Executive Summary…Finding 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 1,000 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 to a broader set 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—Published on July 24, 2015
IV. Defined Benefit Financial Benchmarking in the Health Care Industry
V. Managing Legacy Pension Liabilities in the Health Care Industry
III. Efficient Retirement Design and Its Effect on Retirement Readiness for Health Care Employees

Part III of our series on retirement benefits in the health care industry focuses on the efficiency of the overall retirement programs offered by employers in the industry. Health care employers have an opportunity to improve outcomes for their employees without increasing employer cost.

In order to gauge how well employees are prepared for retirement, Aon Hewitt regularly analyzes the data from millions of retirement plan participants. The findings are published in *The Real Deal: Retirement Income Adequacy at Large Employers*.

Shown below is a comparison of the average resources and needs of employees in the health care industry compared to employees in general industry. These charts include employees who have actively contributed to their retirement plans throughout their full careers.

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1 2015 update to *The Real Deal* expected in August 2015.
Employee Needs

On balance, the needs of the average health care employee are similar to the needs of those in a broader industry grouping because of two unique characteristics of the average health care employee that directly offset one another. First, health care employees have somewhat lower average wages than employees in general industry. This means that Social Security replaces a larger portion of income for average health care workers than for the average general industry role, thus reducing their private needs. However, the lower wage is offset by attributes of a larger female population in the health care industry. Since females have a longer life expectancy than males, their money needs to last longer.

Employee Resources

Private resources available to health care employees through accumulation of employer-provided benefits and employee savings are expected to come up short. In Part II of this series, we saw that the health care industry provides about 73% of the retirement value provided by employers in other industries. It is no surprise that the average health care worker is expected to have fewer resources available at retirement than the typical general industry employee.

Expected Retirement Shortfall

Even full-career contributors are expected to have a shortfall in retirement resources at age 65. Employees in the health care industry are expected to fall short by a multiple of 3.1 times final pay. To put this shortfall in perspective, in order to close this gap of 3.1 times pay at age 65, a 35-year-old employee would need to save an additional 7.5% of pay every year to age 65.

Without further incentives from private employer plans, it is unlikely the average employee will take action to close this gap. Consequently, employers in all industries—including health care—are taking steps to improve retirement outcomes for their employees. This paper considers not only the employer cost of an array of retirement vehicles, but also the size of the retirement benefit made available to employees who fully participate in their employers’ programs.

With employers facing increased financial pressures, it is more important than ever to design retirement plans that maximize the benefits available at retirement for every dollar of employer cost.
Introduction and Key Findings

Part III of our five-part white paper series on retirement benefits in the health care industry takes the benchmarking data laid out in Part I and combines it with the detailed employer cost analysis from Part II to measure overall plan efficiency.

The following findings within the health care industry stand out:

Retirement Plan Efficiency

- In Part II of our series, we saw that the average health care employer “spends” 4.6% of pay per annum for retirement benefits.
- The expected age 65 benefit as a multiple of pay provided for this cost of 4.6% of pay per annum ranges from about 4.5 times pay to over 6 times pay. In general industry, the range is even wider, from less than 4 times pay to over 8 times pay.
- Plan design is the sole reason for these differences in efficiency.

The Power of Employee Savings

- To close the retirement income gap, employers in all industries must encourage additional employee savings.
- As noted in Part II of this series, the vast majority of employers in all industries provide some sort of matched savings plan. It is notable that 60% of health care employers with matched savings plans require less than 6% of pay to get the full employer match.
- In contrast to health care, close to 60% of Fortune 500 companies with matched savings plans require 6% or more to get the full employer match.
- Health care employers have the opportunity to significantly improve retirement outcomes for their employees by ramping up the efficiency of their matched savings programs and incenting employees to save more.

The rest of this paper reveals the wide range of outcomes produced by different plan designs having the same employer cost. We then explore ways to improve outcomes so that employees have adequate savings at age 65.
Retirement Plan Efficiency—Employer Cost vs. Employee Benefit Value

The chart below plots hundreds of retirement programs by the following criteria:

- **Plan type**
  - Defined benefit
  - Noncontributory defined contribution
  - Matched savings

- **Employee age 65 benefit as a multiple of final pay**
  - Assumes full employee participation in employer plans
  - Assumes graded employee contribution schedule varying by plan design features
  - Includes benefit from employee money if required to get employer match

