

CCH®

Employee Benefits Management

Directions

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Economic storm of past decade strikes benefits industry, holistic approach emerges, experts explain

Market crashes. Investment scandals. Recession. Our nation has endured endemic economic volatility during the past decade. The ensuing effects have permeated our lives and livelihoods. These effects have altered many industries, including employee benefits. To understand how the benefits industry has changed over the last ten years, **CCH**, a Wolters Kluwer business, spoke to Stewart D. Lawrence, SVP and National Retirement Practice Leader for The Segal Company and Sibson Consulting, and Edward A. Kaplan, SVP and National Health Practice Leader for The Segal Company.

CCH: What have been the most significant benefits trend over the past 10 years?

Stewart Lawrence: I think the most significant trend in the last ten years is the decline in the prominence of defined benefit plans and the resultant increase in the prominence of defined contribution plans. I think that really pales almost anything else that's changed in the retirement environment.

Edward Kaplan: On the health care side, probably the most significant change in the last ten years is the continued shift between employer and employee cost sharing and contributions. In 2000, employers on average picked up about 80% of the cost of health care benefits premiums, and now it's close

to 70%. So we've seen a combination of higher copays and deductibles for members and higher employee payroll deductions for having that coverage.

"It's been quite a shakeout."

CCH: Which have been most surprising to you and why? Also, what factors have influenced these trends?

Lawrence: The decline in the prominence of defined benefit plans has been extremely surprising. I think if you stand back in the year 2000, the things that had influenced the decline of defined benefit plans were completely unpredictable. There was the market crash in 2002 and that was compounded by the decline in interest rates, creating what was referred to as the "perfect storm" as far as the financing of defined benefit plans where suddenly the assets are way down and the liabilities are way up. So that was one event that caused a lot of employers to have second thoughts about whether or not a defined benefit plan was the right plan for them. Then in the middle part of the decade, along came the new funding rules, which caused a rapid acceleration in the funding of defined benefit plans. That in and of itself was not bad, but was

exacerbated by the third event, which was the market crash of 2008.

At the beginning of this decade, I think the average plan was certainly over 100 percent funded and then things got very bad in 2002. Companies had recovered to some extent by 2006 and 2007. The new funding law kicked in and we had the capital market crash in 2008. The crash was compounded by the recession, which meant that not only are the funding requirements up, but a company's ability to pay those high requirements is down. And indeed that's one of the pitches that's made to Congress as to why companies need funding relief. The companies are simply saying if we have to put money into the pension

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plan, we will have to lay off people. So if you want to protect the worker, then you've got to give us some relief. We will own up to this unfunded liability, but we can't pay it in the accelerated fashion created by the new law. So, all of this was unknown in 2000.

Without a doubt, employers that were not committed to defined benefit plans, but had them because they didn't cost a lot because they were so well funded, have all closed their plans. I think the employers that are left that sponsored defined benefit plans are those that are committed to the defined benefit feature. This is slightly over 1/2 of the plan sponsors of large defined benefit plans who are still sponsoring open defined benefit plans.

So, it's been quite a shakeout. It was one shot after another. I think if it had been just the perfect storm of 2002, as bad as that was, companies recovered. And, then, the tighter funding rules weren't that bad because the funding status wasn't that bad. But then the third shoe fell, the capital markets fell apart.

It's actually going to get a lot worse if current trends continue. The reason is that a lot of older workers haven't got time to reestablish their assets by the time that they retire. I'm not sure what that's going to mean as far as the fabric of the workforce goes because you're going to have a whole cohort of workers who can't afford to retire. So, there's still a fourth shoe waiting to drop.

Kaplan: We had expected, due to the escalating costs year after year of health care coverage, a precipitous drop in employers providing health care coverage to their employees, but it has happened gradually during the decade occurred in the small group arena and didn't really start to happen until the second half of the decade. About 70% of employers offered health care coverage until 2005, and it's about 60% today. So it wasn't until the last five years of the decade that

we began to see the exit out of retiree and employ health, which is probably due to the unabated health care trends. We have very tight wage pressure; many employers can't raise wages. Price inflation has been stable, but with health costs going up seven or eight percent a year, eventually more and more employers may drop coverage.

I'm surprised that it didn't happen sooner and that there hasn't been state health reform on a larger scale like Massachusetts, Utah, and Hawaii. I would have thought by now more and more

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states would have adopted state-specific mandatory health insurance policies and programs. Perhaps they are waiting for federal health care reform.

These trends are driven by cost and competition for labor. Health care trends started to come down in early 2000 and by 2006 or so, they bottomed out, but yet they are still three times CPI so health care trends continue to influence employers and now we're starting to see this drop in the percentage of employers that offer health care coverage. So price is one issue, but, providing employee health care benefits is a major feature in the contract between employer and employee and it is still a tax-free form of compensation at least for now. That's a compelling reason why it's been pretty inelastic. Employers would prefer to stay with it, maybe tweak the benefits by shifting the burden of cost more to their employees, but not abandon their employees altogether.

CCH: How has the benefits industry changed for benefits professionals over the last decade?

Lawrence: The primary change is that benefits professionals are more holistic. In other words, they typically are expert in one area of the business, whether it's health or retirement or compensation, but more and more em-

ployers are expecting their consultants to at least be familiar with and conversant with, at a high level, all areas of the benefit package that affect them. That's a significant change that I've seen — the emergence of the holistic consultant.

