flooring
- Marsh & McLennan
- PAS Technologies
- Petco
- Sanborn Map Co.
- Surgical Specialties Corp.
- Vistronix
- Convergys
- GameStop
- Sheraton Hotels
- Time Inc.
Move to Private Exchanges for Early Retirees Already Happening

### Predicted Growth in Private Exchanges

<table>
<thead>
<tr>
<th>Consultant</th>
<th>Estimated Enrollment</th>
<th>By Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBRI</td>
<td>5-6 million (5%)</td>
<td>2015</td>
</tr>
<tr>
<td>Accenture</td>
<td>40 million</td>
<td>2018</td>
</tr>
<tr>
<td>Oliver Wyman</td>
<td>39.1 million</td>
<td>2018</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>35 million</td>
<td>2019</td>
</tr>
<tr>
<td>EBRI</td>
<td>13-15 million (10%)</td>
<td>2020</td>
</tr>
<tr>
<td>Consumerdriven, LLC</td>
<td>75 million</td>
<td>2020</td>
</tr>
<tr>
<td>HSA Consulting Services, LLC</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


- 200 or more employees: 9% (2013) vs. 13% (2014)
- 200-999 employees: 7% (2013) vs. 12% (2014)
- 1,000-4,999 employees: 13% (2013) vs. 18% (2014)
- 5,000 or more employees: 29% (2013) vs. 20% (2014)

Source: Kaiser Family Foundation.
Distribution of Private Sector Participants in an Employment-Based Retirement Plan, by Plan Type, 1979-2010

Percentage of Covered Workers Enrolled in a CDHP, 2006-2013

Source: Kaiser Family Foundation.
EBRI: Just the Facts™

www.ebri.org
www.choosetosave.org
Case Study: Hilton Worldwide
Hilton at a Glance

- Global in scope, with twelve distinct brands serving different needs of our guests
- We own properties, manage properties on behalf of Owners, and franchise properties
- Approximately 155,000 Team Members globally at the company’s owned and managed hotels, HGV and corporate offices
- We have approximately 70,000 Team Members on our payroll in the U.S.
- In the U.S.
  - We operate hotels in 44 states plus Puerto Rico and Guam
  - Approximately 400 locations
  - Employer sponsored plans and union sponsored plans
  - No retiree medical benefits
Hilton’s Beliefs on Benefits

- Provide competitive benefits that are designed to **attract, retain and motivate** our Team Members to achieve our strategic objectives.

- Use benefit program design, subsidies, policies and service to **differentiate Hilton** and support our desired culture.

- Properties with higher medical enrollment have higher scores on the question: **“This is a great place to work”**.

- Positive **correlation** between “This is a great place to work” and answering positively about our benefits - stronger correlation than to compensation or training.

- Properties with higher medical plan enrollment correlate with **higher hotel overall service scores**.

- Team Members not enrolled in medical and 401(k) plans have much **higher turnover rates**.

- Employees who are highly satisfied with their benefits have a **higher sense of loyalty to their employer** and are 3 times more satisfied with their jobs overall (MetLife Survey).
Multipronged Approach to Managing Healthcare Costs

1. **Funding Mechanism**
   - Self Insured

2. **Employees Choice**
   - Aggressively managed Rx
   - Network-only plan designs (HMO)
   - Group Plan 1
   - Benefits Credit
   - Group Plan 2
   - Benefits Credit
   - Group Plan 3
   - Benefits Credit
   - Group Plan 4
   - Benefits Credit

3. **Defined Contribution**
   - Benefits Credit

4. **Carrier Options**
   - Best-In-Market Approach
   - Best-in-Class
   - Best-in-Class
   - Best-in-Class

5. **Health Imperatives**
   - Early Stages of Wellness Journey
Hilton’s Broadened View and Fresh Perspective

Fueled by the changes and complications of the ACA, Hilton took three distinctive actions:

**Studied the marketplace for insurance alternatives**
- Insurance, self insurance, public exchanges, private exchanges

**Discussed results of marketplace experiments**
- Accountable care organizations
- Narrow networks
- Direct contracting
- Wellness
- Population health
- Transparency tools for provider cost and quality of care

**Monitored cost increases and plan design changes in the market**
- The movement to high deductible plans
- The use/non-use of HSAs
The ACA Provides An Opportunity For Fresh Thinking

The ACA essentially redefines how employers will structure their total rewards approach

- A new “floor” on what constitutes acceptable coverage (2010-2014)
- A common definition of who should be covered (2010-2016)
- A new “ceiling” on what constitutes acceptable coverage (2018)

Result: Healthcare benefits will be a less useful differentiator in total rewards between employers, and the effect will be compounded by health care inflation over time.

