Aon Hewitt
Retirement and Investment

Redefining Retirement in the Health Care Industry

Aon Hewitt 2015 Report on Retirement Benefits in the Health Care Industry

Part Two of a Five-Part Series:
Look Deep Inside Retirement Plans in the Health Care Industry

March 2015

Risk. Reinsurance. Human Resources.

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Executive Summary…Find the “Right” Retirement Program

What’s Going on with Health Care???

That question is being asked every day as the health care industry continues to adjust to a changing health care system. The Affordable Care Act introduced significant financial challenges for virtually all health care organizations, especially hospitals. As multiple hospitals and related service providers band together, they are faced with the challenge of choosing the “right” retirement program for the new organization. The purpose of this white paper series is to provide insight and strategy for health care organizations in the midst of such dramatic change.

We based our insights on facts from financial and design data that is publicly available. We also maintain detailed data on the retirement designs of over 1000 organizations of all sizes and industries, including over half of the Fortune 500. This rich background allows us to compare detailed retirement plan data for over 100 health care organizations nationwide with a broader group of industry and corporate data.

Our expertise in this area is highlighted in a five-part white paper series covering the following topics:

I. Retirement Design Benchmarking in the Health Care Industry—*Published on January 15, 2015*

II. **Look Deep Inside Retirement Plans in the Health Care Industry – Published on March 3, 2015**

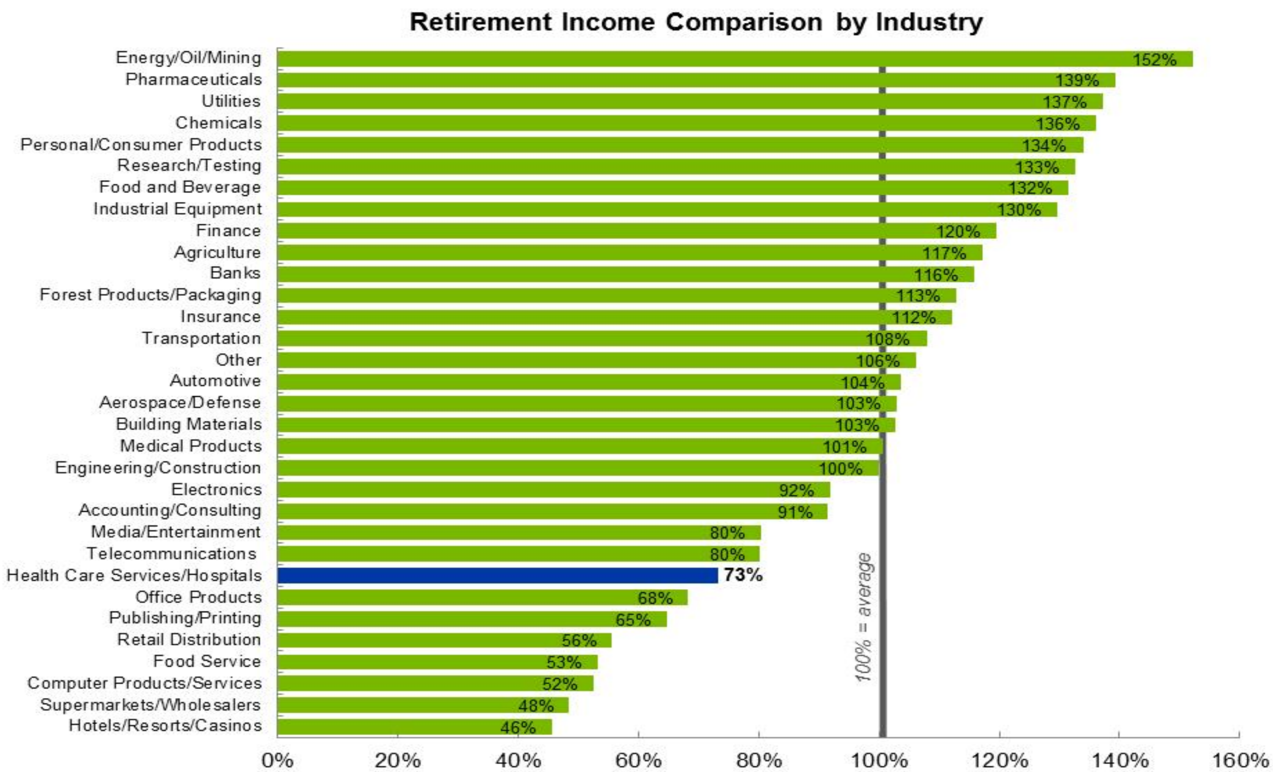
III. Efficient Retirement Design and Its Effect on Retirement Readiness for Health Care Employees

IV. Defined Benefit Financial Benchmarking in the Health Care Industry

V. Managing Legacy Pension Liabilities in the Health Care Industry

II. Look Deep Inside Retirement Plans in the Health Care Industry

As the health care industry adjusts to the financial pressures brought about by the Affordable Care Act, more large health care systems are recruiting their current and future leaders from corporate America. As you will see in the enclosed material, retirement benefits look quite different in large publicly traded companies than they do in health care organizations. The chart below shows the value of the retirement programs by industry sector. The health care industry is providing about 73% of the average value provided by organizations across all industry sectors.



Cost pressures may make it impossible for health care organizations to put additional employer monies into the retirement program. In order to encourage more employee savings, health care organizations are expected to shift their focus away from noncontributory retirement plans, like defined benefit and noncontributory defined contribution plans, into matched savings programs. As such, this paper includes significant analysis of the features in matched savings programs for health care organizations and general industry. We believe the health care industry has an opportunity to improve retirement readiness for employees through increased usage of matched savings programs.

We also see a trend developing as health care employers want to attract the best talent, and integrate diverse cultures. Many health care employers are revisiting their total rewards programs. Aon Hewitt's expertise covers all aspects of designing a total rewards program. This white paper considers the retirement program design issues for health care and other organizations.

About This Material

In this study, the employee retirement income programs of 97 health care organizations are analyzed using our Aon Hewitt Benefit Index® methodology. The methodology is described in the Appendix section at the end of this paper.

Some of these organizations may have more than one benefit package covering employees. This study is based on one package offered by each organization; generally, the one for newly hired exempt salaried employees. Of course, in some cases, the same benefits may be provided for hourly and salaried employees.

In addition to analyzing the retirement income programs available to new salaried employees, this study includes information on retirement benefits provided by four select national health care labor unions currently active across the country. Unless stated otherwise, these union benefits are not included in the averages quoted in this study.

Introduction and Key Findings

The second paper in our series on retirement benefits in the health care industry focuses on the value provided by the overall retirement income program, including defined benefit and defined contribution plans. The value of the overall retirement program is influenced by many factors. Value is determined not only by the benefit available to employees, but also by the type of plan (e.g., matched savings versus non-matching), the details within the plan (vesting, forfeitures, early retirement incentives, etc.), and the employee behavior required to receive an employer benefit from the plan.