- **Employer cost**
  - Expected cost based on Benefit Index™ methodology

**Defined Benefit**
The defined benefit plan is more efficient than the noncontributory defined contribution plan. The most efficient defined benefit plan designs are of the traditional final average pay type. These plans tend to be more expensive than hybrid designs such as cash balance plans, so we do see increased plan efficiency at the higher employer cost levels. Defined benefit plans provide smaller value to employees who leave prior to retirement, leaving greater value to be distributed to those reaching age 65.
Noncontributory Defined Contribution
Based on the retirement value matrix, the relationship between employer cost and employee benefit value is linear for nonmatching defined contribution plans, with the exception of a few outliers resulting from different plan features such as profit sharing provisions, vesting, eligibility, definition of pay, etc. Of the three plan types, the nonmatching defined contribution is the least efficient. Better outcomes can be achieved through improved investment returns, but the plan design itself has limited ability to improve outcomes without increasing employer cost.

Matched Savings
The matched savings plan is the most efficient retirement income vehicle because it requires employees to contribute\(^2\). This also makes the matched savings plan the least expensive plan from an employer’s perspective. This is due to the fact that the employer benefit goes only to employees who contribute their own money into the plan.

\(^2\) The age 65 benefit in the retirement value matrix includes employee contributions and employees are assumed to contribute up to the match level.
Retirement Plan Efficiency—Health Care Industry vs. General Industry

Let’s see how health care employers’ retirement plans stack up on an efficiency measure. Aon Hewitt actuaries have determined the expected cost of retirement benefits provided by nearly 100 health care organizations across the country. In addition to the expected employer cost, we have also calculated the potential retirement benefit at age 65 available from each plan as a multiple of final pay. As with the chart on the previous page, the chart below plots the employer cost on the horizontal axis and the age 65 benefit on the vertical axis. The age 65 benefit includes assumed employee contributions.3

Not-for-profit health care organizations provide a wide variety of benefits, and we can see a wider spread of benefit values for a given employer cost level. For-profit health care organizations are seen closer to the bottom left of the chart since, as laid out in Part I, they provide lesser retirement benefits than the typical not-for-profit organizations. Health care unions provide much richer benefits and appear on the upper right side of the chart.

If we focus on the center of the chart, one employer spending 6% of pay per year provides a maximum employee benefit of less than 5 times pay at age 65, while another employer spending 6% of pay provides an age 65 benefit of almost 8 times pay. This is a function of the mix of plan designs offered, and demonstrates that some retirement programs are significantly more efficient than others.

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3Employee contributions are based on historical employee savings rates in combination with the employer match amounts. A schedule of employee contributions is summarized in the appendix on page 14.
Now let’s see how the health care industry compares to other industries. The chart below compares retirement plan efficiency for organizations in the health care industry, general industry, and Fortune 500.

Notably, since general industry and Fortune 500 employers provide richer retirement benefits than does the health care industry, we can clearly see health care clustered near the lower left portion of the chart. The spread between the highest and lowest benefit values at a particular cost level is widest for general industry, followed by Fortune 500 and then the health care industry. In other words, general industry employers tend to offer more efficient retirement benefits—as can be seen by the gray dots in the upper portion of the chart.

Employers in the health care industry have an opportunity to improve plan efficiency by focusing on getting more from their matched savings plans.
Matched Savings Plan Efficiency—Health Care Industry vs. General Industry

Since the matched savings plan is the most efficient plan design, here we look more deeply into the efficiency of the matched savings plans in the health care industry, general industry, and Fortune 500. Similar to previous retirement value matrices, the age 65 benefit includes employee contributions.4

General industry and Fortune 500 employers provide richer matched savings plans than the health care industry does, which is why they are skewed more toward the right of the chart.

In addition to having a higher overall employer cost, even at the same cost level general industry and Fortune 500 companies are getting better outcomes than the health care industry for the dollars they spend. For instance, at the 3% cost level, health care employees are getting approximately 3 to 4 times pay, but some employees in general industry are getting more than 7 times pay. This is because general industry requires a higher employee contribution to receive the full match, which directly encourages employees to save more.

4 Employees are assumed to contribute up to the match level.
Closing the Retirement Income Gap

As mentioned earlier, a 35-year-old employee can close the retirement income gap by saving an additional 7.5% per year for the next 30 years. Based on data from *The Real Deal*, the average health care employee is saving 5.9% today. Closing the gap through additional employee savings could mean employees would more than double their current savings rate. Without additional employer incentives, it is unlikely the retirement income gap will be closed through voluntary employee savings alone.

The good news for health care employers is that there are many steps they can take to help employees close the gap. In the example below, we illustrate the different steps an employer can take to reduce the shortfall for a sample health care employee. Note that these different steps will not impact every employee in the same manner, and changing the order of the steps will also produce different outcomes. In the appendix, we show two additional examples for employees of different ages and starting account balances.

