

INTRODUCTION TO GROUP BENEFITS (325-1)

- Obj 1. **FIVE CATEGORIES OF EMPLOYEE BENEFITS:**
1. **Legally required payments for government programs (social insurance):**
 - a. Social Security.
 - b. Medicare.
 - c. unemployment compensation insurance.
 - d. workers' compensation insurance.
 - e. temporary disability insurance.
 2. **Payments for private insurance and retirement plans:**
 - a. old age.
 - b. death.
 - c. disability.
 - d. long-term care expenses.
 - e. medical expenses.
 - f. dental expenses.
 - g. legal expenses.
 - h. property and liability losses.
 3. **Payment for time *not* worked:**
 - a. vacations.
 - b. holidays.
 - c. jury duty.
 - d. maternity leave.
 - e. military leave and National Guard duty.
 4. **Extra cash payments, other than for wages and bonuses:**
 - a. educational assistance.
 - b. moving expenses.
 - c. suggestion awards.
 - d. holiday and year-end bonuses.
 5. **Cost of services to employees:**
 - a. subsidized cafeterias.
 - b. employee discounts.
 - c. wellness programs.
 - d. day care.
 - e. adoption assistance.
 - f. financial planning programs.
 - g. retirement counseling.
 - h. free parking.

SIGNIFICANCE OF EMPLOYEE BENEFITS: As a percentage of payroll, employee benefits have increased from about 3% in 1929 to about 40.2% in 2005. Deviations from the average are the result of company, industry, geographic, and employee differences. **The percentage of participating employees is often lower than the percentage of eligible employees because** many employees might not meet the plan's eligibility requirements.

- Obj 2. **SIX FACTORS INFLUENCE THE GROWTH OF GROUP BENEFITS:**
1. **Industrialization**--caused workers to rely more on monetary wages than self-sufficiency and family ties.
Employers began offering medical and retirement benefits in an effort to reduce turnover and remain competitive.

2. **Organized labor**--gave employees more voice to negotiate within organizations.
A 1949 Supreme Court ruling removed all questions regarding labor unions' legal right to negotiate employee benefits.
To remain competitive and, often, to avoid unionization, employers provide generous benefit plans.
In unionized environments, employers often provide the same benefits to nonunion and union workers alike.
3. **Wage controls**--during World War II and the Korean War caused employers to increase benefits to attract and retain employees.
Wage controls during the 1970s did not significantly affect group benefit plans, due to the relatively short duration of the controls.
4. **Cost advantages**--provided by economies of scale, as well as favorable tax treatment for both the employer and employee, encourage growth in group benefits.
Note: Nondiscrimination rules deny favorable tax treatment *if* the benefit plan discriminates in favor of highly-compensated employees.
5. **Inflation**--affects both the amount and type of group benefits offered by employers. Recent increases in medical costs have caused the costs of benefit packages to increase faster than wages.
6. **Legislation**--has increased both the types and costs of available benefits.
Mandated benefits for treatment of alcoholism and drug abuse, maternity, and family leave have significantly broadened the scope of employer-provided group benefits.

Obj 3. **EXPECTED BENEFIT TRENDS IN THE NEAR FUTURE:**

1. Small firms will continue to provide a growing market for new benefit plans.
2. Increasing benefit costs will encourage employers to switch to voluntary plans under which employees pay the full cost of coverage through payroll deductions.
3. The cost of medical expense benefits will continue to rise faster than the rate of inflation.
4. Employers will continue to make employees pay a higher proportion of their medical expenses.
5. Almost all employee medical expense coverage will use managed care plans.
6. Employers will continue to reduce retiree benefits.
7. More plans will include benefits for domestic partners.
8. State governments (rather than federal governments) will continue to take incremental steps toward health care reform.
9. More employees will receive benefits under cafeteria plans.
10. Changing demographics will lead to growth in certain benefits, such as day-care centers, retirement planning, and long-term care insurance.
11. Wellness and employee-assistance programs will become increasingly popular.
12. Technological advances will improve benefits administration and make on-line information available to employees.

Obj 4. **THE FIVE-STEP BENEFIT-PLANNING PROCESS:**

1. **Determine the employer's objectives**--Decide if the benefit plan should meet, or should beat, the competition.
2. **Design a plan to meet the objectives**--Analyze both short-term and long-term costs.
Decide the method of funding: insurance, current revenues, or a combination of both.
3. **Implement the plan**--Begin new programs or pursue competitive proposals from third-party administrators (**TPAs**) (insurers, banks, etc.).
4. **Communicate the plan to employees**--Identify the plan's coverages and explain the value of its benefits.
5. **Monitor the plan's performance**--Evaluate employee participation, demographic changes, new funding possibilities, and new benefit options. Change the plan as appropriate.

