EMPLOYEESfirst

Supplemental Health Plan Overview

» The Market Evolution and Why It Matters to Plan Fiduciaries

[redacted]

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Supplemental Health Plan Overview

Executive Summary

The purpose of this document is to provide a review of the evolution of the Supplemental Health Plan market to educate employers on general market practices related to these plans, some of which are not widely known.

Supplemental Health Plans (SHPs) have experienced meteoric growth over the last 25 years. Employers have adopted SHPs to help their employees offset rising out-of-pocket heath plan expenses and high deductibles. Additionally, SHP growth has been fueled by well-funded carrier marketing campaigns and substantial broker commissions. Today, SHPs represent one of the fastest-growing plan offerings, related to both employer adoption and employee enrollment.

Since the Affordable Care Act (ACA), SHP plan structures and enrollment technologies have been streamlined, minimizing enrollment expenses that were historically inherent to these plans, availing higher revenues and wider profit margins to the industry ecosystem. With the new revenue opportunity, traditional health and welfare consultancies have adopted commission-based fee models, compared to the traditional fee-for-service pricing model, which has contributed to removing actual costs of consulting projects from the employers' direct line of sight.

Plan loss ratios are a primary measure of benefit plan value. The SHP average loss ratio for the top eight large-market carriers is 37%, as reported by the NAIC[i]. In this example, only 37 cents of every dollar are paid to employees for claims. The remaining premium dollars after paid claims are either retained by carriers or are distributed as compensation. Usually, the premiums are 100% employee-paid, through salary payroll deductions, from after-tax dollars. Although most state Departments of Insurance now require a least 50% loss ratio for SHP plans, the actual loss ratios do not reflect this target.

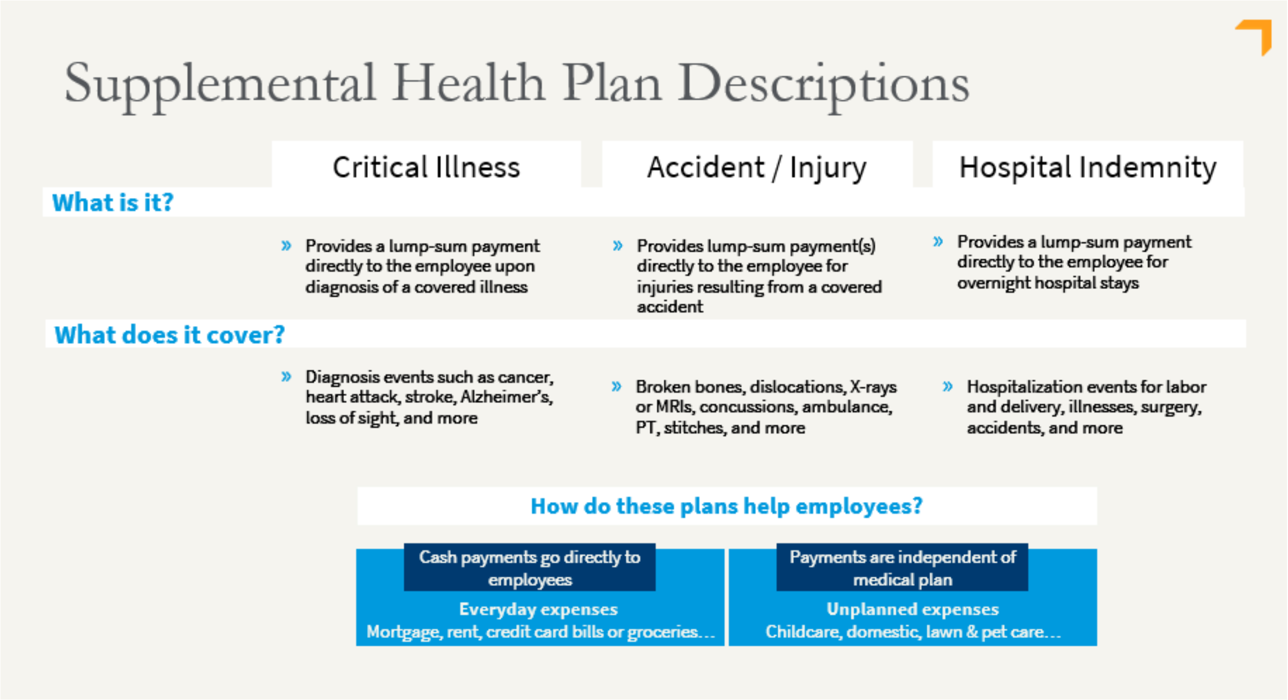
Until now, employers have not had a pathway to influence the SHP status quo. As SHPs are required to remain fully insured, which is requisite of the 'excepted' benefit rules to be exempt from ACA medical plan requirements, employers may not have visibility into the SHP financials, nor would they have control of the amount that is distributed as compensation. The market is due for a more ethical and transparent model where employers, as plan fiduciaries, can directly impact SHP plan value.

