

# Annual Report & Directory

# GROUP

## BENEFITS AND PENSIONS

## 21<sup>st</sup> Century Cost Containment For Rising Group Insurance Premiums

By: Peter J. Merrick & Andrew Duckman

In the face of Canada's public healthcare crisis, providing your employees with adequate and competitive health and dental coverage has never been more important. In 2005, more than \$142 billion was spent for healthcare in Canada with 70 per cent of the costs paid for by the federal and provincial governments' publicly funded system. Corporate Canada paid for most of the remaining 30 per cent of non-essential medical and dental expenses, says the Canadian Institute for Health Information and Statistics Canada.

While employer medical and dental plans were originally designed to be supplementary to the publicly funded government plan, as a result of the federal and provincial cutbacks in healthcare services, employers and private insurers across this country have had to alter and redesign their medical and dental plans to keep up with emerging trends of higher claims and new cost realities. In an age where publicly covered services continue to be reduced, we are likely to see Corporate Canada's share continue to increase in the coming years.

### Economic Pressures

In the midst of these economic pressures on the current healthcare system, employees are demanding an enriched company medical and dental benefit plan. While the traditional corporate employee medical and dental benefit plan in Canada provides coverage for semi-private hospital rooms, prescription drugs, dental, chiropractors, physiotherapists, vision care, extended health coverage, and travel medical insurance, employees are asking for more options than ever before. Opinions on what to add are largely influenced by age and experience – items like teeth whitening can compete with orthotics. Older employees want expanded drug coverage, while younger workers are concerned about their deductibles. The end result is employees want choice and employers want and need to contain their costs.

The vast majority of Canadian small and mid-sized businesses offer medical and dental benefits to their work-

forces by utilizing insurance carriers. With the consolidation frenzy of the last decade in an effort to make the Canadian players more globally competitive, the number of insurance carriers has dwindled. This new, streamlined landscape has been good for the carriers, but not for the small and medium sized Canadian business, which have been underserved by the carriers focused on delivering shareholder value with big clients who pay \$500,000 or more in annual premiums.

The increasing pressures on the current healthcare system, the consolidation of the insurance industry, and the growing employee demand for more flexible and expanded coverage are all affecting small and medium-sized Canadian businesses. Small and medium-sized employers are facing uncontrollable and unpredictable costs to their businesses to provide these benefits. Employers have tried to curtail these costs by introducing annual limits, co-insurance, deductibles, and exclusions to their medical and dental plans.

### Closer Review

Upon closer review of the average group medical and dental policy for small to mid-sized businesses, usually only 60 per cent to 75 per cent of the overall premium dollars are earmarked for payment for eligible claims. The remaining portions of these premiums are used to pay administration costs, create reserves, pay commissions, and earn insurance carriers profits for shareholders.

As an alternative to the traditional medical and dental insurance solution, some employers are choosing to move towards the Administrative Services Only (ASO) model offered by traditional insurance companies and third-party administrators. There are generally three components to this model:

- ◆ *Self-Insurance* – The employer self-insures, assuming the cost of all claims.
- ◆ *Stop Loss Insurance* – To reduce the risk of a large employee claim, Stop Loss insurance provided by a traditional carrier or specialty provider is combined



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with the self-insurance to payout claims beyond a certain level. The premium for this reduced level of insurance is reasonably affordable.

- ◆ **Third-party Administrator (TPA)** – In order for the cost for medical and dental plans to be tax deductible for the employer and the benefits to be non-taxable in the hands of employees, the administration of plans operated through the ASO model must be handled by a third party.

By avoiding a great deal of the administrative costs and reserves incurred by traditional insurance companies, this model allows the employer to pay more claims with every dollar spent and offers greater flexibility when

designing a plan. Under the ASO model, the company assumes the cost of predictable claims and purchases Stop Loss insurance for the catastrophic risk of unpredictable large claims.

When an insurance company assumes a small business' (under 50 lives) full health and dental risk from \$1 to \$3,500, the premium is high. Under the Stop Loss conditions, where the risk and expenses for an insurance company start only after the first \$3,500 per employee per year for eligible medical and dental expenses, employers could see their costs reduced significantly, as much as 10 per cent to 40 per cent from that of traditional group medical and dental insurance.

## Fewer Control More

**B**arring some unexpected government intervention, the consolidation of the insurance industry that ended the 1990s is over, says Larry Jackson, senior consultant, health and welfare, at ACS HRO Solutions.

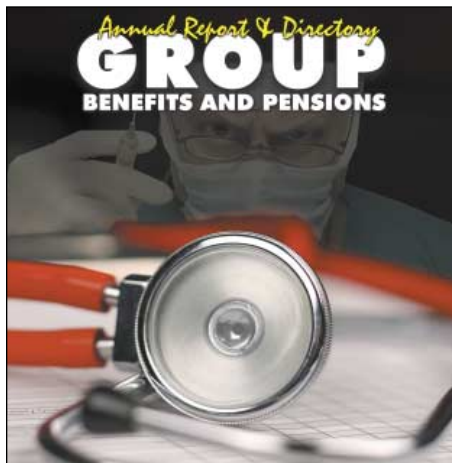
As *Benefits and Pensions Monitor* presents its 2006 'Annual Report & Directory: Group Benefits and Pensions,' Jackson says the major players from that go-round of consolidation seem to be concentrating their efforts on other countries "where they see opportunities for growth, especially getting into the Chinese market."

