Navigating the ever-changing health care landscape
Implications for employer-sponsored retirement benefits

IN BRIEF
The article summarizes key insights from a panel discussion titled “Navigating the ever-changing health care landscape: Implications for employer-sponsored retirement benefits,” which was held at J.P. Morgan Asset Management’s 2015 Defined Contribution Advisor Summit in New York City on May 18-19, 2015. The speakers on the panel included:

- **Mark Hope**, Senior Consultant, Health and Group Benefits, Towers Watson
- **Laurence McGrath**, Research Analyst, U.S. Equity Team, J.P. Morgan Asset Management
- **Aaron Pottichen**, CRPC®, CRPS®, Retirement Consultant, CLS Partners Retirement Services
- **Moderator: S. Katherine Roy**, CFP®, Chief Retirement Strategist, J.P. Morgan Asset Management

**RISING HEALTH CARE COSTS ARE A KEY CONCERN FOR THE MILLIONS OF AMERICANS WHO ARE CONTEMPLATING RETIREMENT AND FOR THE COMPANIES PAYING FOR THEIR HEALTH BENEFITS.**

This article, which summarizes highlights from a recent J.P. Morgan panel discussion, reviews the health care landscape; examines the implications for retirement planning and employer-sponsored retirement benefit offerings; and considers employer strategies to integrate benefits, increase employee participation and improve retirement outcomes.

**HEALTH CARE SPENDING ON THE RISE**
As a nation, we are spending more on health care than ever. Spending has more than tripled to 17.2% of the U.S. gross domestic product (GDP) in 2011 from 5.2% in 1960.¹ Some of the factors driving the increase include longer life expectancies, medical

Innovations to treat once-deadly illnesses and investments in research to treat age-related diseases, such as Alzheimer’s. But higher health care spending levels imply that the government, individuals and companies have less to spend elsewhere. By 2023, almost half of health care expenses are expected to be paid for by the federal, state and local governments (EXHIBIT 1). That, in turn, raises concerns about government’s ability to pay for future benefits, such as Medicare, Social Security and other vital programs like education, defense and infrastructure.

The U.S. government is expected to shoulder nearly half of health care expenses by 2023

**EXHIBIT 1: PROJECTED NATIONAL HEALTH EXPENDITURE DISTRIBUTION, 2012-2023**

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>State and local government</td>
<td>18%</td>
<td>18%</td>
</tr>
<tr>
<td>Federal government</td>
<td>26%</td>
<td>31%</td>
</tr>
<tr>
<td>Other private revenues</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Households</td>
<td>28%</td>
<td>26%</td>
</tr>
<tr>
<td>Business</td>
<td>21%</td>
<td>19%</td>
</tr>
</tbody>
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Source: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group.

Numbers may not add to 100% due to rounding.

Where does the money go? As shown in **EXHIBIT 2**, hospital care is the largest category, followed by doctor visits and related tests; the remaining categories represent the services people pay for in order to keep themselves healthy and out of hospitals, such as prescription drug use, which makes up 9% of health care spending.

**EXHIBIT 2: 2013 NATIONAL HEALTH EXPENDITURES, PERCENT**

- Hospital care: 32%
- Doctors and tests: 27%
- Prescription drugs: 9%
- Investment: 6%
- Medical equipment: 8%
- Net cost of health insurance: 6%
- Other: 9%
- Long-term care: 3%
- Households: 26%
- Federal government: 31%
- State and local government: 18%
- Other private revenues: 7%
- Business: 21%

Source: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group.

Without further structural changes, health care costs are likely to move higher due, in part, to the inefficiencies in the health care system. Since most health care services are based on a fee-for-service model, doctors, hospitals and health care professionals have an incentive to deliver incremental health care services. Offsetting factors—such as new technologies that increase efficiencies, good health behaviors and drugs going off patent—can help drive down costs. Moving to a value-based reimbursement model—where payments to providers are based on the value of care delivered instead of being paid by the number of visits and tests ordered—will drive further improvements to the delivery of care by mandating better care at a lower cost.

