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Testimony
on Behalf of Hewitt Associates LLC

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Before

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Committee on Education and Labor
Subcommittee on Health, Employment, Labor, and Pensions

Hearing on

Strengthening Employer-Based Health Care

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Hewitt Associates (NYSE: HEW) provides leading organizations around the world with expert human resources consulting and outsourcing solutions to help them anticipate and solve their most complex benefits, talent, and related financial challenges. Hewitt consults with companies to design and implement a wide range of human resources, retirement, investment management, health management, compensation, and talent management strategies. As a leading outsourcing provider, Hewitt administers health care, retirement, payroll, and other HR programs to millions of employees, their families, and retirees. With a history of exceptional client service since 1940, Hewitt has offices in more than 30 countries and employs approximately 23,000 associates who are helping make the world a better place to work. For more information, please visit www.hewitt.com.

I. Introduction

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to testify at this important hearing on the future of America's employer-based health care system. My name is Jim Winkler, and I am Hewitt Associates' Health Management Consulting Practice Leader. I am pleased to focus my remarks today, as requested, on the experience of large employers, the majority of whom provide health care coverage today.

Hewitt Associates is a global human resources outsourcing and consulting company, providing services to major employers in more than 30 countries and employing 23,000 associates worldwide. Headquartered in Lincolnshire, Illinois, we serve more than 2,000 U.S. employers from offices in 30 states, including many of the states represented by the members of this distinguished Subcommittee.

As one of the world's premier human resources services companies, Hewitt Associates consults with large employers to design their health plans and evaluate bids by competing health providers. In addition, we are the leading provider in Benefits Outsourcing services, administering health and welfare plans for 195 clients representing more than 7.5 million participants. Our access to large employers led us to create the Hewitt Health Value Initiative™ database, which contains detailed information on more than 1,800 health plans throughout the U.S., including 350 major employers and more than 13 million health plan participants. This rich data source allows us to analyze the impact of rapidly rising health care costs on employers and employees.

II. Hewitt's View of the Challenges

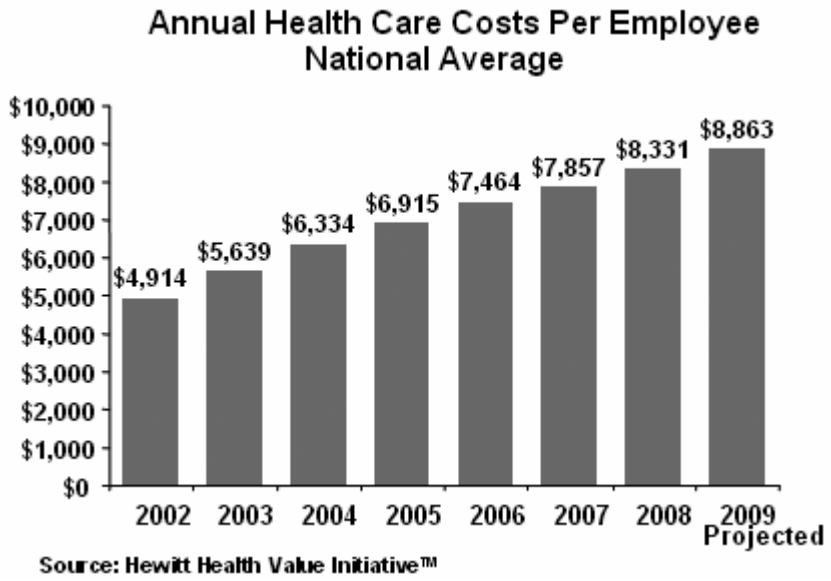
We agree, Mr. Chairman, with the view that the employer-based health care system must be preserved and strengthened as part of any viable health reform plan. Large employers support the urgent need for health reform and the objective of providing universal coverage. Further, employees and their families must have confidence that reform will not disrupt their existing coverage. Nationwide, employer-sponsored health care plans provide health care coverage to 160 million participants. Data from the Kaiser Family Foundation shows that 99% of employers with 200 or more employees offered health benefits in 2008, the latest data available.[1]