Kaplan: I agree with that, and in addition, as an example on the health care side, 10 or 15 years ago, we were mostly financial benefits consultants, and now we're involved with wellness, behavior modification, and chronic disease management. Clients want a wider landscape of knowledge as to how health care benefits fit into workers' compensation, productivity and absenteeism.

CCH: What education and skills do benefits professionals need now to be successful?

Lawrence: I think there are two ways of looking at this. From the retirement perspective, if you go back ten years, typically there were the liability consultants — the actuaries — who would value the liabilities of the plan. You had asset consultants — the investment houses — who would typically consider only the asset side of the equation. And, what's happened over time, and correctly so, is that employers have been educated to the fact that they don't really care about assets or liabilities, but what they care about is the relationship between the two. Because if you think about it, if your assets go up by \$10 and your liabilities go up by \$15, then you're further in the hole even though your assets have done well. So there's much more of a holistic approach where this is not a question of familiarity, this is a question of acquiring expertise and knowledge where you have a growing number of professionals who are consulting on both the asset and liability side. Because it's really the difference between the two that drives the employer's funding and therefore both the actuary and the investment advisor need to be in the discussions.

Then taking a step back out of the retirement realm, I'll echo something that Ed said before: there's much more of a business orientation. Benefits

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professionals were more myopic in the past. They were looking deeply at their areas of expertise. Now it's understanding the employer's business context and then taking the deep dive into the benefits area.

Kaplan: Buyers are expecting more data-driven solutions, so I think consultants now need to have strong skill sets handling huge amounts of data and interpreting data and presenting it to clients so that they can make informed decisions. It was that way in the past, but it's even more so today. Ten years ago the relationship was paramount. If you liked your advisor and they were attentive, you didn't have to look to them to really prove the ROI of a wellness program. Today, especially large employers, are saying they want their consultants to be data-savvy and CFOs are now involved in these decision making processes. Consultants really need to know how to present the case from a financial perspective — that this benefit program makes sense from an economics point of view. The skill sets have to be deeper from a financial, data-driven view. Also, on the health side, there is a growing demand for more. We hire doctors and pharmacists. It's not just health actuaries and underwriters any more.

Over the past 10 years or so, clients have demanded that benefit professionals understand how their industry is affected by competition, free trade, labor issues, and the political landscape. We have been pushed to expand our knowledge about clients' industries and the economics of those industries. They want to have our plan designs tested against those environmental and industry issues as well. We have to do more homework before we present long-term strategies. There are a lot more factors involved now.

CCH: What trends do you anticipate in the next decade?

Lawrence: One of the things I learned in the last decade is that it's impossible to

predict trends. If you put yourself back in the year 2000, I don't think you would have predicted what we've seen in this last decade. And that probably is my prediction: whether it's Congress or the economy or whatever it is, it really follows the metaphor of the pendulum.

To some extent, I think the shift from defined benefit to defined contribution plans and, with that, all of the risk on the shoulders of the employee, swung too far. I don't know when it's going to start to swing back, because the answer is not that it swings back all the way and that the employer shoulders all the risk, but I don't think that it's going to be that the employee must shoulder all the risk. I think you're going to get some creative plan designs, and I hope some legislation, that will enable hybrid plans — something that allows for a reasonable sharing of risk between the employer and the employee. I do speak with employers that say when you look at

what happened with employee 401(k) balances in 2008 and 2009, maybe things have gone too far. It's a far leap from that to a plan design and making a financial commitment. But that's my guess: there will be a swinging back of the pendulum.

Kaplan: For the early part of this decade, all the signs on the health care cost trend side show that pressures are mounting to push prices back up for hospital stays and name brand prescription drugs, but that could be a reaction to providers and manufacturers getting price increases in before price controls happened to them under health care reform, which hasn't happened yet. In the short term, we will see price pressures renewed on employers health care benefits. For the long term, I do think some form of health care reform, either at the state level or some modest form of national health reform, may get passed in the next decade. □

FORM 5500

EBSA announces that EFAST2 online filing system can now receive Form 5500s

The Employee Benefits Security Administration (EBSA) has announced that the all-electronic EFAST-2 system is now operational for the receipt and processing of Form 5500 filings. EFAST2 allows the public to submit Form 5500 and Form 5500-SF and access filings at www.efast.dol.gov.

The revised EFAST website provides filers with tools and guidance, including the 2009 and 2010 Form 5500 and new Form 5500-SF, schedules and instructions, frequently asked questions, user guides, and a tutorial. Filers and preparers can register for an account, complete forms and schedules in multiple sessions, print a copy of the forms and schedules, and submit the filing at no cost. Filers may also use EFAST2-approved software to complete and submit their filings. A list of EFAST2-approved software can be found at the website above.

Filing changes. 2009 and 2010 annual returns/reports must be submitted electronically through EFAST2. In addition, prior year delinquent or amended Form 5500s must be filed electronically, except that timely 2008 plan year filings can still be filed through the original EFAST on paper until October 15, 2010, or electronically through June 30, 2010.

Other important changes include expanded disclosure on Schedule C of indirect service provider compensation, more extensive reporting by Code Sec. 403(b) plans, and the removal of IRS Schedules E and SSA. Information provided in Schedule SSA must now be filed directly with the IRS.