**EMPLOYERS RESPOND TO HEALTH CARE TRENDS BY MOVING TO ACCOUNT-BASED HEALTH PLANS**

Individuals are increasingly concerned about retirement security as they struggle to simultaneously save for retirement and pay for health care costs. As a result, higher health care expenses are forcing many employers to consider changes to their health plans in order to rein in costs and help employees’ ability and
willingness to save for retirement. For example, companies are dealing with the 2018 U.S. Health Care Reform excise tax (known as a “Cadillac tax“) with an estimated 35% of employers expected to exceed the excise tax in 2018 if no design changes are made, according to a 2015 Towers Watson Emerging Trends in Health Care Survey.

Some employers are reducing costs by moving to account-based health plans (ABHPs). About 75% of employers are expected to offer ABHPs by 2015, with nearly 49% offering one as the only choice by 2017. As a component of consumer-driven health care, ABHPs typically come with a high-deductible health plan and a health savings account (HSA) that can be used to pay for out-of-pocket medical expenses. Total HSA assets stood at $24.2 billion at the end of 2014 and are expected to increase to $43.6 billion by 2017 as employers turn to them as a way to encourage employees to spend their health care dollars more carefully.

Meanwhile, the impact of health care reform is also spurring employers to reassess their current approach to pre-Medicare retiree benefits, with many using or considering the services of a private Medicare exchange to offer services to retirees.

ADVISORS CAN PLAY A KEY ROLE HELPING COMPANIES AND EMPLOYEES

Retirement advisors can play a critical role in getting employers to view retirement savings in the context of the broader benefits package. By helping companies understand the implications of health care costs on employees’ ability to save in 401(k) plans, they can help employees get to the finish line of retirement in a respectable fashion.

Advisors at CLS Partners Retirement Services, an Austin-based employee benefits and retirement consulting firm, worked with a professional employer organization (PEO) firm that offered a preferred provider organization (PPO) plan and a 401(k) plan. The 401(k) plan, however, only had a 35% participation rate. The advisors worked with the company to determine how its health benefits were designed and how those costs affected 401(k) participation. They concluded that a majority of the employees (mostly healthy men in their late 20s and 30s) were likely over-insuring themselves and not putting enough money into their 401(k) plans. In the end, the company offered an HSA (which it seeded with an employer match) and changed the PPO plan to a high-deductible health care plan. Doing so freed up an average of $300 per month per participant, which, when coupled with expanded participant education, resulted in a 10% increase in participation rate in the company’s 401(k) plan. The changes also reduced costs for the employer, which was looking at a 15% increase in premiums. By moving more people into the HSA, the total cost of the company’s insurance fell.

“…moving away from a one-size-fits-all type of insurance to a defined contribution health care world, where people get a subsidy—either from their employers, the government or their own pockets—and decide how to spend that subsidy.” — Laurence McGrath

“In the totem pole of concerns that a company has, health care far exceeds anything in retirement. Whatever your solution is, try and tie it to the benefits, which is something [participants] desperately care about.” — Aaron Pottichen

“If the ‘Cadillac’ tax continues on its current path, then I can see a system [20 years from now] where employers start to pull away from providing employer-sponsored health care and start shifting people to the public exchange or make use of private exchanges.” — Mark Hope

“Health and wealth are incredibly integrated. The healthier we are, the better our wealth outcomes will be and likewise the opposite.” — Katherine Roy

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4 Implemented as part of the Patient Protection and Affordable Care Act (PPACA), the excise or “Cadillac” tax is a 40% tax on the value of all affected health care programs a participant elects that exceed certain dollar thresholds in 2018 and beyond. This non-deductible excise tax must be paid by the employer (although some employers are contemplating charging the tax back to plan participants).

5 An HSA provides a triple tax break: Contributions are sheltered from income taxes, the money grows tax deferred and the funds can be withdrawn tax free for medical expenses.

6 Devenir HSA Market Survey; as of December 31, 2014.

7 The company did not want to use an automatic enrollment feature to increase enrollment in its 401(k) plan.
CONCLUSION

With rising medical expenses, increased longevity and volatile markets, retirement security remains a top focus. According to a recent survey, more than half of workers say retirement security has become an even more important issue for them in recent years, with 74% identifying their employer-sponsored plan as the primary way they save for retirement. Since health care plans and retirement benefits remain important to employers and employees, advisors can add value to client relationships by acting as total benefits consultants.

For more information, please visit jpmorganfunds.com/RI and select “Individual Retirement” to read our Health care costs in retirement paper.