

Case Study: How An Employer's Internal Cost-Reduction Strategy Can Totally Wipe Out A Health Insurer's Chances Of Earning a Profit On The Group If The Insurer Doesn't Properly Reflect The Probable Impact Of This Strategy In The Group's Premium Rates

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Employer XYZ has an employer contribution of 90%. Their health plan also has very low deductibles and co-pays which makes it a very attractive health plan. Employer XYZ has 150 employees and the average employee salary is \$40,000 per year. Their employees can either choose individual coverage or family coverage, and no employees are uninsured. Assume that this employer either has a fully-insured plan or an experience-rated plan.

Out of their 150 employees, 60 are unmarried and 90 are married. Out of the 90 married employees, 70 of them have a working spouse that has access to a health plan where they work. These 70 employees could enroll their family in their spouse's health plan (i.e., opt out) if they want to, but let's assume that none of them have opted out of this very generous health plan. The other 20 married employees either have a spouse that doesn't work, or their spouse has a job but they don't have access to a health plan where they work, so these 20 families can't opt out. A summary appears below:

	<u>Employees In The Health Plan</u>
60 Unmarried Employees That "Can't Opt Out"	60 With Individual Coverage
90 Married Employees	
70 That Could Opt Out If They Wanted To ("Potential Opt Outs")	
All 70 Didn't Opt Out	70 With Family Coverage
20 That "Can't Opt Out"	<u>20</u> With Family Coverage
	150 Employees In The Health Plan

Let's assume that employer XYZ's health insurer has assumed that this group's annual claims for their next plan year will come in at \$7,000 for Individual Coverage and \$20,000 for Family Coverage. The insurer developed premium rates for employer XYZ that were based on these claims estimates. The premiums they developed were intended to cover the insurer's claims, their administrative expenses, and also generate a 5% profit for the insurer. This insurer isn't aware that employer XYZ will be implementing an aggressive cost-reduction strategy at the beginning of their next plan year. [Insurers should require sales personnel and brokers to provide detailed information about anything that can substantially impact a large group's future loss ratio and/or enrollment level. This can be accomplished by having them complete an **"Information Request Form"** that spells out the types of information that's needed to price a large group properly.]

Fairness would dictate that employer XYZ should only have half of their 70 "potential opt outs" in their health plan which is 35. Unfortunately, all 70 of employer XYZ's "potential opt outs" are in the health plan instead. These 35 "extra families" over and above their "fair share" is costing employer XYZ a great deal of money. Employer XYZ will be addressing this huge cost problem starting at the beginning of their next plan year.

There are many strategies that employer XYZ can use to dramatically reduce or potentially nearly eliminate this huge "extra cost". We'll assume that they'll be implementing a "cash incentive" strategy to get a substantial number of these "extra families" to opt out of their health plan next year. [Any employer could use this strategy whether their health plan is self-funded, fully insured, or experience rated.]

Starting next year, employer XYZ will offer their employees \$4,000 if they enroll their family in their spouse's health plan. They'll receive this \$4,000 every year that they remain in their spouse's health plan. [NOTE: If this employer had any employees who opted out months or years ago (which they don't), they'd have to pay each of these employees \$4,000 as well.] Although there are many considerations involved when a family is deciding on which of the two health plans they should be in, \$4,000 per year is an attractive offer since the

average salary of employer XYZ's employees is only \$40,000 per year. [Most employers that offer cash incentives only offer their employees \$1,000 or \$2,000 which won't generate many new opt outs. On the other hand, some employers offer \$6,000 or more.]

Let's assume that 22 of the 70 who didn't opt out decide to take advantage of this \$4,000 offer and opt out of the health plan at the beginning of the next plan year. So next year, employer XYZ will have 128 employees in their health plan instead of 150.

60 Employees With Individual Coverage That Obviously Can't Opt Out
48 Employees With Family Coverage That Could Have Opted Out But Didn't
20 Employees With Family Coverage That Can't Opt Out
128 Employees In The Health Plan

Let's assume that the 22 new opt outs have claims that are **40% lower** than the 48 families that could have opted out but didn't because families with existing medical problems rarely opt out of their current health plan. These new opt outs are also probably younger than average and they also probably have smaller family sizes as well. Therefore, the annual claims associated with the 22 new opt outs WOULD HAVE BEEN \$13,725 PER FAMILY IF THEY STAYED IN EMPLOYER XYZ'S HEALTH PLAN (which they didn't), and the annual claims of the 48 that could've opted out but didn't will be \$22,876 per family. (NOTE: The weighted average of the 22 families at \$13,725 and the 48 families at \$22,876 is \$20,000, and is equal to the insurer's claims estimate. Also note that \$13,725 is 40% less than \$22,876.)

$$48 Y + 22 (.60 Y) = 70 \times \$20,000$$

$$61.2 Y = \$1,400,000$$

$$\text{So, } Y = \$22,876 \text{ and } .60 Y = \$13,725$$

Now, let's look at how the insurer's claims estimate of \$20,000 per family compares to what employer XYZ's actual claims will be for an average family that's actually in their health plan next year. Employer XYZ will have 48 family subscribers at \$22,876 each, and 20 family subscribers at \$20,000 each (these are the 20 families that can't opt out that are shown in the table near the top of this page). The weighted average of these 68 families with Family Coverage is \$22,030 which is **10.2% more** than the \$20,000 claims estimate that the insurer assumed when developing employer XYZ's family premium rate which means that **the family rate will be about 10.2% lower than it needed to be**. Even if the premiums for Individual Coverage were perfectly on-target, the 10.2% deficiency in the family premiums will result in nearly an 8% deficiency in the group's total premiums. Therefore, not only will the insurer's 5% profit margin be totally wiped out, they'll actually lose nearly 3% of premium on this group! **This health insurer needed to know about this employer's cost-reduction strategy, and then they should have reflected the probable impact of this strategy on this group's loss ratio and enrollment level when setting the group's premium rates.**

We have several seminars and on-site training programs that address this topic in great depth, as well as many others. Check out the "Upcoming Seminars" section on the home page for detailed information regarding our seminars. You can also check out the "On-Site Training" page for additional information regarding our on-site training programs. If you'd like us to add you to our mailing list or our email list, just email us at smsnow@smsnow.com and we'll make sure that you'll know about all of our upcoming seminars

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