Employees First was created specifically to address this opportunity in the marketplace – giving fiduciaries transparency and control over SHP plan metrics. Based on recent trends and reported "inforce" SHP premium **for large market employers, we estimate that the Employees First model has the potential to return approximately $1.5 billion** to fiduciaries – to elevate SHP plan value, lower SHP plan cost, or reinvest in permissible benefits enhancements for their employees.

Market Overview of Supplemental Health Plans

What are Supplemental Health Plans, or SHPs?

SHPs, namely Critical Illness, Accident (injury), and Hospital Indemnity plans pay an indemnity-based, cash benefit directly to employees. Employees can use the benefit dollars to offset out-of-pocket expenses resulting from injuries, hospitalizations, or catastrophic illnesses, such as cancer or a heart attack. Although covered medical events trigger a claim payment, employees can use these dollars any way they wish, including non-medical expenses that may arise out of a catastrophic illness, accident, or hospitalization.



Supplemental Health Plan Descriptions

	Critical Illness	Accident / Injury	Hospital Indemnity
What is it?	» Provides a lump-sum payment directly to the employee upon diagnosis of a covered illness	» Provides lump-sum payment(s) directly to the employee for injuries resulting from a covered accident	» Provides a lump-sum payment directly to the employee for overnight hospital stays
What does it cover?	» Diagnosis events such as cancer, heart attack, stroke, Alzheimer's, loss of sight, and more	» Broken bones, dislocations, X-rays or MRIs, concussions, ambulance, PT, stitches, and more	» Hospitalization events for labor and delivery, illnesses, surgery, accidents, and more

How do these plans help employees?

Cash payments go directly to employees

Everyday expenses
Mortgage, rent, credit card bills or groceries…

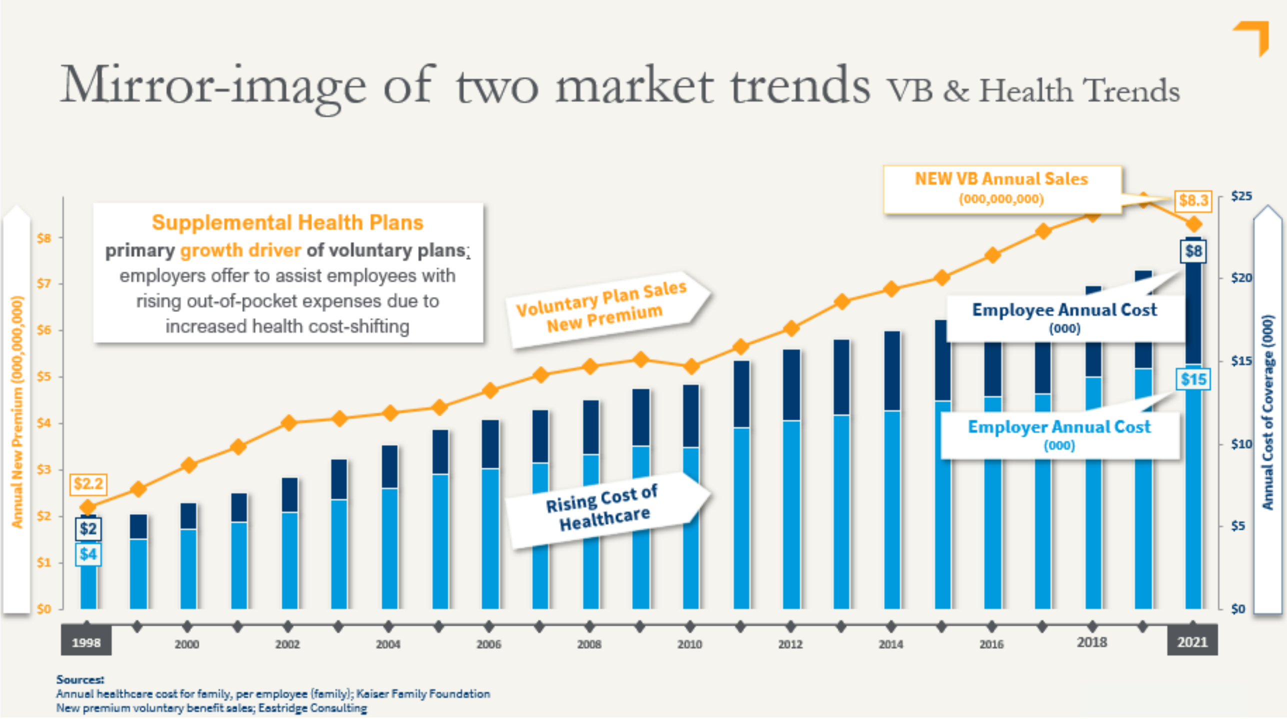
Payments are independent of medical plan