The following findings stand out within the health care industry:

Average Value of Retirement Programs

- On average, the value provided by nonunion retirement programs at health care organizations is 4.6% of pay per annum. This compares to 6.3% of pay per annum provided by retirement programs at Fortune 500 organizations.

- Our first white paper in this series showed that 5.6% of pay, on average, was made available to employees of health care organizations through their employer-sponsored nonunion retirement programs. With a 1% differential in benefit availability versus benefit value, employees of health care organizations are, on average, leaving 1% of pay per year “on the table” by not fully participating.

Key Facts and Observations on Matched Savings Programs

- Close to 90% of health care organizations offer some form of matched savings program to new employees. This compares to 97% of the Fortune 500 with matched savings plans.

- Fifty-three percent of health care organizations in our study provide more than one retirement program to employees, typically a matched savings plan plus a “core” plan that does not require employees to contribute. This compares to 71% of the Fortune 500.

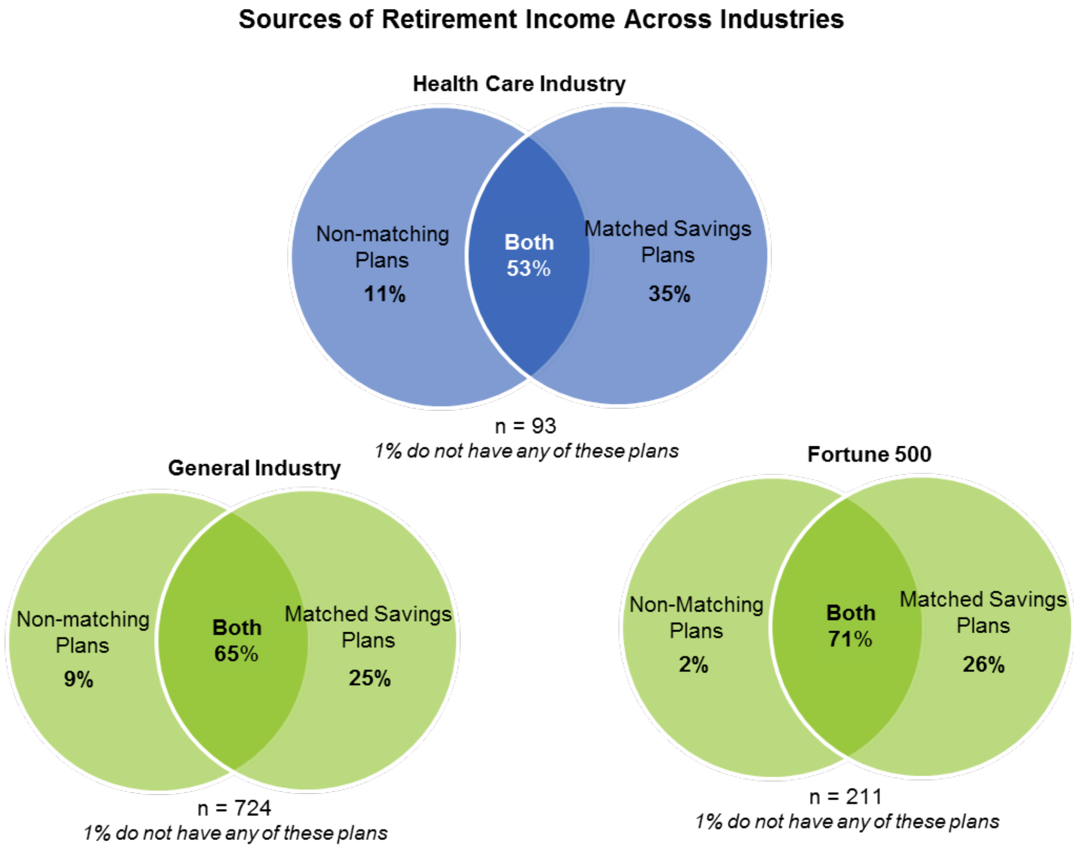
- Employees are automatically enrolled in 37% of the matched savings plans in our study. This use of automatic enrollment by health care employers is significantly lower than the 67% and 65% we see in general industry and Fortune 500 respectively.

- Only 7% of health care organizations with matched savings plans use automatic escalation to improve participant participation over time. This low use of automatic escalation is in contrast to the roughly 32% of general industry and 40% of Fortune 500 companies that have adopted automatic escalation features in their matched savings plans.

- To help close the retirement income gap, we expect health care employers to continue to “fine tune” their matched savings plans to encourage greater employee savings. The use of automatic enrollment and escalation is a tool that more health care employers are likely to use in the years ahead.

Sources of Retirement Income

The diagram below offers a high level comparison of retirement income plan types in the health care industry compared to general and Fortune 500 industry groups.



Sixty-four percent of nonunion health care organizations provide non-matching retirement income plans with ongoing accruals for new hires. Three out of 10 of these organizations have an open defined benefit plan; the remaining organizations provide noncontributory defined contribution plans.

Eighty-eight percent of nonunion health care organizations have some level of matched savings in their retirement programs. Only the employer money involved in such programs has been valued, since the employee account (while necessary to get organization-matching dollars) is an investment that is ultimately returned to the employee with interest and differs little from an individual account that an employee could be accumulating while working for an organization that does not have this type of plan.

Fifty-three percent of nonunion health care organizations provide some sort of non-matching retirement income plan (a “core” plan), in addition to a matched savings plan. General industry and Fortune 500 are more likely to offer both “core” and matched savings plans as noted in the diagrams above.

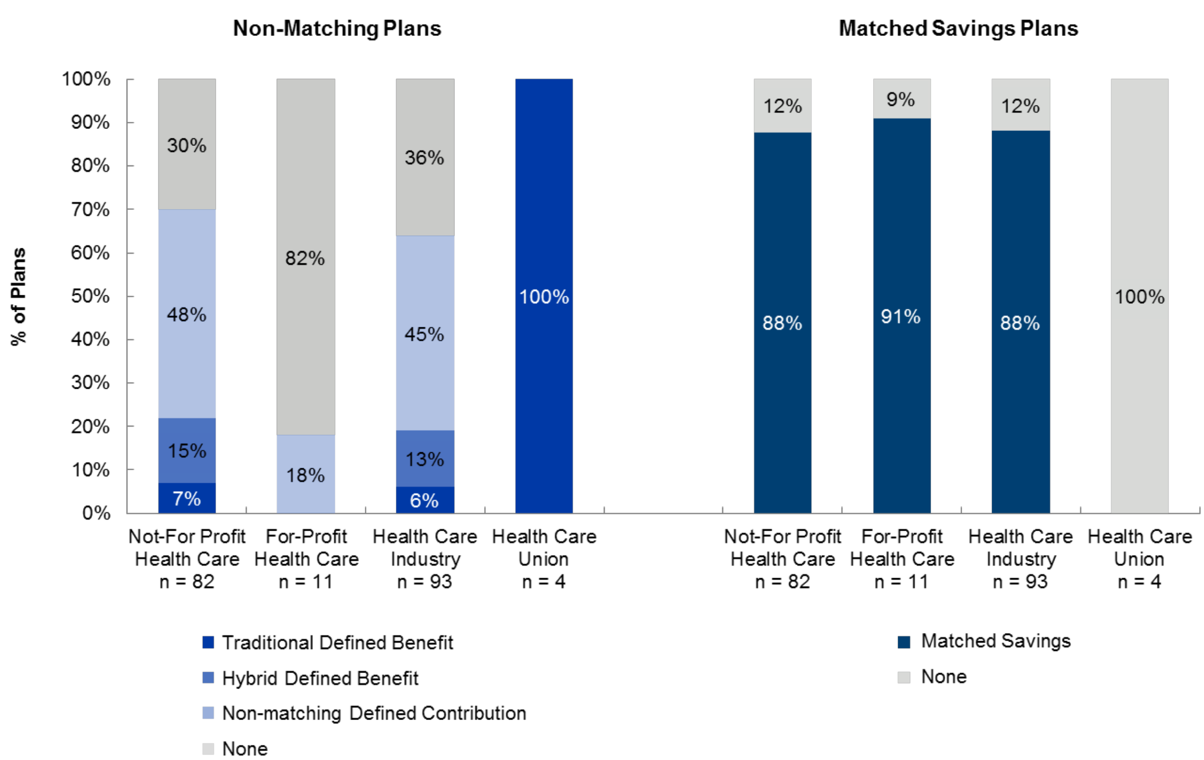
Plan Type (Pension, Hybrid, Defined Contribution)