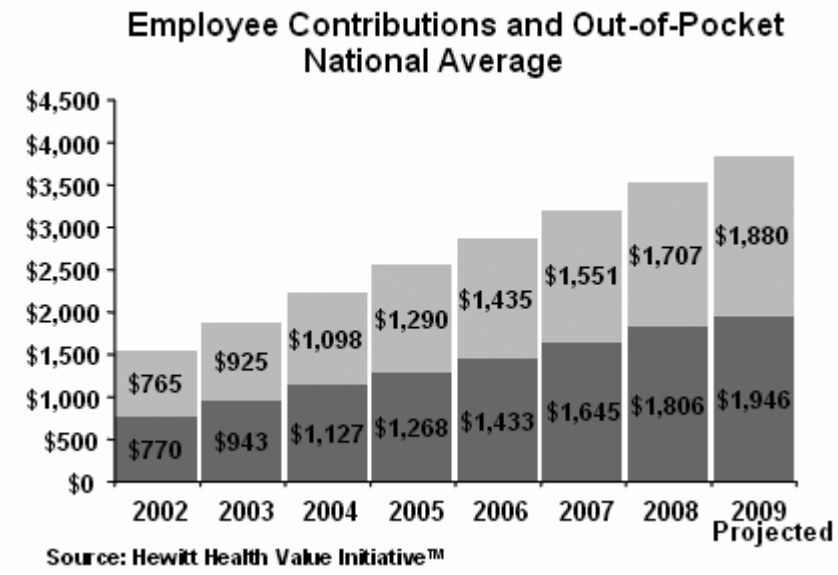
The employer-sponsored model works well because it allows the pooling of risks and because group purchasing lowers health care costs, enabling those who are less healthy to secure affordable coverage for themselves and their families. Employer-based plans typically waive pre-existing conditions and do not increase premiums or limit coverage based on health status. Employers have a vested interest in the health and productivity of their workforce, and the employer-based system has consistently produced innovative health care solutions. The poor health of employees not only affects an employer's health care costs; it can also directly affect employer costs in terms of lost productivity, absence from work, and higher disability costs.

[1] Kaiser/HRET Survey of Employer-Sponsored Health Benefits 2008.

As good as it is, this system is increasingly at great risk, given the combination of cumulative increases in health care costs and the current severe economic downturn. Despite the positive actions of many employers, there are many problems to solve in the current U.S. health care system. Among the most pressing:

- **Health care is too costly.** Most large employers that Hewitt has surveyed see the need for health reform, if not in 2009, then at least in the next four years. According to Hewitt data, annual large-employer health care costs (i.e., total costs for all health plan participants divided by the number of employees) have more than doubled since 2001 and are projected to reach $8,863 in 2009. Over the same period, annual employee contributions and out-of-pocket costs are expected to increase by 190% to $3,826.[2]





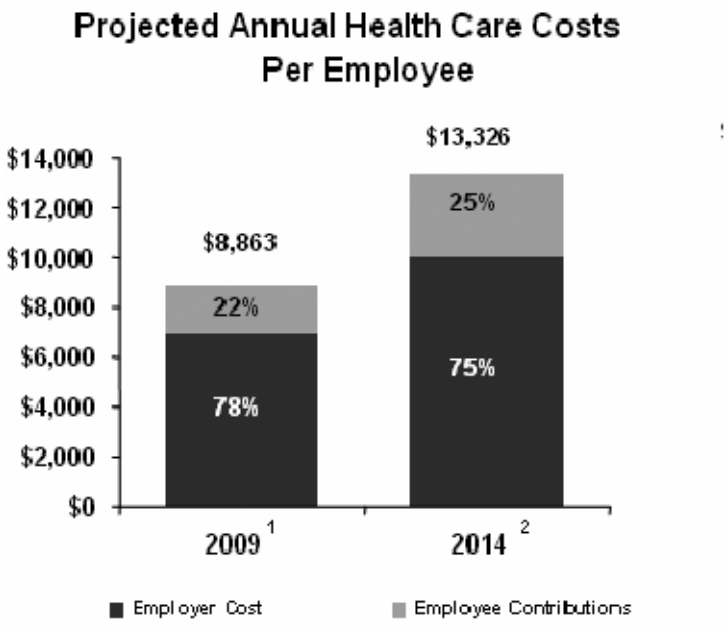
Average Employee Contribution

Average Employee Out-of-Pocket Costs

[2] Estimates calculated from the Hewitt Health Value Initiative (HHVI) database.