Unplanned expenses
Childcare, domestic, lawn & pet care…

SHP Adoption by Employers

The plan adoption and premium growth of SHPs over the last two decades has been significant and in direct alignment with the rising cost of healthcare. These plans have emerged as a foundational addition to employers' benefits menus, primarily as a counter to rising employee out-of-pocket medical expenses and the increased prevalence of high deductible health plans.

Since SHPs have become a common addition to employers' benefits menus, it is essential that employers better understand the nuances of embedded broker compensation, and concurrent impact on loss ratios (the amount of money that goes to paying employee claims).



Mirror-image of two market trends VB & Health Trends

Supplemental Health Plans

primary growth driver of voluntary plans; employers offer to assist employees with rising out-of-pocket expenses due to increased health cost-shifting

Sources:
Annual healthcare cost for family, per employee (family); Kaiser Family Foundation
New premium voluntary benefit sales; Eastridge Consulting

The Timeline and Evolution of SHPs

To fully convey the relevance of Employees First's emergence and why the program provides a solution to an inherent, market-wide problem, it is beneficial to retrace the path of how these plans have evolved.

Late 1990's

The late 1990's was characterized by flat healthcare cost trends, an extremely tight labor market, and tremendous market investment in internet companies. The battle for talent led employers to focus on expanding or differentiating benefit options to attract and retain high-performing employees. With this came the emergence of *voluntary benefit outsourcing* companies (VBOs), who streamlined the administration of offering several voluntary plans. VBOs were a convenient, one-stop shop for employers to add multiple voluntary benefits to their benefits suite through a single relationship. VBOs socialized the "single-source" concept that was widely adopted within the large employer market, as the model removed the significant administrative burden of adding voluntary benefits to an employer's benefit menu.