The creation of public exchanges redefine the marketplace. A new consumer experience is created. Insurers compete in a more transparent way.

The infrastructure created to support public exchanges and mindset created by public exchanges can be leveraged for a private exchange model.
Aon’s Exchange Emerged as the Best Model Forward in This New Era

HealthChoice: A new dynamic of providing health care to Hilton Worldwide US Team Members

Competing carriers
- Aetna
- Anthem
- United
- BCBS
- Kaiser
- HealthNet

Standardized plans
- Bronze Plus
- Silver
- Gold
- Platinum

Exchange
- Multi-carrier
- Fully insured
- Standard designs
- Group plan

Real competition
- The largest, most respected coverage administrators in the country quoting competitive, binding rates
- Competition for individual employee enrollment creates accountability and incentive for innovation
- An economically stable option in an era of rising health costs

Real Consumerism
- HealthChoice gives Team Members freedom to choose medical coverage that best fits their needs
- High deductible plans encourage consumerism and accountability to make the best health decisions for Team Members and their families
- Large variance in cost when comparing lower value to higher value plans
Aon’s Exchange Provides an Innovative Alternative at a Lower Cost

- Known service provider
- Less administration
- Maximum cost avoidance
- Advanced movement to exchanges
- Choice of insurers

- Extension of existing agreement
- Costs are only for insurance plans
- Better overall pricing
  - Lower costs for team members – can “draft down” in their plan choices
  - Allows us to offer competitive employer/employee cost sharing

System moving to exchange model
Better local provider coverage
Fully Insured vs. Self Insured

Myth

+7% to +12%
Fully Insured vs. Self Insured

Fact

-1.3%
The Private Health Exchange Reduced Our Cost Structure

THE AON ACTIVE HEALTH EXCHANGE PROVIDED REAL SAVINGS

- The move to HealthChoice for 2014 reduced an increase of 8% per Team Member down to an overall decrease of 1% without reducing plan designs or company subsidy.

- Renewal rates for the second year remained at market-competitive levels. We anticipate annual per capita increases to be consistent with market increases, leveraging our initial savings.

<table>
<thead>
<tr>
<th>Year</th>
<th>Without change in 2014</th>
<th>HealthChoice</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>$7,000</td>
<td>$7,500</td>
</tr>
<tr>
<td>2014</td>
<td>$8,000</td>
<td>$8,500</td>
</tr>
<tr>
<td>2015</td>
<td>$9,000</td>
<td>$9,000</td>
</tr>
<tr>
<td>2016</td>
<td>$10,000</td>
<td>$10,500</td>
</tr>
<tr>
<td>2017</td>
<td>$11,000</td>
<td>$11,500</td>
</tr>
</tbody>
</table>
Second Year Rate Increases

Up to 25%

Myth
Fact

5.3%
Employee Satisfaction
Hilton Employee Reaction

- 84% liked being able to choose their carrier (and associated provider network)
- Team Members were very positive about the enrollment website and decision-making tools that Aon provides as part of the Exchange experience
  - Health plan comparison chart
  - Provider directories for each health plan
  - Prescription coverage tool
  - Estimate my usage and “Need Help Deciding?” tools
  - Links to carrier websites
- 76% said the Aon site made it easy to compare options, made it easy to enroll and that the confirmation process assured them that their choices had been saved
- Two-thirds said the site was easy to navigate
- Some employees opted up from prior plan levels, some employees opted down. Overall, more enrollment in “Silver” than its predecessor
Insurer Behavior
Insurer Behavior

Average Medical Ratings

- Overall Rating: 4.07
- Customer Service: 4.03
- Network: 4.22
- Prescription Drugs: 4.01
- Online Experience: 3.95
- Other Services: 3.85
Hilton’s Key Recommendations and Future State

**DO:**
- Look 5-10 years into the future
- Evaluate exchanges for retirees, part time employees, lower paid, and active full time employees
- Evaluate your current health plan pricing strategy
  - Regional vs national pricing structure
  - Integration of insured and self-insured plans
  - Pure actuarial vs behavioral modification to actuarial value