Many large employers fear that rising health care costs may encourage small- and medium-sized businesses to drop health coverage to keep their business competitive, especially during this severe economic downturn. Such a trend will lead to large employers (who are doing the right thing in offering and heavily subsidizing coverage) having to assume an even larger economic burden because of a variety of factors, including increased costs they pick up indirectly through cost shifting. Cost shifting is discussed in more detail in Section III.

- **Systemic changes are needed.** Systemic changes must be made in our health care delivery system if we hope to mitigate or reverse the current cost acceleration. For example, our health care system rewards physicians when they provide more services for sick care, rather than rewarding them equally for spending time to help patients avoid the 80% of illnesses that are lifestyle-related. Employers and health plans must work together to radically change the payment system to reimburse physicians and hospitals for excellent primary care supplemented with appropriate specialty care and chronic care management. Without meaningful change soon, large employers fear that rising costs will make health care unaffordable for millions more Americans. According to Hewitt data, on their current trajectory, average annual health care costs per employee will rise from $8,863 per person in 2009 to $13,326 per employee by 2014.[3] Employers will have difficulty subsidizing the additional cost, and employees will increasingly be unable to afford the increasing contributions.



1. Data Source: Hewitt Health Value Initiative™ database
2. Cost projection based on a +8.5 annual health care trend and a deterioration in employer-provided subsidy of 3.0%

- **We spend too much on chronic care and do not achieve desired quality outcomes.** Hewitt estimates that among large employers, approximately 51% of employees or their family members have a chronic health condition.[4] This includes often largely preventable conditions like diabetes and cardiovascular disease that are afflicting the U.S. population at alarming rates. The direct and indirect costs of cardiovascular disease and stroke alone were $475.3 billion in 2008.[5] There are many studies

[3] Estimates calculated from the Hewitt Health Value Initiative (HHVI) database.
[4] Hewitt Associates, *The Road Ahead: Employee Views on Health 2008* survey, April 2008.
[5] The American Heart Association (AHA) and National Heart, Lung and Blood Institute.

documenting this trend, including major contributions by Mr. Kenneth Thorpe, who is testifying before the Subcommittee today. For example, one recently published Milken Institute study estimates that the total cost of managing chronic health diseases in the U.S. is $1.3 trillion annually, with $1.1 trillion spent in lost productivity and $277 billion spent on treatment. That same report also identifies a $1.1 trillion savings opportunity by addressing avoidable chronic disease early, which assumes just a moderate behavior change by participants.[6]

To slow the upward trend of health care costs, Hewitt believes that health reform must attack the root causes of poor nutrition, obesity, and physical inactivity in this country. Public and private employers, governments, and those in the health care system can start by offering financial incentives to employees and their families to engage in healthy behaviors. Many large employers already have promising efforts under way. Allowing those financial incentives to be tax-favored would further accelerate the necessary focus on health and wellness.

- **The real cost of health care goes well beyond premiums.** While many people are justifiably focused on the high price tag for health coverage, lost workforce productivity is another real cost that the ailing health care system exacts from the U.S. economy. On average, eight in every 100 employees take an extended absence in a given year, with the average absence lasting about *42 days*. For an employer with 20,000 employees, that adds up to the equivalent of 260 full-time employees not working for an entire year, or almost $13 million in lost productivity.[7] Further, health care safety issues, such as adverse drug reactions, dispensing incorrect prescriptions, and poor patient compliance, lead to preventable injuries, extended illnesses, and even death. By investing in the health of their workforce and by helping to improve patient safety, employers enhance the quality and longevity of employees' and their families' lives. At the same time, they gain better control over health care costs and employee productivity.

- **Health care information technology is antiquated.** PricewaterhouseCoopers estimates that as much as $315 billion of annual health care spend is essentially the wasted cost of operational inefficiencies resulting from a lack of electronic connectivity in the health care system.[8] Federal health care reform should encourage the creation of a centralized, digitized, and accurate medical record system driven by 21st century technology to reduce duplicative treatments and medical errors and improve coordination of care among providers. Employers view the recent incentives for Health Information Technology (HIT) in the ARRA law as a very positive direction, with the Congressional Budget Office projecting that the vast majority of physicians and hospitals are now more likely to adopt electronic medical records within a decade.