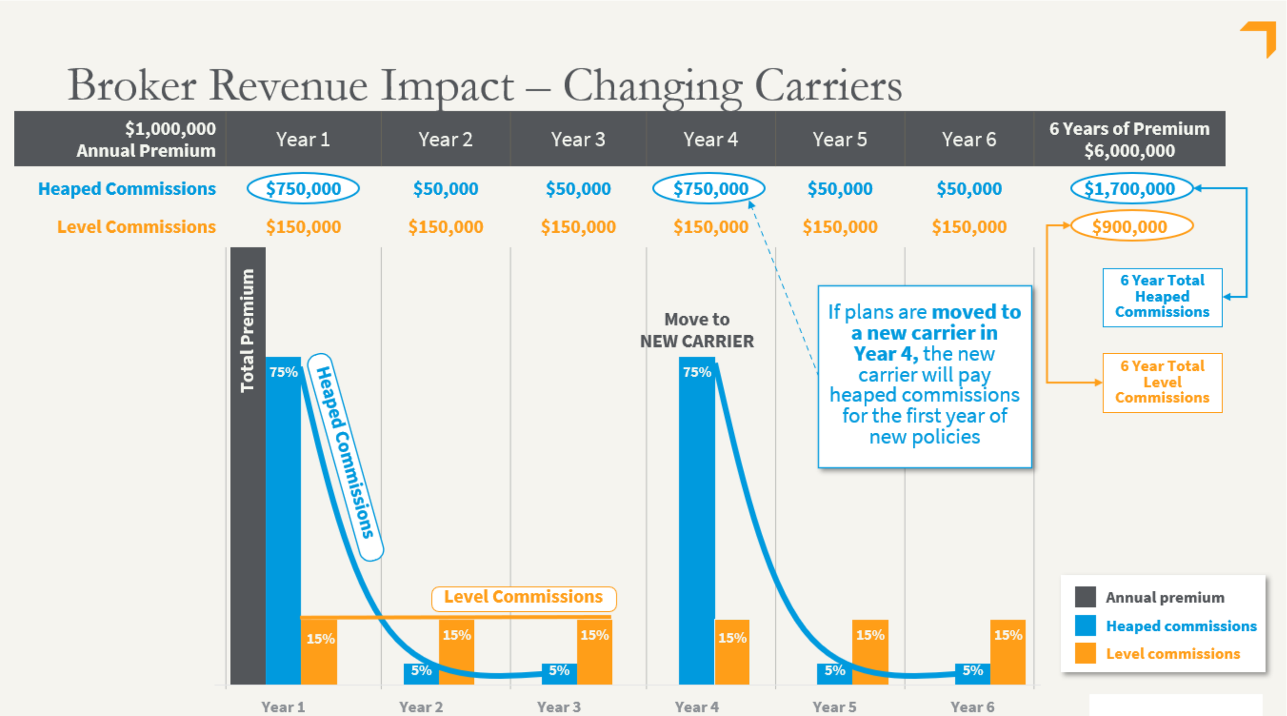
Early 2000's

In the early 2000's, voluntary benefit carriers launched massive direct-to-consumer marketing campaigns (i.e., "Ask about it at work," said the duck). This helped to drive increased employer adoption of "non-traditional" voluntary plans, like SHPs, into their core or traditional benefits menu. Previously, these voluntary plans were sold as individual policies, with multiple state variations, so the complex plan administration made it untenable for SHPs to be enrolled on an employer's existing benefit enrollment system. Only SHP carrier systems or *onsite/worksite enrollment firms* had the technology that accommodated multi-state variations in SHP plans.

The SHP carriers removed many of the underwriting requirements, and embedded significant commissions to help mitigate adverse selection through financially incentivized agents or brokers that would maximize plan participation. Carriers filed the plans to pay high commissions in the first year of the policy, which is commonly referred to as *heaped* commissions. For example, a policy may pay 60% to 90% of the premium in commissions, in the first twelve months of the policy; then, commissions drop to 3% to 8% in subsequent, renewal years. Conversely, *level* commissions pay the same percentage of commission throughout the life of the policy. Level commissions for SHPs are generally 20% to 30% of premium for each year of the policy, which is substantially higher than industry norms. Most brokers opt for the heaped structure. **As an illustration of heaped commissions, $1,000,000 of SHP annual premium equates to approximately $700,000 in commissions in the first policy year.**

Heaped commissions made it possible for brokers, partnering with worksite enrollment firms, to offer many services without charging employers for these services. The 'free' services included one-to-one employee meetings with an on-site or on-phone benefit counselor, comprehensive benefit plan materials, and an enrollment platform to communicate and enroll employees in both traditional benefits and voluntary benefits. However, the commissions from the voluntary plans (like SHPs) paid for these services. The low or no-charge services offered by worksite enrollment firms were particularly attractive to mid-market companies or large-market industries that had lower margins, such as retail, healthcare, hospitality, food processing, and manufacturing.

Heaped commissions, however, also set the stage for misalignment of broker financial incentives. Since **broker compensation is considerably higher in the policy's first year, brokers are incentivized to move the plans from carrier to carrier as often as every three years**, and sometimes *only* to maximize the high first-year policy compensation they would receive from the new carrier. More recently, brokers have negotiated with the incumbent carrier **to pay heaped commissions a second time** (often referred to as 're-heaped'), to avoid a market bid and concurrent threat to move the plans to a new carrier.