**Do NOT:**
- Underestimate your employees — they can handle an exchange approach

**The Future and what still matters:**
- Carriers WILL compete for your business if they know they need to
- The consumer experience created by Aon on the exchange platform is well-received
- The choice of insurers, networks, plan designs, and price points are all important to employees—exchanges can deliver that
- Population health still matters
- Best-in-class clinical care still matters
Smart Decision-Making
Private Health Insurance Exchange Discussion

Employee Benefit Research Institute
Washington, D.C.
May 14, 2015

David Burroughs
Sr. Consultant, Total Rewards & HR Policy
Who We Are

• $3.1 billion humanitarian services organization
• 23,000+ benefit eligible employees
  • Including 4,100 collectively bargained under 67 contracts
• Five lines of service
  • Biomedical – blood collections, testing, sales and distribution
  • Disaster – response to national and local emergencies
  • Preparedness/Health & Safety – CPR, First Aid, Lifeguard training
  • Armed Forces – liaison between service members and families
  • International – support and response to international emergencies
• Locations in all 50 states and U.S. territories, plus overseas
  • 36 Blood Services regions
  • 495 Chapters
  • 52 Armed Forces stations
Where We’ve Been

1989
First National Health Ins. Program Established
Regional Pricing and Contrib.

1995
Locally-Contracted HMOs Brought into Program

2002
Administration Outsourced (180+ HMOs)

2003
Best in Market Approach
4 National Carriers plus HMOs

2008
“One Red Cross”
1 National Carrier plus Kaiser
National Pricing and Contrib.

2012
HDHP Plans & Wellness Incentive Program

2015
Defined Contribution Adopted

2011 – Medicare retirees moved to an exchange
What We Did

Step 1 – Approval to investigate Private Exchanges for 2015

Step 2 – RFP to identify consultant/partner for Exchange Analysis

Step 3 – Dual track RFPs for Exchange and Existing model

Step 4 – Side-by-Side Analysis of RFP Results

Step 5 – Recommendation and Approval by Board

Assessment Criteria
- Cost
- Member Impact
- Risk
- Market Maturity
- Control
## Results

<table>
<thead>
<tr>
<th>Assessment Criteria</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost</strong></td>
<td>A reduction in the organization’s healthcare benefits cost would have been a positive aspect of moving to an Exchange. However, Red Cross could achieve cost savings through plan design changes and employee contributions as well as leveraging the traditional RFP proposals.</td>
</tr>
<tr>
<td><strong>Member Impact</strong></td>
<td>While the impact on membership could have been eased through strong communications, moving to an Exchange would have been a meaningful impact on the majority of employees.</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>Although there would not have been annual claims fluctuation risk, there was the risk of carrier volatility year over year, as well uncertainty of the Exchange’s economic model</td>
</tr>
<tr>
<td><strong>Market Maturity</strong></td>
<td>Given leadership’s position on Red Cross avoiding being the first to market in adopting benefit practices, the lack of market maturity was a primary reason why Red Cross did not move to an Exchange for 2015</td>
</tr>
<tr>
<td><strong>Control</strong></td>
<td>The Exchange would have meant loss of control over plan management activities, as well as reverting back to regional plan costs and designs.</td>
</tr>
</tbody>
</table>
What We Decided for 2015

• Stay with current model
  • Continue to monitor the Exchange market for later consideration
  • Redesign current model to prepare for future move

• Change the plans offered
  • 2 HDHP (Bronze and Silver)
  • 2 PPOs (Silver and Gold)
  • Kaiser HMO with deductible and coinsurance

• Change the contribution strategy
  • Adopt Defined Contribution model
  • Red Cross contribution is based on the Silver HDHP plan
    • 90% employee only/75% dependent tiers
  • Full buy-up or buy-down to other plans
What We’ve Seen

2014

<table>
<thead>
<tr>
<th>Enrollment</th>
<th>PPO</th>
<th>CDHP</th>
<th>HMO</th>
<th>Waived</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>10,961 (48%)</td>
<td>5,241 (23%)</td>
<td>4,033 (18%)</td>
<td>2,373 (11%)</td>
</tr>
</tbody>
</table>