Traditionally, pension plans used formulas that expressed benefits as annuities. Most organizations calculated benefits using highest average pay, but some used pay throughout an employee's career. Career pay plans typically provide less value than highest average pay plans because of the negative effect of inflation on pay replacement levels.

Many employers have replaced or added to their traditional pension plans with "hybrid" plans or defined contribution plans. Hybrid plans usually express benefits as a lump sum. Pension equity plans state the accrued benefit as a lump-sum percentage of highest average pay. Cash balance plans state the accrued benefit as an account balance. Cash balance plans operate like career pay plans, but interest is credited on past service benefits.

Defined contribution plans limit the employer's commitment to the annual contribution. The employee invests this contribution in a variety of investment vehicles. This differs from cash balance pension plans where the account grows at a rate defined by the plan. Matched savings plans encourage employees to save for retirement by providing an organization matching contribution on the first several percent of pay the employee contributes.

Retirement income plans for all the health care organizations in our study are categorized below, both by organization type (not-for-profit, for-profit, union) and in total:



Non-Matching Plans

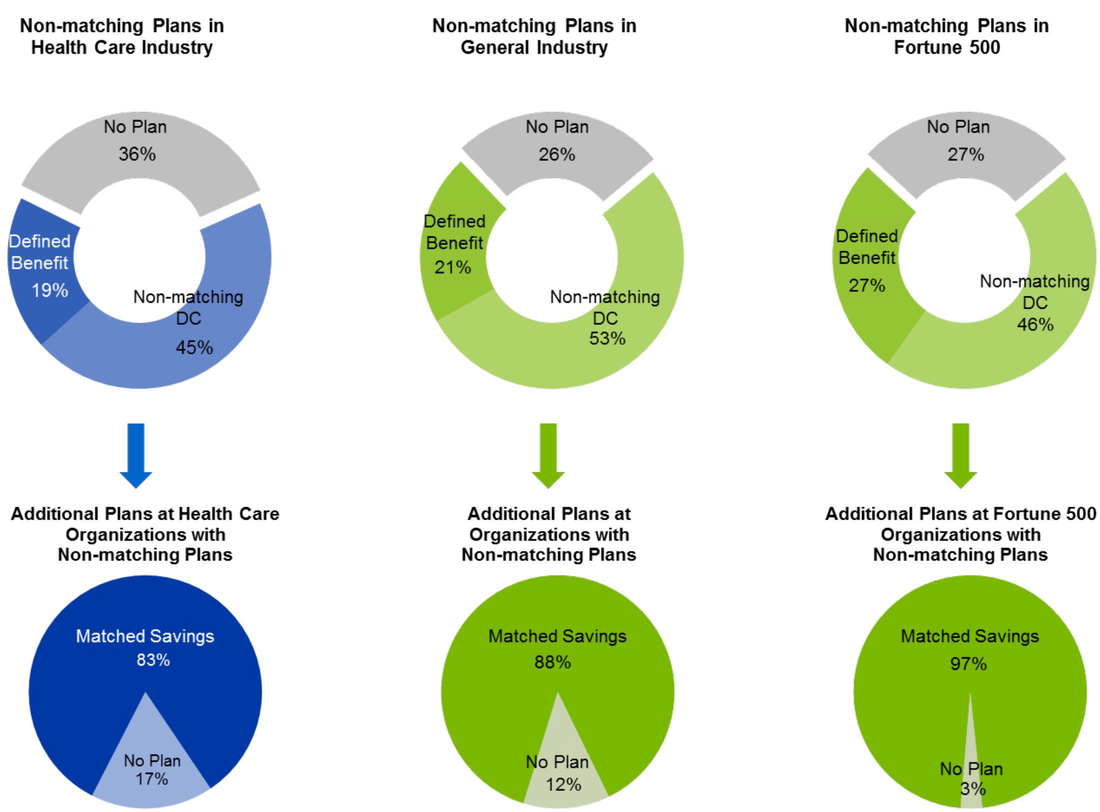
Defined Benefit Pension Plans

The pension value depends on the level of the benefit accrual rate after reflecting integration with Social Security and limits on service credited for benefit accrual, as well as interest crediting rates for cash balance plans. Overall, the average annual pension plan accrual (including the four health care unions' pension plans) is worth about 5.1% of pay for the Benefit Index population, based on "middle-of-the-road" actuarial assumptions and methods. However, union pension plans are providing the most value, with an average of 8.6% of pay, compared to the not-for-profit average of 4.3% of pay. No for-profit health care organizations in this analysis offer a defined benefit pension plan to new hires.

Noncontributory Defined Contribution Plans

Forty-five percent of nonunion health care organizations provide retirement income from a non-matching defined contribution plan. The average annual employer contribution is about 4.0% of pay. None of the union benefits evaluated offer a noncontributory defined contribution plan. Not-for-profit health care organizations are providing somewhat more value than for-profit organizations, with an average contribution of 4.1% of pay versus the for-profit 3.4% of pay average.