Broker Revenue Impact – Changing Carriers

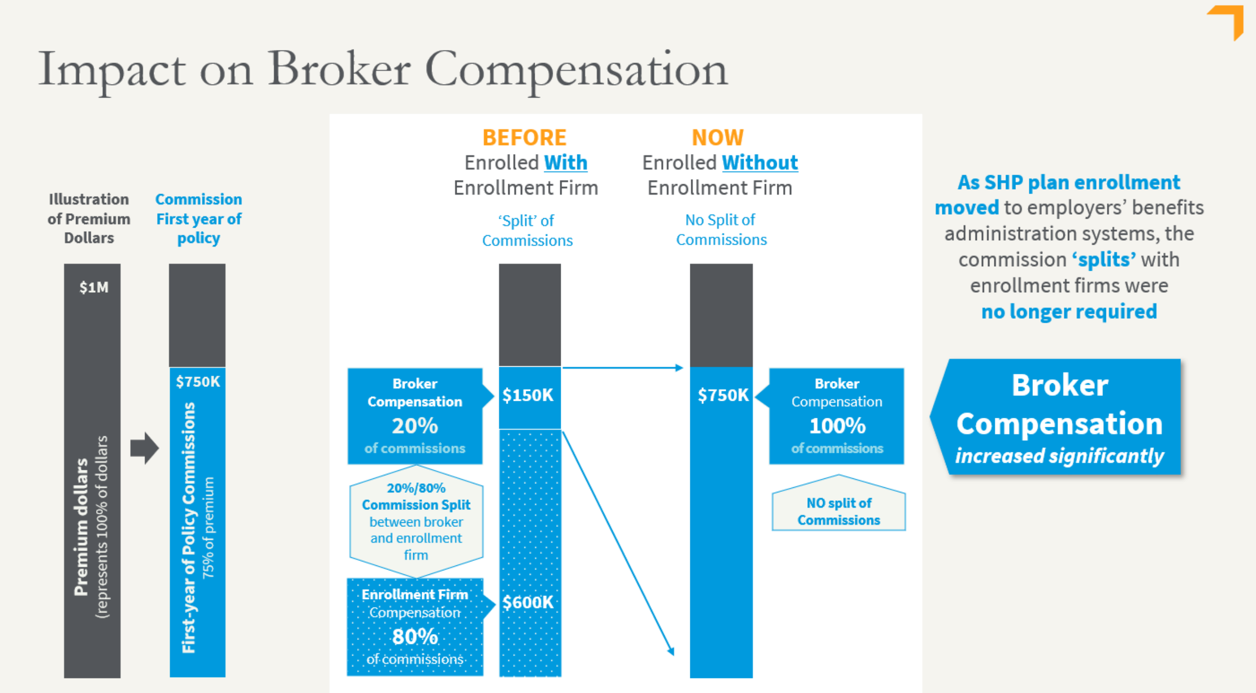
$1,000,000 Annual Premium	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	6 Years of Premium $6,000,000
Heaped Commissions	$750,000	$50,000	$50,000	$750,000	$50,000	$50,000	$1,700,000
Level Commissions	$150,000	$150,000	$150,000	$150,000	$150,000	$150,000	$900,000

If plans are moved to a new carrier in Year 4, the new carrier will pay heaped commissions for the first year of new policies

2010’s

As popularity of SHP plans grew, some SHP carriers modified the policy structure from an individual plan structure to a group plan structure. This plan evolution was significant, as it **allowed employers to bypass the worksite enrollment firm model** and build the plans onto traditional benefits enrollment and administration platforms. **SHPs could now be offered on the employers’ enrollment system, with core benefits, (i.e., medical, life, disability).**

> **Since brokers were no longer required to “split” commissions with worksite enrollment firms, all SHP commissions could now be retained by the broker. With this, SHPs became a significant revenue source. The major, national consultancies created specialty voluntary benefits practices that anchored business development strategies around capturing this new-found revenue opportunity.**



Impact on Broker Compensation

Illustration of Premium Dollars
Commission First year of policy
$1M
Premium dollars
(represents 100% of dollars
$750K
First-year of Policy Commissions
75% of premium
BEFORE
Enrolled With Enrollment Firm
‘Split’ of Commissions
NOW
Enrolled Without Enrollment Firm
No Split of Commissions
Broker Compensation 20% of commissions
$150K
20%/80% Commission Split between broker and enrollment firm
Enrollment Firm Compensation 80% of commissions
$600K
$750K
Broker Compensation 100% of commissions
NO split of Commissions

As SHP plan enrollment moved to employers’ benefits administration systems, the commission **‘splits’** with enrollment firms were **no longer required**