2015

<table>
<thead>
<tr>
<th>Enrollment</th>
<th>PPO</th>
<th>CDHP</th>
<th>HMO</th>
<th>Waived</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>8,158 (37%)</td>
<td>5,428 (24%)</td>
<td>6,236 (28%)</td>
<td>2,505 (11%)</td>
</tr>
</tbody>
</table>

Enrollment shifted from PPO Plans to the Consumer Directed Plans

22,608 Avg. Eligible Employees

22,327 Eligible Employees

<table>
<thead>
<tr>
<th>($PEPM)</th>
<th>2014</th>
<th>2015 (Old)</th>
<th>2015 (New)</th>
<th>2015 YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Cost</td>
<td>$858</td>
<td>$915</td>
<td>$866</td>
<td>$861</td>
</tr>
<tr>
<td>Employee Share</td>
<td>$153</td>
<td>$167</td>
<td>$164</td>
<td>$164</td>
</tr>
<tr>
<td>Red Cross</td>
<td>$705</td>
<td>$748</td>
<td>$702</td>
<td>$697</td>
</tr>
</tbody>
</table>

Increase over 2014

<table>
<thead>
<tr>
<th>Item</th>
<th>2014</th>
<th>2015 (Old)</th>
<th>2015 (New)</th>
<th>2015 YTD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee</td>
<td>-</td>
<td>9.2%</td>
<td>7.2%</td>
<td>7.2%</td>
</tr>
<tr>
<td>Red Cross</td>
<td>-</td>
<td>6.1%</td>
<td>-0.4%</td>
<td>-1.1%</td>
</tr>
</tbody>
</table>
Questions?

Not all heroes wear capes.  

#BeAHero
About the Red Cross

Since its founding in 1881, the Red Cross has been the nation's premier emergency response organization. As part of a worldwide movement that offers neutral humanitarian care to the victims of war, the Red Cross distinguishes itself by also aiding victims of devastating natural disasters. Over the years, the organization has expanded its services, always with the aim of preventing and relieving suffering.

Today, in addition to domestic disaster relief, the Red Cross offers compassionate services in five other areas: community services that help the needy; support and comfort for military members and their families; the collection, processing and distribution of lifesaving blood and blood products; educational programs that promote health and safety; and international relief and development programs.

Our volunteers, employees, and local chapters mobilize and respond to emergencies in homes, communities, and throughout the world. Some four million people give blood through the Red Cross, making it the largest supplier of blood and blood products in the United States. The Red Cross helps thousands of U.S. service members separated from their families by military duty to stay connected. As part of the International Red Cross and Red Crescent Movement, a global network of 186 national societies, the Red Cross helps restore hope and dignity to the world's most vulnerable people.

An average of 91 cents of every dollar the Red Cross spends is invested in humanitarian services and programs. The Red Cross is not a government agency; it relies on donations of time, money, and blood to do its work. The Red Cross is headquartered in Washington, D.C. More information is available on the Internet at www.redcross.org.
EXAMINING PRIVATE HEALTH INSURANCE EXCHANGES FOR ACTIVE EMPLOYEES

May 14, 2015

Chris Calvert
SVP, Health Practice Leader
ccalvert@sibson.com
Private Exchange Misconceptions

- Moving to a Private Exchange is a move to Defined Contribution Healthcare
- Private Exchanges eliminate claims fluctuation and trend risks for employers
- By moving to a Private Exchange an employer avoids the Excise Tax
- Private exchanges allow the employer to stop worrying about wellness
- By moving to a Private Exchange you pool your risk with other employers
- Private Exchange are for health insurance only
- All Private Exchanges work the same way
Should You be an Early Adopter?

Following are some of the considerations that might lead an employer to be an early adopter or to wait and see.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Early Adopter</th>
<th>Wait and See</th>
</tr>
</thead>
<tbody>
<tr>
<td>HR Role in Health Care Delivery</td>
<td>Want to get out</td>
<td>Will stay very involved</td>
</tr>
<tr>
<td>Role of Health Plans in Total Rewards</td>
<td>Not Important</td>
<td>Differentiator</td>
</tr>
<tr>
<td>Competition</td>
<td>Jumping On</td>
<td>Staying Away</td>
</tr>
<tr>
<td>Health Costs</td>
<td>Aberrantly High</td>
<td>Low</td>
</tr>
<tr>
<td>Current Participation Levels</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Health as an Asset</td>
<td>Not Important</td>
<td>Core Strategy</td>
</tr>
<tr>
<td>Turnover</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Employee Affordability</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Geographic Dispersion</td>
<td>National</td>
<td>Local</td>
</tr>
<tr>
<td>Benefit Consistency (need to harmonize)</td>
<td>Not Important</td>
<td>Important</td>
</tr>
<tr>
<td>Need for Technology Upgrade</td>
<td>Urgent</td>
<td>Not pressing</td>
</tr>
<tr>
<td>Desire for new/additional program offerings</td>
<td>Great</td>
<td>Not necessary</td>
</tr>
</tbody>
</table>
Employer Feedback
What We Have Seen/Heard So Far…