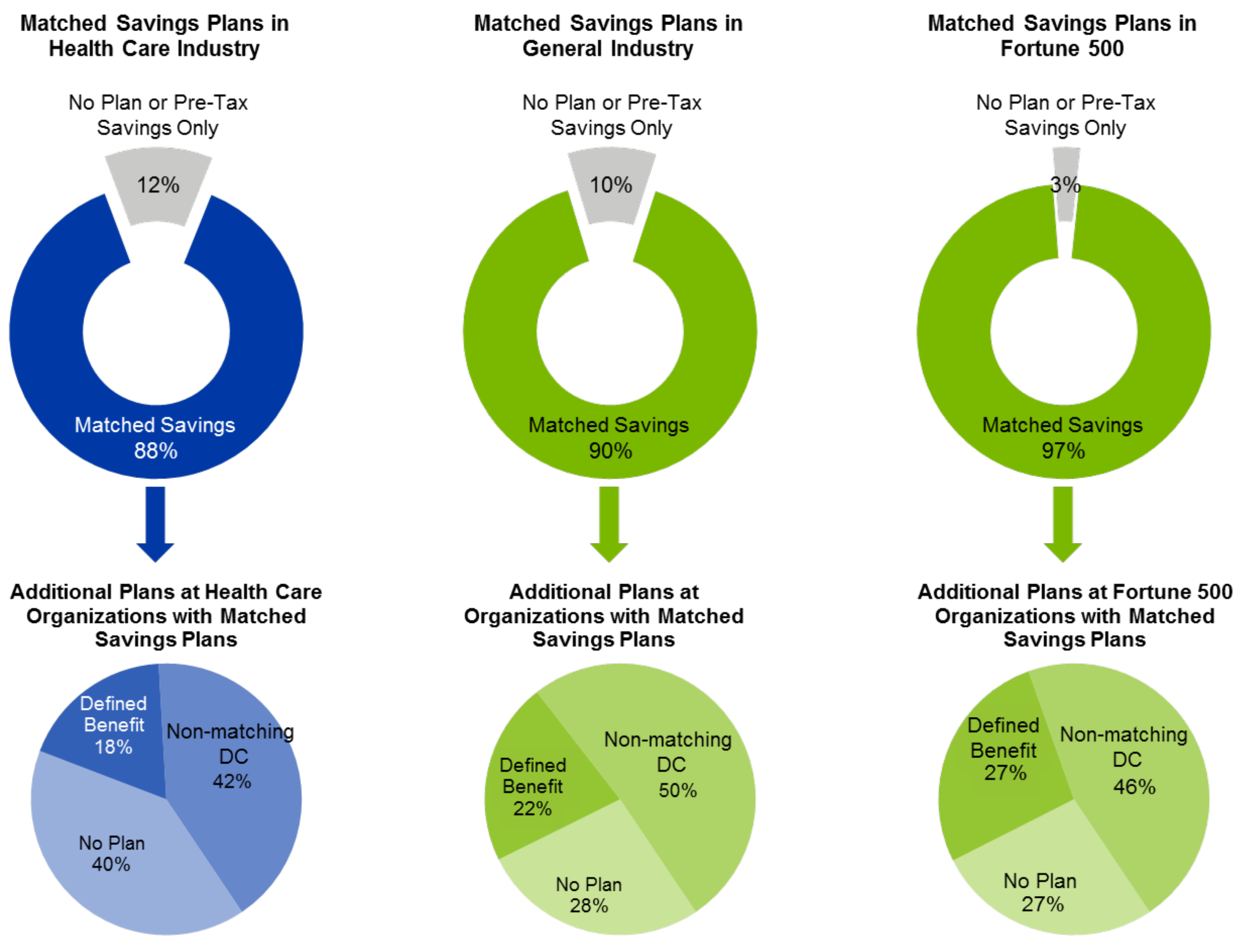
The diagram below shows that organizations in general industry and Fortune 500 are more likely to offer a matched savings program on top of their non-matching defined benefit or defined contribution plan.



Matched Savings Plans

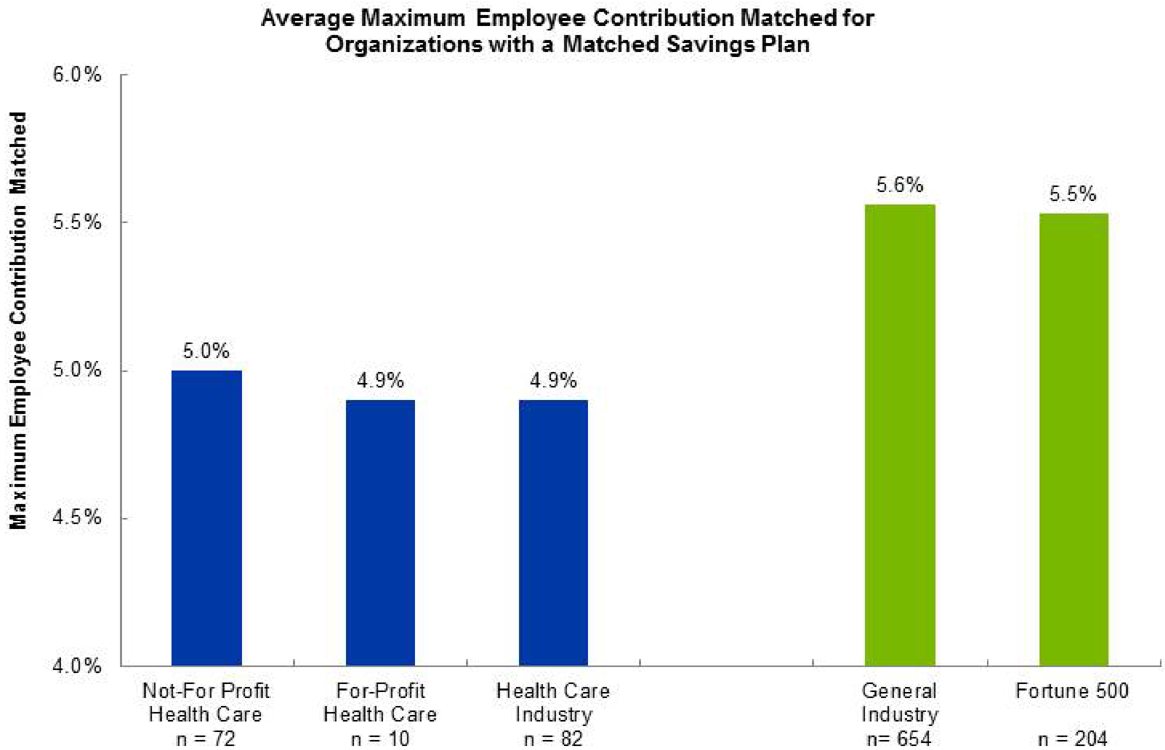
The primary factors to consider in determining the value of a matched savings plan are the maximum employee contribution matched, match per $1.00 of employee contribution, and the resulting maximum employer contribution opportunity. Eighty-eight percent of nonunion health care organizations provide a matched savings plan to new employees. In comparison, 90% of general industry and 97% of Fortune 500 companies provide a matched savings plan. None of the union plans evaluated provide a matched savings plan.

Out of the nonunion health care organizations that offer a matched savings plan, 60% also offer some sort of defined benefit or non-matching defined contribution plan. As a point of comparison, out of the general industry and Fortune 500 companies that have a matched savings plan, the number of organizations that also provide some sort of "core" retirement plan is higher, at 72% and 73% respectively.



Maximum Employee Contribution Matched

A comparison of the amount eligible for employer matching contributions is shown below. The health care industry tends to anchor matches at either 4% of pay or 6% of pay, while both general industry and Fortune 500 companies tend to anchor at 6% of pay.