Broker Compensation ***increased significantly***

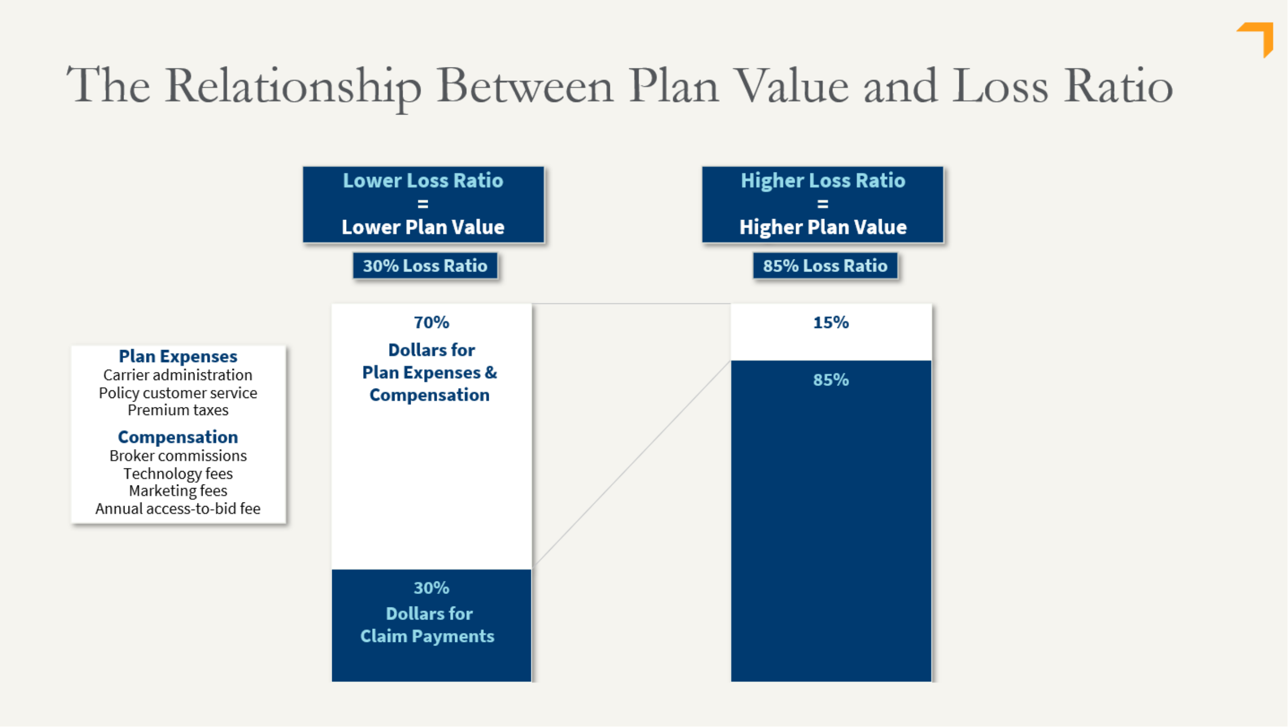
In some situations, the “excess” SHP commissions have been used by brokers or consultants to offset other consulting projects or benefits administration service costs. The growing popularity of voluntary benefits, and the concurrent high margins of these plans, incentivized both carriers and the traditional larger-market health and welfare consultancies to expand their business in this space.

Traditional, large market consultancies had historically worked within traditional, fee-based arrangements with their clients. However, voluntary benefits created the financial incentives that drove a broader adoption of commission-based fee arrangements. In many situations, this began to **remove the actual costs of consulting projects from employers’ direct line of sight.**

A Discussion of SHP Loss Ratio & Impact on Overall SHP Plan Value

Employer Considerations of SHP Loss Ratios

ACA requires medical plan loss ratios to be at least 85% (85% of the premium dollars are to be paid in claims). SHPs are in a category of group health plans that are “excepted” from the rules of ACA (like dental or vision plans) and there are **no ACA-stipulated loss ratio requirements**. Most SHP loss ratios have been under 50% since a significant share of the premium dollars goes towards compensation and profit margins. As employees usually pay 100% of the plan premium, employers have been concerned about the low financial value for employees.



The Relationship Between Plan Value and Loss Ratio

Lower Loss Ratio = Lower Plan Value

30% Loss Ratio

Higher Loss Ratio = Higher Plan Value

85% Loss Ratio

Plan Expenses
Carrier administration
Policy customer service
Premium taxes

Compensation
Broker commissions
Technology fees
Marketing fees
Annual access-to-bid fee