➢ From those who have moved:
  • Strong administrative burden on lean HR staff post-ACA; movement to an exchange allowed these employers to offload this burden at little to no cost
  • Opportunity for savings outweighed other factors
  • Able to provide “more” to employees than previously able to administer

➢ From those who have remained in employer plans:
  • Not ready to be a first adopter of significant change—is this just a fad, or really the future?
  • Too much change from current state for employees; need to phase change in to be more “exchange ready”
  • Administration platform issues…and concern with being stuck with a bad decision due to difficulty to move
  • Doesn’t provide value that can’t be offered through in-house administration
  • Prefer to manage benefits on their own
# The Employee Experience

<table>
<thead>
<tr>
<th>What You Say</th>
<th>What Employees Hear; What They Think</th>
</tr>
</thead>
<tbody>
<tr>
<td>You have more choice</td>
<td>I have more decisions to make; Spare me…I’m on overload</td>
</tr>
<tr>
<td>You have new tools at your fingertips</td>
<td>I have to learn how to use something new; I don’t know how to use the last thing that was “new”</td>
</tr>
<tr>
<td>Contact the Exchange if you have questions</td>
<td>Now I have to call another customer service department and deal with them; I want to speak with someone I know and trust</td>
</tr>
<tr>
<td>Now you can learn the real cost of medical tests and procedures, and find the most cost-effective, high quality care options</td>
<td>I’m being asked to make decisions I’m not equipped to make; I don’t have the time to do this</td>
</tr>
<tr>
<td>You will have lower-cost coverage options available</td>
<td>I’ll have lower-quality health care options available; How will I know if I have the right coverage?</td>
</tr>
</tbody>
</table>

Understanding your population and their experience in navigating the health insurance system is essential to success
Panel 2: Implications and Outcomes of Various Policy Proposals for Retirement Security

EBRI–ERF Policy Forum #76
Thursday, May 14, 2015
Implications and Outcomes of Various Policy Proposals for Retirement Security

EBRI-ERF POLICY FORUM
May 14, 2015

Jack VanDerhei
Research Director, EBRI
Outline

• Changes to the Retirement System: Impact on Current 401(k) Participants
  • Universal Adoption of a Minimum 3% Default Rate and 10% Escalation Cap
  • Assuming Employees Continue Recent Contribution Rates Across Job Changes
  • Impact of a Proposed Stretch-Match Alternative to the PPA Safe Harbor

• Automatic IRAs: Impact on all Households ages 35-64
  • Impact on the Probability of a “Successful” Retirement
    • By Age and Employer Size
  • Impact on Retirement Deficits
Changes to the Retirement System: Impact on Current Participants in Automatic-Enrollment 401(k) Plans With Automatic Escalation

- Only measuring 401(k) balances and IRA balances originating from 401(k) rollovers
  - Different from RRR and RSS analysis later
  - Includes job change and leakages
- Converts to real annuity at age 65
- Adds in currently scheduled Social Security benefits
- Computes percentage expected to have combined income of at least 80 percent of age 64 earnings
Percentage of Successful* Retirements for Automatic-Enrollment 401(k) Plans With Automatic Escalation,** by Income Quartile: Impact of Universal Adoption of a Minimum of 3% Default Rate and 10% Plan-Specific Escalation Cap (Assumes Employees Continue Recent Contribution Rates Across Job Changes)

* "Success" is defined as achieving an 80 percent real replacement rate from Social Security and 401(k) accumulations combined as defined in VanDerhei and Lucas (2010). The population simulated consists of 401(k) participants currently ages 25–29. Workers are assumed to retire at age 65 and all 401(k) balances are converted into a real annuity at an annuity purchase price of 18.62.