III. Large Employers Are Shouldering More Costs

The cost of health care for large employers and their employees is higher because of gaps in coverage and differences in reimbursement rates between public and private health care programs. Under the current system, the cost of health care for employers offering good health coverage to their employees is higher than it "should be" due to a combination of the following factors:

- **Private payers are charged somewhat higher fees to offset a portion of the costs for uncompensated care.**

  Economists who have studied the costs shifted to private plans by providers seeking to offset uncompensated-care costs have estimated different ranges. A recent Congressional Budget Office report put the cost of uncompensated care at 5% of hospital costs and 1% of physician costs.[9] We believe it is

[6] Milken Institute, *An Unhealthy America: The Economic Burden of Chronic Disease—Charting a New Course to Save Lives and Increase Productivity and Economic Growth* report, October 2007.
[7] Hewitt Associates, *The Nuts & Bolts of Leaves of Absence 2008* survey, December 2008.
[8] PricewaterhouseCoopers, *The Price of Excess: Identifying Waste in Healthcare Spending*, April 2008.
[9] Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals* report, December 2008.

reasonably conservative to assume that the additional cost incurred by private plans to offset provider costs for uncompensated care is about 2% to 3% of an employer's health care costs. Based on the current data, economists do not agree, with some projecting higher ranges and some projecting lower ranges.[10]

■ **Large employers provide coverage for their employees' working spouses who have no coverage or who have less generous coverage at their own employer.**

Spouses frequently choose coverage under the employee's plan when the spouse's employer doesn't offer a health plan or when the employee's plan is perceived as superior in terms of cost, benefits, or access. Large employers then pay more because they are providing medical coverage for another company's employee. Hewitt conservatively estimates that large employers could see a net savings of 5% to 8% of their total health care costs if all employees were to get coverage from their own employers.

If a health care reform package provides universal coverage while retaining and strengthening the employer-based system, minimizing uncompensated care and requiring all employees to enroll in their own employers' health plans could give large employers a potential savings of 7% to 11%.

■ **Providers shift costs to employer-sponsored plans to make up for reimbursements from public programs that are lower than the total costs of providing care.**

Employers also see higher price tags in their medical plans because Medicare and Medicaid payment rates are set by law and are comparatively lower than rates for employer-sponsored group health plans. It is no secret that providers receive much higher payments from private insurance plans than from public plans. Economists vary in their views about how much of the difference between employer-sponsored and public payments truly represents "cost shifting" from public to private plans. But the fact remains that Medicare and Medicaid reimburse providers at much lower levels than commercial payers. For example, according to a 2008 Milliman actuarial study,[11] Medicare reimburses hospitals at an average of 70% of private plan reimbursements and pays physicians 78% of what they receive from private plans. Medicaid reimburses hospitals at an average of 67% of private plan rates and pays physicians at an average of 53% of private plan rates.

It is desirable, but perhaps not fiscally feasible, to close this gap in public/private reimbursement rates to providers. At a minimum, health reform should ensure that the payment differential does not worsen further, because this would create even more cost-shifting pressure on private payers and potentially lead to a two-tier system where employers offering their own plans are at a significant cost disadvantage.

IV. Five Imperatives for Health Care Reform

Hewitt believes that comprehensive health care reform must start by first addressing the very real issues that drive up cost, preventing more employers from participating and more individuals from taking advantage of the public and private health care programs available to them.

Accordingly, we believe that federal health care reform must focus on the following priorities:

1. **Preserve and promote the employer-based health care system.** Reform should seek to both protect and expand the number of employers who provide health care for their employees. Over the years, the

[10] For different views on the degree to which uncompensated care increases the cost for private payers, see, for example, The Kaiser Family Foundation analysis at http://www.kff.org/uninsured/upload/7809.pdf and the Families USA report at http://www.familiesusa.org/resources/publications/reports/paying-a-premium.html.

[11] Milliman, *Hospital and Physician Cost Shift: Payment Level Comparison of Medicare, Medicaid & Commercial Payers* study, December 2008.

system has encouraged employers to be innovators of health care solutions. Recent innovations include evidence-based plan design, value-based design, pricing transparency, and consumer-oriented incentives. There are promising outcomes emerging from extensive wellness and disease management programs that encourage participants to engage in healthy activities, identify their health risks, and manage their illnesses. By investing in the health of their workforce, employers help make employees and their families healthier, while also gaining better control over health care costs and employee absences. The employer-based system has also preserved broad access to primary care, specialists, and hospitals, as well as on-site services and pharmacies.