70%
Dollars for Plan Expenses & Compensation

30%
Dollars for Claim Payments

15%

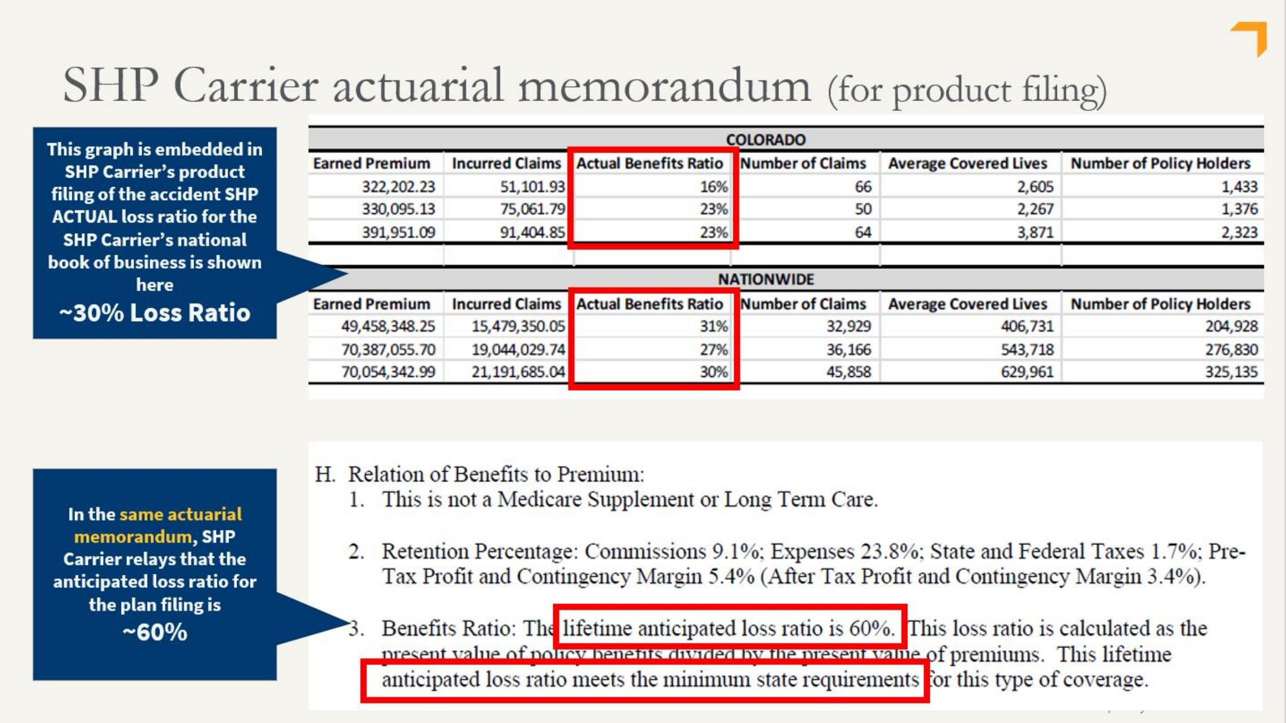
85%

Higher commissions within SHPs directly contribute to a lower plan loss ratio and concurrent lower plan value, which has been the focal point of some employers’ concerns. Prior to 2010, the low loss ratios can be attributed to extremely high carrier profits, but today, the loss ratios are primarily driven by some broker requirements for higher compensation.

Carrier-Filed Loss Ratios

SHP carriers have been reluctant to report loss ratios to employers and consultants, for obvious reasons. In recent years, the state Departments of Insurance require that SHP plans be priced and filed to meet a 50% loss ratio. However, the **NAIC reports that the loss ratio on these plans is under 40%.** The 50% state-required loss ratios are not often met, likely due to plan participants *not filing* SHP claims.

In the illustration below, the carrier's actuarial memorandum states that the plan is underwritten to meet the state required 60% loss ratio. In the same document, the carrier provided their book of business of *actual* state and national loss ratios, which were in the low 20% range and low 30% range, respectively.



SHP Carrier actuarial memorandum (for product filing)

This graph is embedded in SHP Carrier's product filing of the accident SHP ACTUAL loss ratio for the SHP Carrier's national book of business is shown here

~30% Loss Ratio

COLORADO					
Earned Premium	Incurred Claims	Actual Benefits Ratio	Number of Claims	Average Covered Lives	Number of Policy Holders
322,202.23	51,101.93	16%	66	2,605	1,433
330,095.13	75,061.79	23%	50	2,267	1,376
391,951.09	91,404.85	23%	64	3,871	2,323

NATIONWIDE					
Earned Premium	Incurred Claims	Actual Benefits Ratio	Number of Claims	Average Covered Lives	Number of Policy Holders
49,458,348.25	15,479,350.05	31%	32,929	406,731	204,928
70,387,055.70	19,044,029.74	27%	36,166	543,718	276,830
70,054,342.99	21,191,685.04	30%	45,858	629,961	325,135

In the same actuarial memorandum, SHP Carrier relays that the anticipated loss ratio for the plan filing is

~60%

H. Relation of Benefits to Premium:

1. This is not a Medicare Supplement or Long Term Care.
2. Retention Percentage: Commissions 9.1%; Expenses 23.8%; State and Federal Taxes 1.7%; Pre-Tax Profit and Contingency Margin 5.4% (After Tax Profit and Contingency Margin 3.4%).
3. Benefits Ratio: The lifetime anticipated loss ratio is 60%. This loss ratio is calculated as the present value of policy benefits divided by the present value of premiums. This lifetime anticipated loss ratio meets the minimum state requirements for this type of coverage.