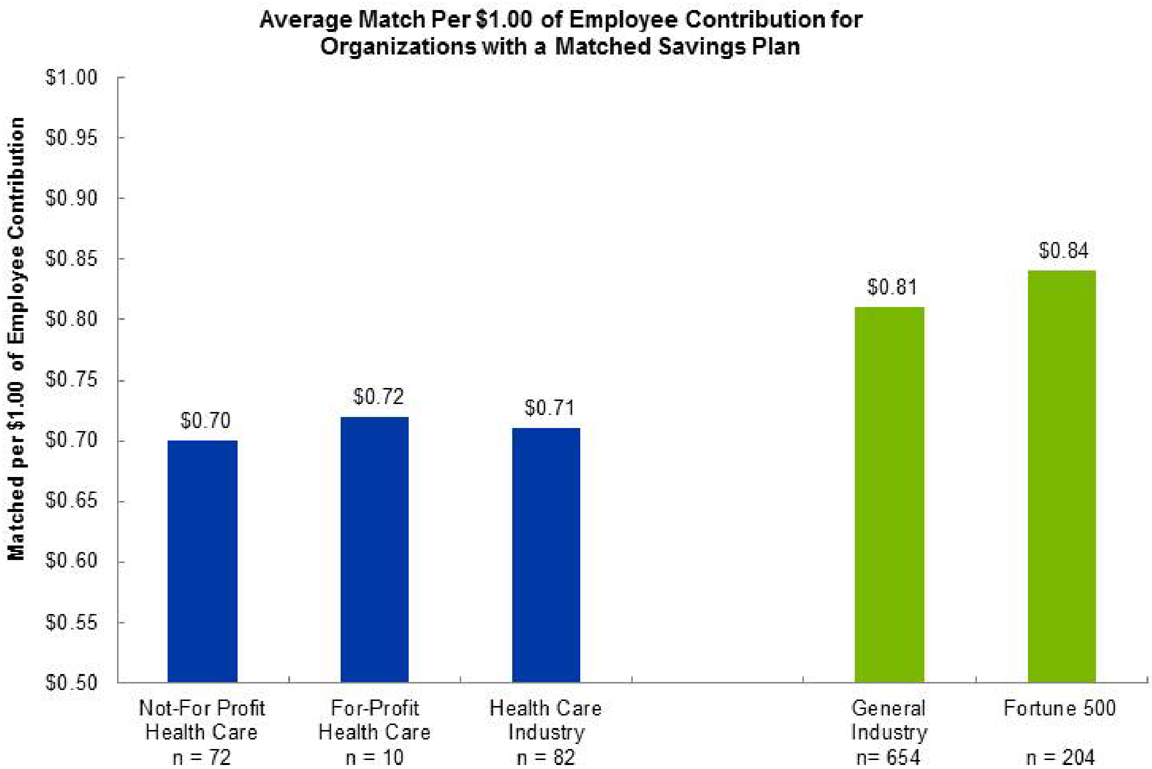


Details on health care organizations' maximum employee contribution matched are shown below.

	Number of Plans		
Maximum Employee Contribution Matched	**Not-for-Profit Health Care**	**For-Profit Health Care**	**Health Care Industry**
2%	2	1	3
3%	2	1	3
4%	25	0	25
5%	11	3	14
6%	25	4	29
7%	1	0	1
Other	6	1	7
Total	**72**	**10**	**82**
Average	5.0%	4.9%	4.9%

Match per $1.00 of Employee Contribution

The health care industry tends to have smaller rates of employer match than do general industry or Fortune 500 companies. On average, health care organizations match $0.71 on the dollar while Fortune 500 companies match $0.84 on the dollar.



The most common match for both not-for-profit and for-profit organizations is $0.50 per $1.00 of employee contribution, and the average match level for the two groups is similar. In spite of having a smaller average match, a higher percentage of not-for-profit plans provide a match of $1.00 per $1.00 or more.

Ten percent of these organizations vary the match by service. In these cases, the amount shown in the table is based on the average match available to an entire workforce. Twenty percent of organizations vary the match with the size of the employee contribution (e.g., $1.00 per $1.00 on the first 3% of pay and $0.50 per $1.00 on the next 2% of pay). The amounts shown in the table are based on full employee participation.

Nine percent of savings plans vary the match based on the organization's performance. The values developed for these plans are usually based on an average of actual experience over the last few years. Although more challenging for not-for-profits, these employers are beginning to explore ways of recognizing and rewarding desired behaviors through some sort of gain sharing components in the retirement program.

Details on health care organizations' match per $1.00 of employee contribution are shown below.

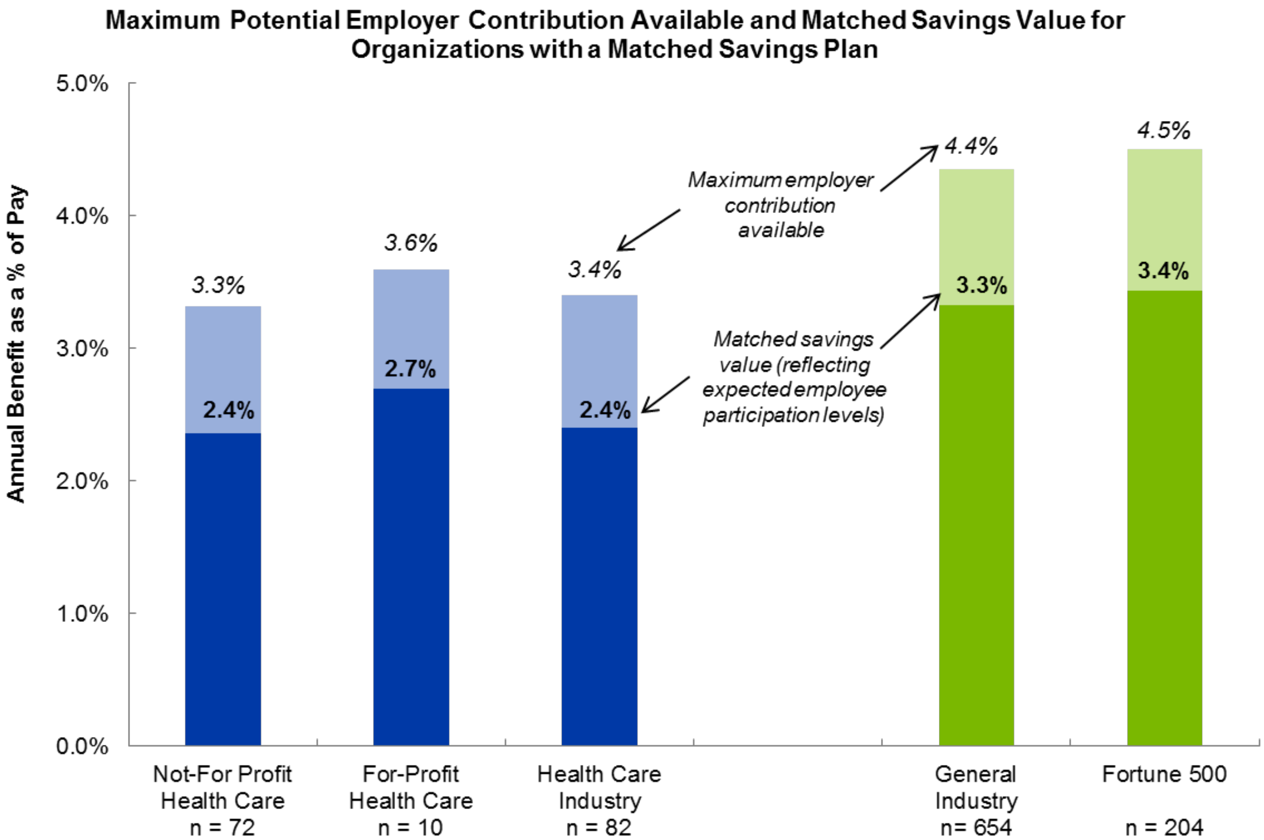
	Number of Plans		
Match Per $1.00 of Employee Contribution	**Not-for-Profit Health Care**	**For-Profit Health Care**	**Health Care Industry**
$0.25 or Less	4	0	4
$0.26–$0.49	8	0	8
$0.50	26	5	31
$0.51–$0.74	4	0	4
$0.75	4	0	4
$0.76–$0.99	4	3	7
$1.00	18	1	19
More Than $1.00	4	1	5
Total	**72**	**10**	**82**
Average	$0.70	$0.72	$0.71