** Plans under the alternative scenario are assumed to have automatic escalation with a 1 percent of annual compensation increase and plan-specific default contribution rates with a minimum of 3 percent up to a plan-specific escalation limit with a minimum of 10 percent. Employees are assumed to retain their previous level of contributions when they participate in a new plan and opt out of automatic escalation in accordance with the probabilities in VanDerhei (September 2007).

Changes to the Retirement System: Impact of a Proposed Stretch-Match on Current 401(k) Participants

• Measuring the impact of a proposed alternative to the PPA safe harbor:
  • Default at 6 percent
  • Auto increase of 2 percent per year until 10 percent
  • Employer match of:
    • 50 percent on the first 2 percent, and
    • 30 percent on the next 8 percent

• How to model something that does not exist (yet)?
  • Starts with the same technique we developed for VE 401(k) plans*
    • Looks at the incentives provided for each 1 percent of compensation
      • e.g., able to differentiate between employee behavior for a 50 percent match on the first 6 percent vs. 100 percent match on the first 3 percent
  • Expands to isolate and simultaneously predict joint influence of:
    • Default contribution rates
    • Auto increase (yearly interval and maximum limits)
    • Level of employer match rates at each 1 percent of compensation

Percentage increase in 401(k) accumulations* at age 65 from **FUTURE employee contributions** by age and income quartile if proposed stretch-match safe harbor was used instead of the PPA safe harbor (assumes employees revert back to default on job change)

<table>
<thead>
<tr>
<th>Income Quartile</th>
<th>25-29</th>
<th>30-34</th>
<th>35-39</th>
<th>40-44</th>
<th>45-49</th>
<th>50-54</th>
<th>55-59</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest income quartile</td>
<td>16.5%</td>
<td>16.8%</td>
<td>17.2%</td>
<td>16.3%</td>
<td>15.5%</td>
<td>16.5%</td>
<td>14.0%</td>
</tr>
<tr>
<td>Second income quartile</td>
<td>18.1%</td>
<td>18.7%</td>
<td>20.4%</td>
<td>20.4%</td>
<td>20.2%</td>
<td>18.6%</td>
<td>17.6%</td>
</tr>
<tr>
<td>Third income quartile</td>
<td>19.0%</td>
<td>20.0%</td>
<td>20.2%</td>
<td>19.6%</td>
<td>18.0%</td>
<td>17.7%</td>
<td>19.2%</td>
</tr>
<tr>
<td>Highest income quartile</td>
<td>18.6%</td>
<td>18.0%</td>
<td>16.4%</td>
<td>14.7%</td>
<td>15.6%</td>
<td>14.7%</td>
<td>17.3%</td>
</tr>
</tbody>
</table>

Source: Employee Benefit Research Institute Retirement Security Projection Model® Versions 2262 and 2263.

* This includes 401(k) balances as well as IRA balances rolled over from 401(k) plans.
Employer Match as a Function of Employee Contribution

- PPA safe harbor
- Proposed stretch match proposal
Percentage increase in 401(k) accumulations* at age 65 from **FUTURE employee AND EMPLOYER contributions** by age and income quartile if proposed stretch-match safe harbor was used instead of the PPA safe harbor

<table>
<thead>
<tr>
<th>Age Range</th>
<th>Lowest income quartile</th>
<th>Second income quartile</th>
<th>Third income quartile</th>
<th>Highest income quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>25-29</td>
<td>2.6%</td>
<td>3.5%</td>
<td>5.5%</td>
<td>6.3%</td>
</tr>
<tr>
<td>30-34</td>
<td>3.0%</td>
<td>6.5%</td>
<td>6.6%</td>
<td>6.6%</td>
</tr>
<tr>
<td>35-39</td>
<td>3.7%</td>
<td>8.1%</td>
<td>8.2%</td>
<td>6.6%</td>
</tr>
<tr>
<td>40-44</td>
<td>2.8%</td>
<td>7.9%</td>
<td>8.3%</td>
<td>5.0%</td>
</tr>
<tr>
<td>45-49</td>
<td>2.6%</td>
<td>7.5%</td>
<td>7.3%</td>
<td>5.5%</td>
</tr>
<tr>
<td>50-54</td>
<td>2.9%</td>
<td>6.4%</td>
<td>7.4%</td>
<td>3.7%</td>
</tr>
<tr>
<td>55-59</td>
<td>3.4%</td>
<td>6.3%</td>
<td>7.1%</td>
<td>6.1%</td>
</tr>
</tbody>
</table>

* This includes 401(k) balances as well as IRA balances rolled over from 401(k) plans.