Beyond commissions, brokers, consultants, and benefits administration or enrollment platforms, are requesting various types of additional compensation. Many have narrowed the employer's carrier options based on those carriers that will pay the most. Below are some examples of compensation categories.

Compensation Category	Compensation Description
Commissions	Heaped: 60% to 80% first year of policy, 5% to 10% in renewal years; or Level: 20% to 35% each year
"**Pay-to-play**" – annual fee to be included in bids	Up to $500,000 annually for all three plans
"**Implementation credits**" – selected carrier pays for the cost of the bid project	Up to $100,000
Marketing dollars – fund employee communications	Ranging from $30,000 to $100,000
Commission overrides – awarded if a broker meets new premium or retention goals	Up to 12% of premium, paid annually
"**Tech credits**" – payment to benefit administration	Ranges from 2% to 6% of SHP premium

SHPs and ERISA – Employer Considerations

SHPs are subject to ERISA compliance requirements. If employers do not intend to treat the plans as ERISA, they must follow the DOL Safe Harbor Exemption guidelines. One of the Safe Harbor requirements includes "no endorsement" of the plan. Plan endorsement can be subjective, but examples may include:

- Enrolling the supplemental health plans within the general flow of benefits enrollment, alongside other ERISA plans
- Plan sponsor involvement with the insurer selection process, plan design and pricing
- Employer-branded communications about the SHPs, i.e., including plan information in the annual enrollment information, which would likely include an employer logo.

Employers must rely on internal counsel for guidance related to ERISA, however, in some situations, employers may believe they are following the Safe Harbor exemption criteria but may be unknowingly out of compliance.

Conclusion

SHPs have evolved to become an essential component of most employers' benefits menus and have contributed to many employees' financial resiliency after a major medical event. The original 'worksite' model for employers was designed around direct-to-consumer individual plans. Operationally, these plans have transitioned both in plan structure (from individual to group) and benefit enrollment (from worksite enrollment firms to employers' benefits enrollment systems). However, the SHP plan transition did not concurrently modify the embedded compensation, nor have employers gained full transparency or fiduciary control of plan design, compensation, 'true' loss ratios, or overall plan value.

These deficiencies established the foundational objectives of the Employees First (E1) model. The E1 program, coupled with industry-first actuarial tools that define SHP plan value, can bring a level of fiduciary confidence that is comparable to other health and welfare benefit offerings. Most importantly, employers have more flexibility in plan design, enabling them to substantially increase plan value by investing those newly found dollars (20-30% of premium) in permissible employee benefit enhancements.

Please visit our website https://myemployeesfirst.com for more information about our program.

About the Author

Amy Hollis is known as one of the top industry experts in the design, implementation, marketing, communication, and enrollment of voluntary benefit programs, predominantly within the large employer market. She has more than 20 years of benefits experience, and while her primary focus has been in voluntary benefits, she also has broad experience ranging from:

- Employer and employee paid benefit plans, designs, and pricing
- Benefit enrollment and administration systems
- Voluntary plan regulatory expertise and application related to ACA, ERISA, DOI, etc.

During her career, Amy created then led highly successful voluntary benefit practices for preeminent, national benefit consulting firms, including Willis Towers Watson, Buck (formally Conduent / Xerox) and Marsh & McClennan (Mercer). She has developed nationally recognized teams within these organizations that continue to drive the industry. Over the last decade, Amy has been engaged with over half of the Fortune 500 organizations, either directly or through her teams, as lead strategist in the overall design, provider selection, and successful implementation of voluntary benefit programs.

Amy's passion, which has been foundational throughout her experience in the core and voluntary benefit spectrum, is to assist employers in optimizing overarching total reward strategies and cost saving measures by creatively and effectively linking employer and employee paid benefit strategies. Prior to her career in the voluntary benefit area, Amy was a National Sales Director for a health care cost management provider in the large employer market.

[i] NAIC Annual Accident and Health Policy Experience Report, 2021