The top five from 2000, which had 60 per cent of the market, are now down to a top three which controls two-thirds of the market in Canada.

What this means for plan sponsors is that their choices are limited when it comes to carriers.

Jackson also says the focus of these companies has moved from market share to an emphasis on shareholder value. In 2000, the industry made less than \$500 million in profit and was averaging less than 10 per cent ROE. Looking at the 2005 results for the top three, they made around \$750 million in profit and had ROEs in the 13 to 20 per cent range. "They certainly concentrated on the bottom line."

For the employer, this means their costs – general administration fees in general – have increased over the last five years, especially with some of the carriers now showing explicit charges for the cost of capital.



reaching a point where they're giving better service in terms of web access and that sort of thing."

Sponsor who use "second-tier providers" have also benefited. These providers are being "forced to spend the money to develop the tools to keep up with the big three."

However, the shrinking number of providers has made it harder for sponsors to shop around for the best rates. "Now providers are sitting back and saying well, how often have you been to market? Do I want you as a client? They're being a little more selective in terms of who they'll quote on." ■

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Lets examine the example of a small transportation company in Ontario with approximately 70 employees. Over the past three years, it faced a number of challenges which involved group insurance plan premiums skyrocketing up at 10 per cent annually. In a competitive industry with only five per cent profit margins, the company had to take immediate action. This company wanted to achieve two objectives when reviewing its group insurance plan:

- ◆ provide an enhanced medical and dental plan that would be attractive to new and existing personnel
- ◆ maintain and, if possible, reduce expenditures on its balance sheet

After a thorough consultation, the corporate benefits program was re-engineered to meet the company's objectives. This was accomplished by modifying the existing fully insured group plan to an ASO and insured model. After the new solution was implemented, annual premiums went from \$403,562 to \$239,706, a 40 per cent savings in year one of the new plan. In year two, the premiums for the ASO and insured plan increased by 5.5 per cent instead of the 10 per cent premium increases seen by the traditional group insured plan.

Based on the above assumptions, this company will realize an accumulative savings by transitioning from the traditional group insured plan to the new ASO and insurance plan totalling \$3.3 million over the next 10 years. Had the employer paid for the entire plan, these savings will have been equivalent to the company generating \$67 million of gross revenue during the same 10-year period.

### Review Plan Designs

Regardless of whether employers continue with traditional group insurance plans or adopt the ASO model, they need to review their plan designs and understand where employee spending is occurring. It is strongly recommended that the employer include Stop Loss insurance coverage with a reputable provider along with a pooled out-of-province, out-of-country travel insurance program. With the ASO model, the cost of benefits are directly claim-driven versus premium-driven as in the old

traditional insurance carrier plan model.

Third-party administrators and insurers will report all claims by employee by category (drug, dental, paramedical, hospital, vision) to the employer. In accordance with PIPEDA, the federal privacy legislation, the employees' names are not disclosed. With this information, employers, together with their administrators, are tooled to act to control skyrocketing medical and dental costs. If an employee or their family has large drug claims, a drug cost management program can be initiated.

While it is recommended, if the employer chooses not to include Stop Loss insurance coverage in their ASO program, there are provincially funded drug programs that employees can access. This falls outside of the scope of employer-provided coverage, but represents an additional option that individuals can access when drugs are not covered by their employer. In the case of Trillium, Ontario's provincial drug program, those who qualify must pay an out-of-pocket deductible based on their family net income and the number of dependant children. The provincial drug formulary is reviewed regularly. However, not all drugs are covered by these provincially funded drug plans.

Lastly, adopting the ASO model allows employers to provide either Health Spending Accounts (HSAs) or enhanced benefits for key executives within an organization. An ASO can be structured to provide varying reimbursement limits to different classifications of employees (executive, part-time, etc.). Each employee classification can be assigned an annual reimbursement limit, with different classes of employees with differing reimbursement limits.

### Edge Over Their Competitors

In this competitive employment environment, employers looking to attract and retain key people are finding that offering enhanced executive medical and dental plans gives them an edge over their competitors aiming to achieve the same results. Enhanced executive medical coverage using the ASO model for key people within an organization, in addition to traditional

healthcare coverage, can include the rest of an individual's costs, such as:

- ◆ insurance premiums paid by the executive/employee or the individual's spouse for private health and dental plans
- ◆ cosmetic dental and medical treatment
- ◆ over-the-counter drugs, provided they are prescribed by a physician
- ◆ drugs for conditions sometimes excluded under conventional plans
- ◆ facilities and services – special school, alcohol/drug addiction, nursing home care, institution for mental or physical handicap, licensed private hospital, semi-private or private charges in a hospital, care of a person who has been certified as mentally incompetent, care of a blind person, full-time attendants in a nursing home, and fertility clinics
- ◆ laser eye surgery
- ◆ professional services of a dietician, acupuncturist, psychologist, or nutritionist
- ◆ dental care (preventive/restorative/orthodontic)
- ◆ medical equipment and devices

However, Canada Revenue Agency guidelines should be consulted for more information.

Individually, employers have no say over the direction of government policy towards healthcare or how the Canadian economy will behave. What they do have is complete control over how they choose to navigate with their employees through these challenging times by providing medical and dental benefit solutions that address the needs of both their company and their people. It is how corporations act during these periods of transition that will create goodwill and profitable results. ■

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