Redefining Retirement in the Health Care Industry

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

Part One of Five-Part Series: Retirement Design Benchmarking in the Health Care Industry

January 2015
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 100 health care organizations nationwide. This series lays bare all key facts and trends employers need to know to manage retirement plans in the health care industry in 2015 and beyond.

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

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

The first paper in our series on retirement benefits in the health care industry focuses on the overall retirement income program, including pension and savings plans. This includes a breakdown of the status of defined benefit plans and types of plans (including cash balance).

The following design trends stand out within the health care industry:

- On average, health care employers make 5.6% of pay available to employees who fully utilize their employer-provided retirement plans.
- There is a clear shift toward defined contribution plans as the key—or only—retirement plan available to employees.
- Defined benefit plans are being closed to new entrants or frozen altogether.
- For those employers with open defined benefit plans, hybrid plan designs like cash balance plans have become the most prevalent pension design.
- Although average retirement amounts available to employees from their health care employers average 5.6% of pay, there is a wide range available in practice. Retirement benefits available from health care employers vary from less than 2% of pay to more than 10% of pay.
- For-profit health care organizations make an average of 3.9% of pay available to employees, compared to an average of 5.8% of pay made available by not-for-profits.
- Health care organizations generally provide smaller retirement plans than general industry. The average retirement amount available to employees of organizations in general industry is 7.5% of pay, compared to the 5.6% of pay noted in the first bullet above for all of health care.
- Retirement benefits are typically an employer’s second largest benefit cost, trailing only health care benefits.
Hospitals were slower to move away from defined benefit plans than general industry, but have since caught up

While the trend in the United States to either freeze pension benefits or close these plans to new hires has been widely publicized, there are variations among industries. The health care industry as a whole was a bit slower to move away from defined benefit plans than general industry. Over the last four years, however, the health care industry has caught up. As recently as 2010, 39% of health care organizations had defined benefit plans that were open to new hires. By 2014, the percentage of health care organizations with open defined benefit plans was down to 24%. That compares to 22% of general industry organizations.

When considering the statistics noted above, it is important to keep in mind that while less than one-quarter of the health care industry still offers new hires a defined benefit plan, more than two-thirds of health organizations’ balance sheets have legacy defined benefit liabilities to contend with.
Retirement Programs Available to New Hires Average 5.6% of Pay

Employers in the health care industry are expected, on average, to make an annual benefit of 5.6% of pay available to employees through employer-sponsored retirement programs. This 5.6% of pay reflects full participation in an employer’s retirement program.

To the extent that not all employees participate at the maximum level in a voluntary plan, employers will not spend the full 5.6% of pay they make available to employees. An upcoming edition of this series will address employer cost and plan efficiency. Keep in mind that averages shown here are based on the retirement design in place for new hires, where some designs provide less than 2% of pay while others provide over 10% of pay.

Although the average retirement benefit available to health care employees through employer-sponsored retirement plans is 5.6% of pay, there is wide variation based on the organization’s:

- Financial structure
- Geographic location
- Size

Financial Structure

Within the health care industry, there are distinct design trend differences based on whether the employer is a not-for-profit entity or a for-profit entity. Open defined benefit plans are virtually nonexistent among for-profit health care organizations, where modest defined contribution plans are the norm. These for-profit plan designs make an average of 3.9% of pay available to employees.

The chart on the following page compares the percentage of pay available to employees from all retirement plans sponsored by not-for-profit health care employers, for-profit health care employers, and key health care unions currently active across the country. For comparison purposes, similar averages are shown for the Fortune 500 and a broader group of general industry employers of all sizes.
The following chart shows the distribution of retirement benefits available for each of the groupings in the preceding chart.
Geographic Location

The chart below illustrates retirement plan design by region. For systems that are geographically diverse, this regional breakdown is based on the headquarter location.

Note that the prevalence of defined benefit plans open to new hires is greater in the West than in any other area of the country. This is primarily due to the heavy union influence that exists in the West. Not surprisingly, the West also has the highest average percentage of pay available to employees, at 6.1%. By contrast, in the South, the average amount available is 4.8% of pay.

As we consider the average trends by geography, it is important to note that competition for talent in the health care industry is driven by local market pressures. Trends in retirement benefits may vary not just by region, but by individual city or county.
Size

If we subdivide the health care industry into three segments by size, we see certain patterns emerge. When it comes to the types of retirement plans offered to new hires, the largest organizations have more open defined benefit plans than the smallest organizations. The largest organizations also have more matched savings plans available to employees than the smallest organizations. The total benefit available to employees in the largest organizations averages 5.9% of pay while the average for the smallest organizations is 4.8% of pay.

Observations on Design Benchmarking

- Less than one-quarter of health care organizations have defined benefit plans open to new hires, but more than two-thirds still have legacy defined benefit liabilities.
- Employees must save aggressively to close the retirement income gap.
- Employers need to maximize the efficiency of their retirement programs in order to help employees close the retirement income gap.

When considering all sources of retirement income, a typical employee needs to set aside 15% of pay every year starting at age 25 in order to have a 50% probability of meeting private income needs at age 65. That same employee would need to set aside 19% of pay in order to have an 80% probability of meeting retirement income needs at age 65. Whether a health care worker is an employee of a not-for-profit organization where the average amount made available for retirement is about 5.8% of pay—or an employee of a for-profit organization where the average amount made available is 3.9% of pay—significant additional employee savings are required over a full career in order to ensure that employees can retire with adequate retirement income.
A Look Ahead…
Health care employers of all sizes and in all geographies are reassessing their retirement programs. As defined benefit plans freeze, employers are increasingly aware of the importance of encouraging employee participation in employer-sponsored defined contribution plans. The next paper in our series focuses on the prevalence of specific features within both pension and savings plans. We will point to plan features that currently are growing in popularity and those that we believe will grow over the next few years.

The third paper in our series will guide employers to create the most cost-effective, benefit-efficient retirement plans for the health care industry.

Although it is critical to identify the “best” retirement program for the future, health care employers cannot afford to ignore the defined benefit liabilities on the balance sheet. The fourth paper in our series 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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