Maximum Potential Employer Contribution Available and Matched Savings Value

To further analyze the value delivered by matched savings plans, we combined the data on the maximum contributions subject to employer matching dollars with the size of the match itself. For example, if an employer provides a $0.50 match per $1.00 of employee contribution for the first 6% of pay, the potential employer contribution would be valued at 3% of pay. This combination is represented by the top number of each chart on the following page. When we add assumptions for expected employee participation, we get the expected value delivered by the program. This is represented by the second line in each chart, and is also a proxy for employer cost.

For the health care industry overall, the average savings plan has a $0.71 match on the first 4.9% of pay for a total amount available of 3.4%. Since employees do not all fully participate in the program, the actual value delivered from matched savings plans in the health care industry is 2.4% of pay.

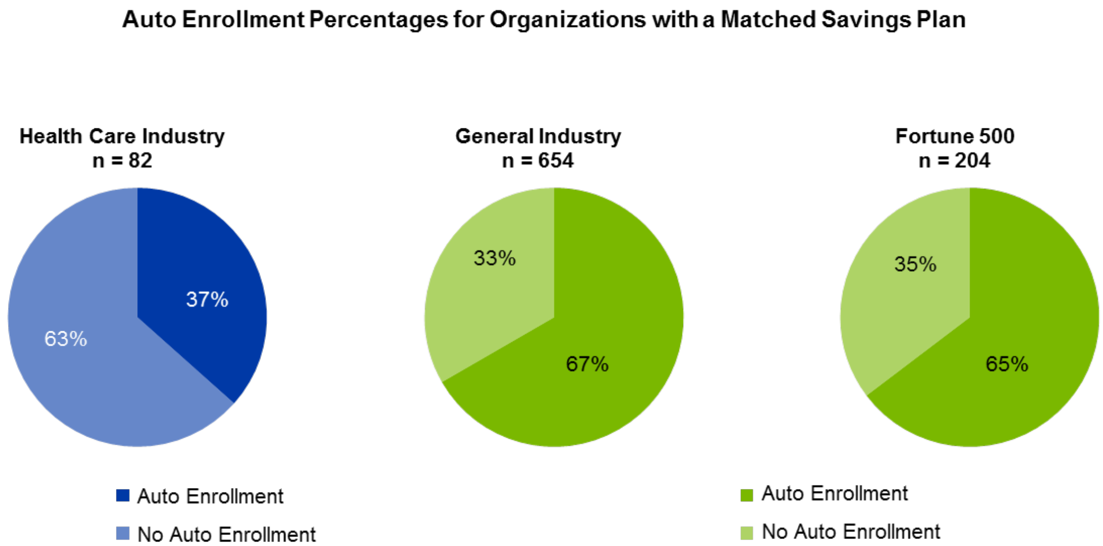
Not surprisingly, the value provided through matched savings plans at health care organization is lower (by 1% per annum on average) than the value provided by matched savings plans at Fortune 500 companies.



Details on health care organizations' maximum employer contribution are shown below.

	Number of Plans		
Maximum Employer Contribution	**Not-for-Profit Health Care**	**For-Profit Health Care**	**Health Care Industry**
Under 2.00% of Pay	11	2	13
2.00%	8	0	8
2.01%–2.99%	10	0	10
3.00%	12	3	15
3.01%–3.99%	2	0	2
4.00%	13	3	16
4.01%–4.99%	4	1	5
5.00%	3	0	3
6.00%	6	0	6
More Than 6.00%	3	1	4
Total	**72**	**10**	**82**
Average	3.3%	3.6%	3.4%

Automatic Enrollment and Automatic Escalation



Thirty-seven percent of health care employers auto-enroll their new hires in their matched savings plans. The use of automatic enrollment by health care employers is significantly lower than the 67% and 65% we see at general industry and Fortune 500 companies, respectively.

Fewer than 10% of health care employers provide their new hires with an automatic escalation feature in their matched savings plans. This is quite low when compared to the roughly 32% of general industry and 40% of Fortune 500 companies that use automatic escalation to increase employee contribution levels over time.

