Group Benefits: Difference Between Cost and Price

Companies are always looking to lower the cost of products and services they use. As a result, it is often tempting to buy strictly on price. However, if price is the only consideration in a buying decision, you may not be truly cutting costs. The true cost of a benefit program is rarely indicated by the billed premium. The price is on the invoice, however the cost of the program is a result of a number of often undisclosed factors.

Same old skit

Plan administrators often receive calls from prospective brokers asking them if they can shop their benefits plan. The promise is always that if you allow them to "shop the market", they will provide savings.

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This process is simply to request a number of insurance carriers to quote similar coverage but at a lower price. The broker will come back with a spreadsheet full of insurer packages detailing the coverage and overall prices. The prices provided are often unsustainable. The savings offered may range from 4% to 12% depending on each insurer's willingness to discount pricing or the broker's willingness to cut their earnings. The challenge is, typically these discounts are marketing discounts rather than sustainable savings due to reduced claims, admin fees or inflation/reserve requirements.

At first renewal, the insurer must now set the "right rate" rather than a discounted rate from year one, and also they have to establish a full IBNR (Incurred But Not Reported) claims reserve that you gave up to the prior carrier when you made the plan switch. The year one savings vanish. Completing a "Market Survey" is not a strategy to control costs; it is simply a repetition of the same old skit resulting in unsustainably lowering your initial price.

After any given five-year period, we would expect the major Canadian benefit insurers to end up roughly at the same cost. How they get there may vary. Therefore, if you're looking to lower your costs, changing insurers or shopping the market isn't usually the right solution.

The real strategy to lowering costs is to manage the factors that influence premiums.

What drives costs of group benefits?

There are four factors that drive benefit cost: claims, inflation, expenses and reserves.

Claims Experience. This year's claims are next year's premiums. Health and Dental claims experience are used to predict what claims will likely reoccur and therefore what premium must be charged to fund those claims. When a plan is marketed, if the plan design or the cost of a claim remains unchanged, what would be the rationale for a lower rate? With an unchanged expectation of claims would it not stand to reason that there would be an expectation of unchanged premium? Your premium calculation is: paid claims/target claims x 1+ inflation.

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If we can reduce claims by efficiently accessing best-in-class claim centres, properly managing care, expediting access to treatment, reducing duration of treatment, etc., we will reduce claims. Typical plan design changes will reduce claims because they eliminate the ability to make a claim. However, our goal is to reduce the cost of the claim rather than reducing an employee's ability to make a claim.

Health and Dental Inflation. Trend (inflation plus the change in utilization of the plan) is the assumed factor applied to last year's claims to offset the cost of inflation. Trend is applied to account for the increase of health and dental services we access that result from fee guide increases, consumer inflation, services delisted from government programs, new forms of treatment, healthcare inflation, etc. Each insurer sets their assumptions for inflation somewhat differently and as they are assumptions, they are subject to change and negotiation. Inflation assumptions can vary as much as 3% to 5% between insurers.

Administration Expenses. Included in plan costs are the administration fees. These fees include charges for claims administration, general administration, premium tax, profit charges, commission, etc. The larger the expense factor, the less premium is available to pay your employee's claims. For example, if the admin fee is 25%, $0.75 of every dollar of premium will be allocated to pay claims with the other $0.25 allocated for the insurer's operations. If the admin fee is reduced to 20%, there is 5% more premium available to pay claims.

As the admin charge is a percentage of premium, typically, the larger the group the smaller the percentage the admin charge. The average small group charge is 27% to 33% with larger companies experiencing 18% to 22%. A small reduction of even 1% of premium can make a large difference to plan costs over time.

Reserve Requirements. Two examples of reserves held by insurers are the IBNR (Incurred But Not Reported) reserve and a Disabled Life reserve. The IBNR is in place to pay for any run off claims should you terminate your benefits and a Disabled Life reserve is set up when there is a pending disability claim, to ensure the funds are available regardless of the length of the disability. One or two disability claims can easily require hundreds of thousands of dollars in reserves to be set up by the insurer.

Regarding the IBNR, insurers apply a factor of ranging between 7% to 12% of health and dental premium (15% on healthcare if you utilize paper reimbursement) in order to pay claims that have been incurred but not yet submitted for reimbursement upon plan termination. Should you change insurers, the current IBNR reserve is relinquished for claim run off (regardless of whether any or all of the reserve is actually used to pay claims) and the new insurer will have to establish a new reserve in the first year of your new plan. This is where the decision to change insurers needs to be weighed carefully as it can immediately wipe out any of those marketing discounts during the first year with a new carrier. We have developed some unique solutions in reserving that provide a great way of unlocking funds and sustainably lowering plan costs.

How are sustainable cost savings achieved?

The simple fact is if a broker indicates they can get you a better "price" without changing any of the above factors, they are at best offering a temporary discount that is completely unsustainable at renewal. Sustainable savings are only achieved by reducing the cost of claims (not the ability to make a claim), reducing administrative expenses, lowering inherent assumptions such as inflation and reducing the collected reserves.