Health care employee profile:
- This employee is age 25, has annual pay of $50,000, and starts with a retirement account balance of $0
- Employer provides 3% nondiscretionary contribution, plus a $1.00 per $1.00 match on first 3% of pay (total potential employer contribution of 6% of pay). This is analogous to the average amount of 5.6% which is made available to participating health care employees as laid out in Part I of this white paper series
- Employee saves 3% to receive full match
- Shortfall is 5.9 times final pay, rather than the 3.1 times final pay average for the industry
In order to raise the bar and redefine retirement in the health care industry, employers should take as many of the steps above as possible. The solution is within reach.
Appendix: Additional Illustrations on Closing the Retirement Income Gap

There are numerous methods an employer can use to help employees close the retirement income gap. Many can close this gap with minimal to no additional employer cost. As mentioned before, these methods have different impacts on different people. The following examples look at a 35-year-old with no opening account balance and a 35-year-old with $50,000 in an opening account balance.

Health care employee profile:
- This employee is age 35, has pay of $50,000, and starts with a retirement account balance of $0
- Employer provides 3% nondiscretionary contribution, plus a $1.00 per $1.00 match on first 3% of pay (total potential employer contribution of 6% of pay). This is analogous to the average amount of 5.6% which is made available to participating health care employees as laid out in Part I of this white paper series
- Employee saves 3% to receive full match
- Shortfall is 7.6 times final pay

This example highlights the importance of starting to save early in one’s career.
Health care employee profile:
- This employee is **age 35**, has pay of $50,000, and starts with a retirement **account balance of $50,000**
- Employer provides 3% nondiscretionary contribution, plus a $1.00 per $1.00 match on first 3% of pay (total of 6% of pay, which is analogous to our 5.6% average health care employer contribution in Part I of this white paper series)
- Employee saves 3% to receive full match
- Shortfall is 5.9 times final pay

The following diagram illustrates some of the assumptions used for both employees.

1. Increase Employee Contribution
   - Change match from $1.00 per $1.00 match on first 3% of pay to $0.50 per $1.00 match on first 6% of pay

2. Introduce Automatic Features
   - Add automatic escalation of 1% per year (maximum of 8%)

3. Offer Investment Help
   - Investment return improvement of 1%

4. Reduce Leakage
   - Prevented two loan defaults of $8,000, one at age 40, the other at age 45

5. Reduce Fees
   - Administrative and investment fee improvement of 30 basis points
Appendix: Employee Contribution Assumption

The retirement value matrices in the “Retirement Plan Efficiency—Health Care Industry vs. General Industry” section includes assumed employee contributions. Employee contributions are based on the maximum employer match amount. The following table summarizes the employee contribution schedule.

<table>
<thead>
<tr>
<th>Maximum Match Provided by Employer</th>
<th>Employee Contribution Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>No match</td>
<td>5%</td>
</tr>
<tr>
<td>Less than or equal to 3%</td>
<td>6%</td>
</tr>
<tr>
<td>More than 3% match but less than or equal to 5%</td>
<td>7%</td>
</tr>
<tr>
<td>More than 5% match but less than or equal to 7%</td>
<td>8%</td>
</tr>
<tr>
<td>More than 7% match</td>
<td>9%</td>
</tr>
</tbody>
</table>
A Look Ahead…

This installment of our series can serve as a guide for health care employers who want to get ahead of the retirement income crisis. The vast majority of retirement plans can benefit from using one or more of the strategies identified in this material. As employers focus on taking steps to improve ongoing defined contribution plan efficiency, finance executives are taking steps to address legacy defined benefit plan issues. Since many health care organizations have a June 30 fiscal year-end date, our next paper will provide important financial benchmarking for health care organizations with legacy defined benefit liabilities.

Finally, the fifth paper in our series will focus on highly efficient holistic defined benefit plan management.

Stay tuned!

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Contact Information

Lynn A. Cornwall, ASA, EA
Senior Partner
Aon Hewitt
+1.847.442.3214
lynn.cornwall@aonhewitt.com
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Aon Hewitt empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. We advise, design, and execute a wide range of solutions that enable clients to cultivate talent to drive organizational and personal performance and growth, navigate retirement risk while providing new levels of financial security, and redefine health solutions for greater choice, affordability, and wellness. Aon Hewitt is the global leader in human resource solutions, with over 30,000 professionals in 90 countries serving more than 20,000 clients worldwide. For more information, please visit aonhewitt.com.

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