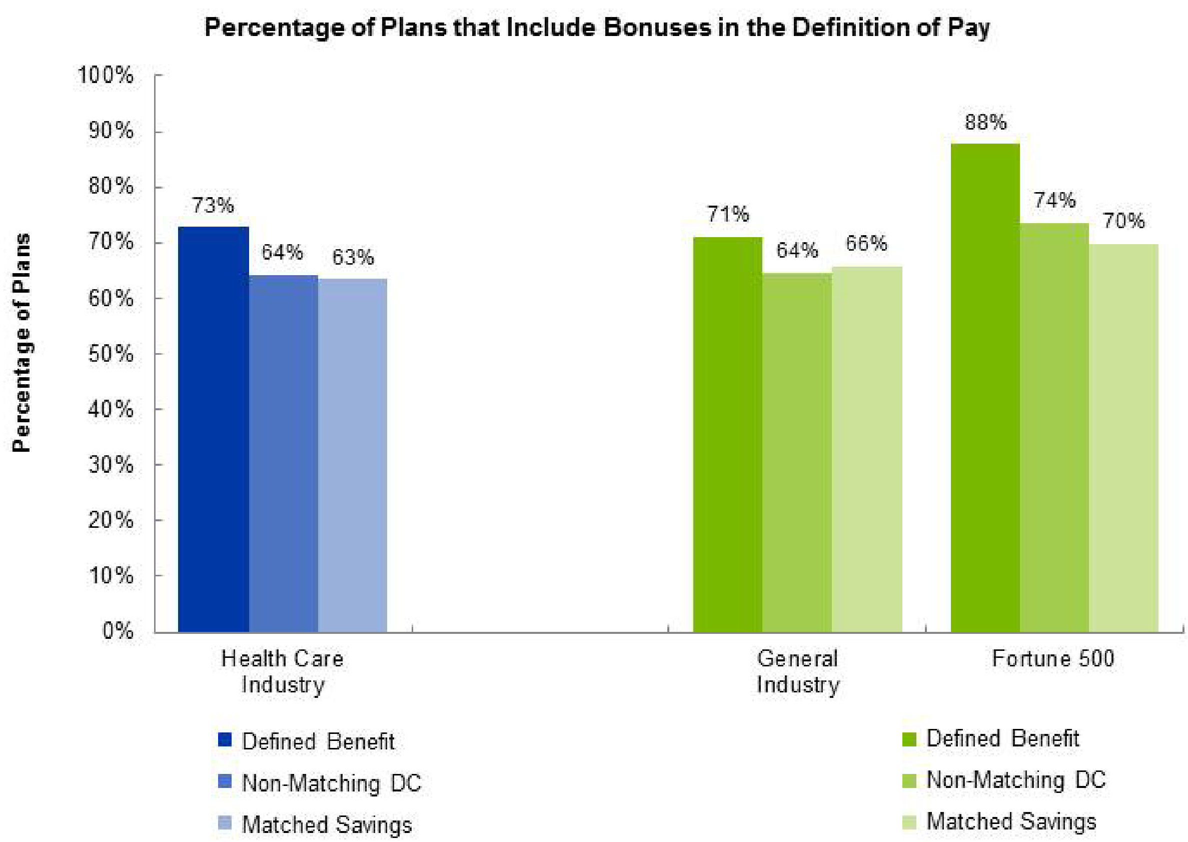
As noted earlier, this is due in part to the fact that certain church plans are ineligible to adopt these automatic features in some states.

Additional Plan Features Affecting Value

Definition of Pay

We have analyzed the definition of pay included in each organization's retirement income plan. Most organizations compensate employees with both base compensation and some form of annual incentive or bonus payout. The majority of plans include bonuses in the definition of plan compensation, as shown in the chart below.

Note that a higher percentage of Fortune 500 companies include bonuses in the definition of pay than do health care organizations. Interestingly, general industry, which includes companies of all sizes, looks similar to the health care industry. In all industries, defined benefit plans are more likely to include bonuses in the definition of pay than are defined contribution plans.



Details on health care organizations' definition of pay are shown below.

	Defined Benefit	Noncontributory Defined Contribution	Matched Savings
Base Pay Only	6	15	29
Base + Bonus	16	27	52
Partial Bonus or Limited Pay	0	0	1
Total	**22**	**42**	**82**

Within the health care industry, for-profit organizations are more likely to include bonuses in the definition of pay. The for-profits studied include bonuses in 92% of their plans, compared to 63% of the not-for-profit plans and 50% of the union plans.

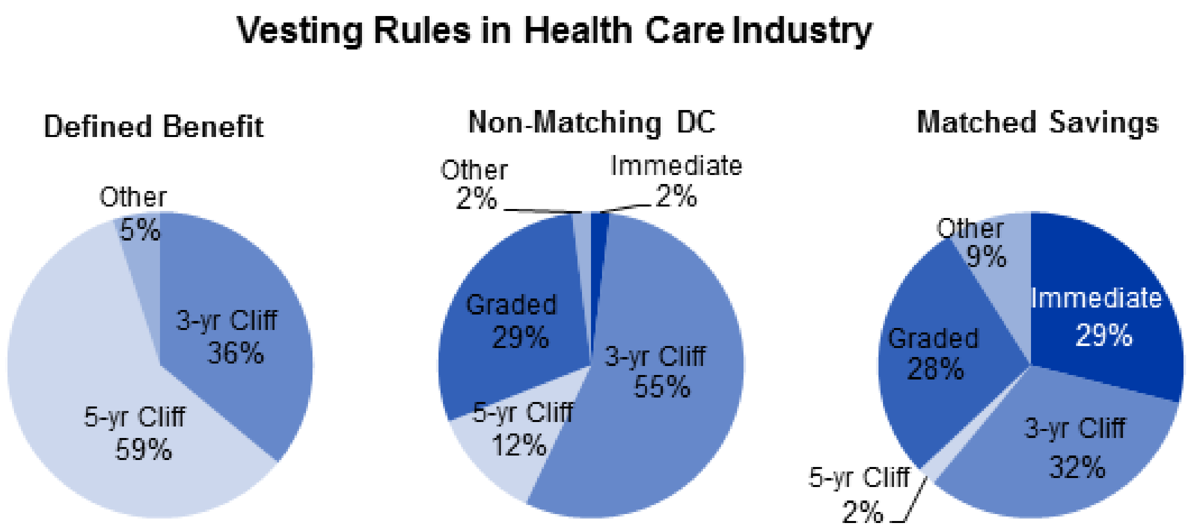
Vesting

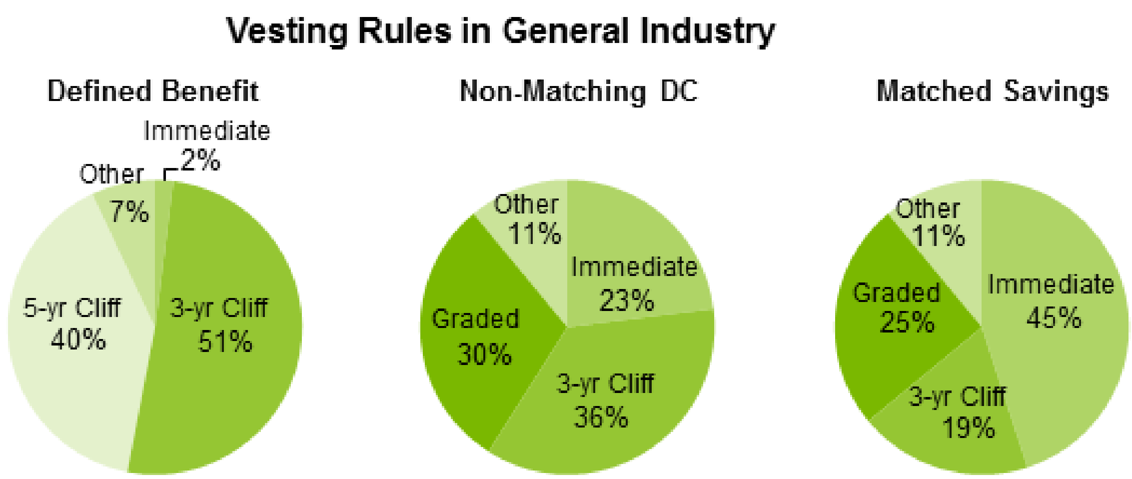
The impact of shorter vesting schedules varies by the type of plan involved.