2. **Preserve and strengthen federal ERISA pre-emption of state laws to promote uniformity in coverage and reduce administrative costs.** The vast majority of large employers operate across multiple states and they must be able to continue to offer uniform benefit packages to their employees. Allowing states to require these employers to comply with varying state and/or local government mandates would raise employer costs even further and result in unequal benefits for their employees. This would create an unnecessarily costly and complex administrative burden with conflicting reporting, withholding, and disclosure requirements from jurisdiction to jurisdiction.

3. **Allow employers flexibility in how they meet any new standards for health care coverage.** Employers must be permitted to satisfy any federal mandate for employer health care coverage by demonstrating that their plans are equivalent to the "standard" benefit requirements, based on either the plan's design or the plan's actuarial value. Any new requirements must not disrupt existing benefits or add unnecessary compliance costs. This is similar to the approach taken under the Medicare Part D retiree drug program and the Massachusetts health care law, both of which focus on the plan's actuarial value rather than simply a benefit-by-benefit checklist. Further, such an approach must permit a multistate employer to offer consistent benefits in all states, pre-empting state-specific criteria.

4. **Encourage greater use of health information technology to reduce costs and improve quality.** A federal government effort to provide consistent and efficient health information technology would help employers reduce their health care costs and improve the quality of care. An integrated health system would provide quality reporting, improve health care outcomes, and reduce duplication and medical errors. The health care system would benefit enormously from the kinds of dramatic productivity gains achievable through appropriate health IT and related business process re-engineering that has transformed business and industry throughout the world.

5. **Provide incentives for employees and their families to engage in healthy behaviors.** Health care reform should enable an increased focus on wellness initiatives and programs designed to encourage healthy behaviors, including adoption of tax-free wellness rewards for individuals who take action to improve their health.

V. Details Really Matter

In a recent Hewitt survey of large employers, 9 out of 10 say that health care reform needs to happen, if not in 2009, then at least over the next four years. But these employers have not yet reached consensus on a preferred approach. In part, that is because the details really matter. Take, for example, an employer mandate, or "pay or play." Most large employers do not currently support an employer mandate based on the limited information currently available. Hewitt itself does not endorse a pay or play approach at this time, in part because the critical details required to fairly evaluate such a plan are still not defined. The specifics of such a mandate will greatly influence the impact and the reactions of large employers and their employees.

For example, with respect to an employer mandate, these are just some of the details to be carefully evaluated:

- What would be the form and size of a "meaningful" employer contribution? Would it be a fixed dollar amount or percentage of pay? At what economic level would the requirement be set?

- Would the mandate apply to both part-time and full-time workers? There would be more consensus around full-time employees. Mandating contributions for part-time employees is more controversial. Part-time workers often change jobs frequently, and workers who take these jobs as supplemental family income often have coverage available through other sources.

- Would the mandate apply to covering all family members? And would the contribution amounts for large employers be the same for single employees and married employees? Many large employers now tier the employer and employee contributions to provide equitable treatment for single employees, single parents, and larger households.

- Would a working couple still have a choice between their respective employers' plans? And if so, how would that work in terms of any mandated contribution?

- Could employers satisfy the mandate by substantiating that they provide a plan of equivalent value to the standard? Or would they have to comply on a benefit-by-benefit basis?

- If a national health exchange is created, would large employers and their employees be permitted to participate in this program? Or would participation be available only to individuals and small businesses?

- Would employees of large employers be permitted to opt out of the employer's plan and enroll in a national health exchange plan? And if so, what would be the terms and the consequences for opting out of the employer's plan? The group health plan "insurance" concept would face a sure demise if younger and healthier employees could opt out and take the full average employer health care contribution with them.

VI. Conclusion

In closing, Mr. Chairman and Members of the Subcommittee, Hewitt believes that employers should remain in the health care system and that reforms that lead to lower health care costs will go a long way toward enhancing the employer-based health care system. Congress has the challenge of sorting through the details of how that would be accomplished, with many competing views. Hewitt would be pleased to offer its data analysis, experience, and consulting and administrative expertise in helping the Subcommittee evaluate the impact of detailed reform plans on coverage provided by large employers today.