Automatic IRAs: Impact on Retirement Readiness Ratings (RRR) and Retirement Savings Shortfalls (RSS)

- RRR = probability that a HH retiring at age 65 will NOT run short of money in retirement
- RSS = present value of deficits in retirement in 2014 dollars
Previous Research on Automatic IRAs
(3 percent employee contribution with no employer match)

• Butrica and Johnson (2011)
  • 3 to 5 percent increase in family income after lifetime of experience
    • 6 to 13 percent increase for the bottom income quartile
  • Enrollment assumptions: 36 percent (low), 70 percent (high)

• Holmer (2012)
  • Replicates the results from Butrica and Johnson ($1907/year)
  • Conducts 12 different sets of sensitivity analyses
    • Reduces the $1907 to as low as $144/year

• GAO (2013)
  • Uses PENSIM to project median changes in HH annuity under automatic IRAs for those born in 1995
    • $1,046 overall; $479 for lowest income quartile

• Questions left to answer
  • How much will this impact those already part way through their working careers?
  • How will this impact retirement income adequacy?
    • Will everyone annuitize?
2014 Baseline Retirement Readiness Ratings from Ages 35-64: With and Without Long-Term Care Costs

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Including LTC costs</th>
<th>Assuming no LTC costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>35-39</td>
<td>56.7%</td>
<td>79.6%</td>
</tr>
<tr>
<td>40-44</td>
<td>58.8%</td>
<td>79.3%</td>
</tr>
<tr>
<td>45-49</td>
<td>58.9%</td>
<td>76.6%</td>
</tr>
<tr>
<td>50-54</td>
<td>58.6%</td>
<td>75.2%</td>
</tr>
<tr>
<td>55-59</td>
<td>57.0%</td>
<td>72.7%</td>
</tr>
<tr>
<td>60-64</td>
<td>56.5%</td>
<td>72.1%</td>
</tr>
</tbody>
</table>

Percentage Point Improvement in Retirement Readiness Ratings (with LTC costs) by Age and Employer Size from Introducing Automatic IRA With No Size Exemption: Assumes NO Opt-out and 100 autocorrelation for employer size

<table>
<thead>
<tr>
<th>Age Range</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>35-39</td>
<td>5.1%</td>
<td>4.0%</td>
<td>3.2%</td>
</tr>
<tr>
<td>40-44</td>
<td>4.0%</td>
<td>3.5%</td>
<td>2.8%</td>
</tr>
<tr>
<td>45-49</td>
<td>3.0%</td>
<td>3.1%</td>
<td>2.5%</td>
</tr>
<tr>
<td>50-54</td>
<td>1.9%</td>
<td>1.9%</td>
<td>1.9%</td>
</tr>
<tr>
<td>55-59</td>
<td>1.3%</td>
<td>1.0%</td>
<td>1.2%</td>
</tr>
<tr>
<td>60-64</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.7%</td>
</tr>
</tbody>
</table>

Note: Husband's Employer Size is Used to Categorize Employer Size for Married HH
Summary of the Aggregate Deficit Numbers by Scenario, with LTC Costs (Trillions of 2014 Dollars)

- Retirement Savings Shortfalls represent the present value (at age 65) of all simulated deficits in retirement
- Expressed in 2014 dollars

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Deficit (Trillions of 2014 Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014 Baseline</td>
<td>4.13</td>
</tr>
<tr>
<td>pro-rata reduction in Social Security benefits starting in 2033</td>
<td>4.38</td>
</tr>
<tr>
<td>2014 baseline with automatic IRA, no opt-out (6.5% reduction)</td>
<td>3.86</td>
</tr>
</tbody>
</table>

Reduction in Average Retirement Savings Shortfalls by Age from Introducing Automatic IRA: Assumes NO Opt-out

35-39: 10.6%  
40-44: 9.9%  
45-49: 7.9%  
50-54: 5.1%  
55-59: 3.1%  
60-64: 1.8%

Evidence on Defined Contribution Health and Retirement: The Road Ahead

EBRI–ERF Policy Forum #76
Thursday, May 14, 2015

Wireless Password: innovation