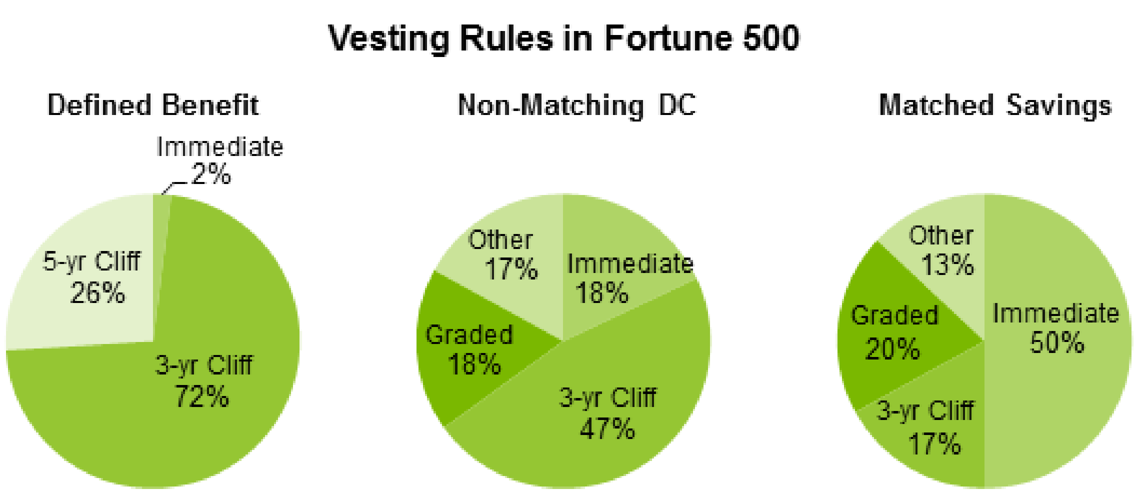
Cash balance and defined contribution plans tend to provide a more level pattern of accruals which, in comparison to traditional pension plans, can produce larger benefits upon early termination and smaller benefits upon retirement. The charts on the next page compare the vesting rules by plan type. They also show the differences between the health care industry, general industry, and Fortune 500.

Traditional defined benefit plans typically have a five-year cliff vesting while hybrid defined benefit plans typically have a three-year cliff vesting. The most common vesting rule for a non-matching defined contribution plan is a three-year cliff or a graded vesting schedule. Matched savings plans typically offer immediate vesting; some are based on a three-year cliff or graded vesting schedule. This trend appears to be similar in all industries. Some church plans may have longer vesting schedules than would be permitted for ERISA plans.

General industry and Fortune 500 companies are more likely to provide immediate benefits to their employees. For example, only 2% of health care organizations provide immediate vesting for non-matching defined contributions benefits, while 23% of general industry and 18% of Fortune 500 companies provide immediate vesting. As for matching savings plans, the number of Fortune 500 companies that provide immediate vesting to their employees is almost double that of the health care industry.


Vesting Rules in Health Care Industry
Defined Benefit
Other 5%
3-yr Cliff 36%
5-yr Cliff 59%
Non-Matching DC
Other 2%
Immediate 2%
Graded 29%
3-yr Cliff 55%
5-yr Cliff 12%
Matched Savings
Other 9%
Immediate 29%
Graded 28%
3-yr Cliff 32%
5-yr Cliff 2%


Vesting Rules in General Industry
Defined Benefit
Immediate 2%
Other 7%
5-yr Cliff 40%
3-yr Cliff 51%
Non-Matching DC
Other 11%
Immediate 23%
Graded 30%
3-yr Cliff 36%
Matched Savings
Other 11%
Graded 25%
Immediate 45%
3-yr Cliff 19%


Vesting Rules in Fortune 500
Defined Benefit
Immediate 2%
5-yr Cliff 26%
3-yr Cliff 72%
Non-Matching DC
Other 17%
Immediate 18%
Graded 18%
3-yr Cliff 47%
Matched Savings
Other 13%
Graded 20%
Immediate 50%
3-yr Cliff 17%

Appendix - Methodology

Benefit Index® is a comparison of the economic **value** of benefit programs provided for newly hired employees. The methodology has been developed to consistently compare different benefit programs using:

- A common population
- "Middle-of-the-road" assumptions
- Uniform valuation methods and techniques

At the end of the process, the only remaining variable is benefit plan design, resulting in a "fair" comparison of the relative value of each benefit program.

We are careful to point out that the economic value calculated using our Benefit Index methodology is not the same as an individual organization's cost, which can be significantly impacted by funding decisions, asset performance, unique employee characteristics, or atypical actuarial assumptions. However, this economic value can still be viewed as a proxy for cost, where cost is determined using middle-of-the-road actuarial assumptions and a standard population.

Employee Population Base

To facilitate comparisons, one common population is used in determining the relative value indices.

Over 20 large organizations furnished information on the age-service-sex-compensation characteristics of their employees. These were used as a guide in developing the population, but the population is not an actual composite of the employees of these organizations.

Developing the Retirement Program Values

In general, the value of retirement benefits is determined by establishing the value of benefits accruing during the year (an allocation of postretirement values to working years).

The actuarial and employee participation assumptions used are chosen with the intention of being as "realistic" as possible. In effect, these values are summed up for all the employees in the population, recognizing that the value of the various benefits varies by the individual's circumstances—age, service, gender, compensation level. The relative value in any benefit area then recognizes, on a composite basis, the value to an entire employee group—using a mix of employees who have a variety of individual circumstances.

Many factors are important in determining where an organization ranks in value for its overall retirement income program. For pension plans, the most important factor is the benefit formula. For noncontributory defined contribution plans, the primary factor is the size of the annual employer contribution. For matched savings plans, the most important factors are the organization matching contribution rate and the maximum matched employee contribution. Additional factors considered in the analysis include the definition of covered pay, pension early retirement features, automatic enrollment and automatic escalation in matched savings plans, vesting requirements, and disposition of forfeitures.

Retirement Benefits Included

- Non-Matching

  Includes all postretirement payments to an employee and spouse from defined benefit pension plans and noncontributory defined contribution plans (excludes savings plans). Excludes payment of Medicare premiums and lump-sum death benefits under a formula (e.g., a flat $1,000 postretirement death benefit is not included, while a subsidized 50% spouse's annuity is included). Vested benefits and disability benefits payable after age 65 are included. Preretirement death benefits (lump sum and annuity-type) and the portion of any disability pension prior to age 65 are not included.

- Matched Savings

  Includes 401(k) and 403(b) savings plans with a direct and significant employer subsidy. Only the employer-provided retirement value of savings plans has been included. The next paper in our series will combine both employer and employee contributions to examine plan effectiveness and retirement readiness.

A Look Ahead…

As the health care industry changes and consolidations continue, employees must become better users of their employers' retirement programs. Employers can help by educating employees, and by adopting certain best practice plan features that will help employees prepare for retirement.

The next paper in our series explores the plan provisions that should be considered in order to improve retirement outcomes for employees of health care organizations.

Stay tuned!

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About Aon Hewitt

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