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Price or value? Choose both

Knowledge is power when it comes to employee benefit plans

In relation to employee benefit plans, the distinction between price and value is many times under analyzed or even ignored. Over the years, business owners and senior managers of business have been led toward looking at their employee benefit renewal and annual financial summary as a pricing matter rather than as an evaluation of value.

Price is defined as an amount due as consideration. Value on the other hand is defined as the usefulness, merit or worth. Tracking price or the amount paid is critical, but the usefulness or the worth of the benefit program is most important to the business owner. Do the employees think the benefits are important and do they perceive them as a perk rather than as a burden? If the benefit plan is being used as a recruitment or retention tool, then the perceived value must be greater than the price.

What is commonly ignored in these value discussions is the expense factor or Target Loss Ratio (TLR) and the other input assumptions insurance carriers make when setting price or premium for a benefit plan. TLR is premium minus administrative costs. The higher the TLR, the lower the administrative expenses charged the plan and the more premium available to pay claims for your employees.

There are two sides to a benefit plan: claims and administrative expense. Claims drive the necessary premium to finance the plan and are not affected by which adjudicator is selected. Other than by changing benefit design, the only way to reduce plan cost is to reduce the administrative cost or profit margin.

PRICE = INPUT COST + OVERHEAD EXPENSE + PROFIT MARGIN

In the language of group benefits, the price is the premium.

PREMIUM = CLAIMS + ADMINISTRATIVE COST + PROFIT MARGIN

Commonly, benefit plan renewal discussions look only at the premium paid versus the claims incurred by the group. In evaluating employee benefit plan pricing, to measure only premium against claims is to ignore overhead cost and profit margin. When you are setting the retail price of your product you factor in not only your wholesale cost but also your overhead costs, value-added costs and your profit margin. That is the insurance carrier's TLR.

The role of your advisor is to negotiate with the insurance carrier or plan provider to keep the overhead cost and profit margin (administrative expense) at the lowest level that matches the desired services. Consideration should be paid to the following:

- Do they ease administration and efficiently resolve issues?
- How quickly are claims reimbursed?
- What personal service is being provided *(not offered)* by the carrier?
- In which province are claims and case management services located?
- Is the carrier a willing partner or adversary in price/premium discussions?

Many brokers act as a conduit between the employer group and the insurance carrier, simply passing information between the two entities. The best advisors operate in a data management role or "knowledge management" role on behalf of the business owner. Rather than a conduit for information, advisors should be providing interpretation, discussing the causes and resulting outcomes of what the data indicates and making recommendations that best suit your particular business. This allows the business owner to make decisions after a complete analysis, not based on emotion or a reflex reaction to a price adjustment.

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When claims are below target, profit for the insurance carrier is greater than the planned administrative cost and profit margin. The concern only comes if the expense factors and the future pricing assumptions of the carrier do not accurately reflect the claim risk of the employee group. As an example, should inflation assumptions be too high and if they are left unquestioned, over time a compounding effect may occur on the required rate of your plan.

If you look at your own benefit plan's financial results of the last few years you would expect to see that on average, the difference between your "paid claims" and "paid premium" is stable. If the differential is increasing or if it is consistently larger than the negotiated expense factor, this is an indicator there is likely a need for a review of the plan charges by your advisor.

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