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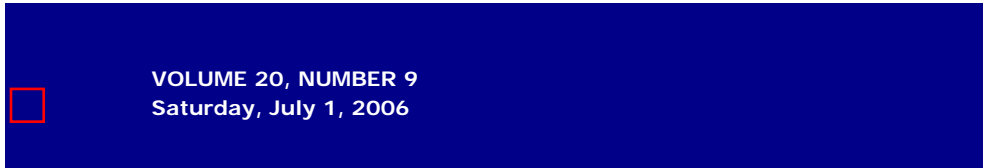
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**The financial case for integrating direct advice programs into consumer-directed health plans**

By: Kevin P. Condon, Ph.D., CFP

As a group, 401(k) plan sponsors have realized, rather belatedly, that education initiatives, online financial calculators and automated advice engines are, by themselves insufficient to help many participants make sound 401(k)-related decisions. Far greater attention is now being paid to direct financial advice alternatives.

A key question in today's benefits environment is whether sponsors offering health savings accounts and other consumer-directed health plans have learned this essential lesson. There is no reason to believe that employees, who traditionally have struggled to make 401(k) deferral and asset allocation decisions, will prove highly adept at deciphering new health care alternatives. CDHPs require employees to make a complex financial decision with a health care overlay.

If CDHP sponsors fail to provide employees with the right support - and, in effect, repeat the same mistake made in the 401(k) arena - it is likely that both sponsors and participants will fail to benefit as much as they should from these tax-advantaged plans.

**CDHP decisions**

Typically there are three basic 401(k) plan decisions made by employees: How much to contribute, which investments to select, and how these investments should be allocated.

In contrast, determining whether to opt into a CDHP is a considerably more complex undertaking. An employee evaluating a Health Savings Account (HSA) option, for example, faces a daunting list of decision criteria:

- Eligibility
- Cost-effectiveness vs. other options, based on anticipated-utilization prescriptions, doctor visits, etc.
- HSA contribution guidelines/limitations
- Understanding what constitutes a "qualified expense"
- Tax treatment of contributions/appropriate contribution levels
- Tax treatment of withdrawals

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- Investment allocation/selection
- Other important features with which the employee is unfamiliar: portability, use as a savings vehicle, ability to pay LTC premiums, etc.

Based on past experience related to participant decisionmaking behavior in defined contribution retirement plans, we can safely assume that the average employee is ill-equipped to effectively process all of these decision criteria. Whether to participate and how much to contribute are sources of confusion that can lead to inaction - and that can be detrimental both to employers and their employees.

### Low participation rate

Indeed, we believe that the complexity associated with CDHP decisions is a major reason for the current low participation rates. According to a recent survey by Mercer Health & Benefits, "A scant 1% of all covered employees were enrolled in [a CDHP] in 2005." A Fidelity Investments survey, which focused solely on large companies, estimated enrollment to be less than 4%.

One-third of the HR managers who responded to OnlineBenefits' consumer-driven healthcare survey of U.S. businesses expect CDH to "cause confusion for employees." The survey also found that respondents believe that communications (86%) and financial planning (74%) are important factors to the success of CDHP plans. This is echoed by the Mercer study, in which about two-thirds of large employers said employees require more assistance in making the decision to enroll in a CDHP.

### Integrating third-party advice

If the 401(k) experience holds true for CDHPs, we can reasonably assume that without a direct advice program, numerous participants will take no action - or will make decisions that do not serve their best interests. A template for integrating third-party advice into a CDHP environment would most likely conform to these specifications:

- **Scalable.** The advice program must be available to employee populations that can run from hundreds to thousands of potential participants, and who may be dispersed across a wide range of company locations.
- **Easy access.** Experience dictates that workplace advice programs work best when employees can access them from anywhere and at times they find convenient. Employees view limited access as an obstacle.
- **Personal dialogue.** Employees are more prone to seek advice when they can communicate directly with an advisor and when the advisor is prepared to discuss the participant's specific situation, goals and questions. The 401(k) experience has repeatedly demonstrated that advice programs fail to gain traction when they involve data entry into intimidating software applications and little opportunity for dialogue with a trusted advisor.
- **Impartial advice.** It is essential for both employers and employees to perceive that the advice offered is totally impartial and free from any financial incentives that could compromise an advisor's recommendations.
- **Qualified advisors.** CDHP guidance requires financial advisors who are knowledgeable about taxes, investments, insurance, financial planning and cash flow issues. Ideally, all advisors should be licensed and have appropriate credentials.
- **Employer-paid.** The 401(k) experience strongly suggests that large numbers of plan participants will not take advantage of employee-paid advice programs.

- **Economic incentive for employer.** Companies will be hesitant to invest in CDHP advice programs unless they can be shown to provide a financial return (see chart).

### **Program results**

The following example provides a clear illustration of how even a modest boost in CDHP participation can dramatically reduce an employer's health care costs.

In our example, we assume that Company ABC has 5,000 employees and can save:

- 7.65% of FICA for every dollar contributed to tax-advantaged accounts
- an average of 20% to 25% in reduced premium or claims costs if employees shift to more cost-effective plans such as high-deductible health plans.

ABC Company introduced an HSA into its benefit plan more than a year ago, and relied heavily on a CDHP information portal and group educational seminars. Despite these efforts, employee participation has remained slightly below 2%, which is in keeping with industry averages. The company is willing to test whether one-to-one advice for employees has the potential to improve employee decision-making and thereby increase CDHP participation rates.

The company contracts with an external provider that can deliver impartial financial advice on a scalable basis at a cost of \$37,500 or \$7.50 per employee, based on the utilization shown in the chart above.

As the chart illustrates, a 5% increase in CDHP participation may enable the company to enjoy an annual savings of nearly \$142,205. This includes the \$37,500 outlay for external advice. It is worth noting that the company, in this example, does not have to meet this 5% target to cover its advice costs. Even with a modest 2.5% increase, the firm still comes out ahead financially - and provides a key benefit to employees. On the other hand, if participation rates increased by 10%, the return on investment for the employer would be \$244,000 in Year 1 alone.

There is a strong financial incentive for sponsors of HSAs and other CDHPs to not repeat the 401(k) experience, which clearly has shown that traditional education programs, interactive information portals, automated advice engines and calculators are not effective in helping many employees make difficult decisions. There also is a strong financial incentive for employers to boost CDHP participation rates, and direct financial advice programs may be the best potential solution to help employers achieve this goal.

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- E.B.N.

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