Obj 5. **THREE WAYS TO STRUCTURE EMPLOYEE BENEFIT PLANS:**

1. **Group insurance**--covers many individuals under a single policy that is issued to another entity. Typically, the entity is the employer and the insureds are the employees.
2. **Self-funding**--is the method under which the employer pays all claims from current revenues, assumes all risks that claims might exceed expectations, *and* administers all plan aspects. Recent trends show smaller employers using self-funding for benefits that were formerly fully insured.
3. **Policies of individual insurance**--are typically found as part of a voluntary benefit plan, under which each employee pays for and is insured under an individual insurance policy.

Obj 6. **THREE CHARACTERISTICS OF GROUP INSURANCE:**

1. **Group contract**--Also known as a **master contract**, the group contract is issued to the policyowner, usually the employer, and provides benefits for a group of individuals (employees). A **certificate of insurance** describes the insurance coverage provided to employees, but is *not* part of the master contract. Unlike individual insurance, the inception of the contract may be prior to or end well after individual employees begin or terminate coverage under the contract. Covered employees are *not* actual parties to the contract, but are third-party beneficiaries with the legal right to enforce the contract.
2. **Experience rating**--Actual experience of the particular group insured (if sufficiently large enough) is used to determine premiums, as opposed to individual policies, which base their premiums on large segments of the population.
3. **Group underwriting**--Individual members of the group are *not* usually required to show **evidence of insurability** (proof that the insured meets the insurer's underwriting standards), whereas persons seeking individual insurance coverage generally must. Group insurance underwriting attempts to minimize the problem of **adverse selection** (the likelihood that those most likely to have claims are also those most likely to seek insurance), as well as administrative costs, thus providing insurance at lower costs than could be available to individual policyholders.

Obj 7. **TWELVE FACTORS OF GROUP UNDERWRITING:**

1. **Reason for existence**--A group seeking insurance must be formed for reasons other than to obtain insurance for its members (to avoid adverse selection). The employment relationship is the typical reason for existence.
2. **Stability**--A reasonable, but steady flow of new persons through the group results in the best premium. High turnover increases administrative costs and low turnover usually represents an aging workforce, often resulting in higher insurance usage (and thus higher premiums).
3. **Persistency**--Underwriters consider the length of time that an insurance contract will remain on the insurer's books. Contract renewals for a minimal period of 3 or 4 years allows insurers to recoup initial acquisition expenses. Underwriters often avoid companies that frequently change insurers or that are having financial difficulties.
4. **Determination of benefits**--Identical benefits for all participants is the preferred underwriting rule. Benefits determined by the individual or the employer based on an individual's position often lead to adverse selection. The general level of benefits is also a concern, as a high level may encourage over-usage, while a lower level may result in low participation if a plan is voluntary.

5. **Determination of eligibility**--To reduce administrative costs and adverse selection, probationary periods are often required before employees may begin coverage under a group plan. Typically, only full-time permanent employees are eligible for coverage.
6. **Premium payments**--
Noncontributory plans (employer-paid plans) requiring 100% participation by eligible employees is the ideal underwriting goal.
Contributory plans (employee pays some or all of the cost) typically result in adverse selection and therefore underwriters generally require a minimum 75% participation rate. Insurers frequently require the employer to pay at least a portion of the premium.
Open-enrollment periods provide opportunities for employees to obtain coverage *without* showing evidence of insurability.
7. **Administrative aspects--The employer is often required to carry out administrative tasks:**
 - a. communicating the plan to the employees,
 - b. handling enrollment procedures,
 - c. collecting employee contributions,
 - d. assisting in claims processing, *and*
 - e. keeping track of various related records.
8. **Prior experience**--Reasons for changing insurers must be investigated to avoid excessive claims. Change due to high premiums, dissatisfaction with the service provided, a desire to change benefits, etc. must all be evaluated by the underwriter to ensure that the new insurer is able to provide the type and level of service and benefits desired.
In some states, **no-loss no-gain legislation** prohibits any insurer from using a preexisting-conditions clause to deny continuing claims from persons covered under a prior group plan. Excessive changes of insurers signals a persistency concern.
9. **Group size**--Larger groups are easier to underwrite based on experience rating.
Smaller groups present concerns regarding
 - a. adverse selection,
 - b. high administrative costs, *and*
 - c. an inability to use experience rating.
Most insurers use pooled rates to determine premiums for small groups, as well as stricter underwriting (sometimes individual) guidelines.
10. **Composition**--The age, gender, and income of the group affects the experience of the group. As a group, females tend to have higher usage of medical benefits.
Higher-compensated individuals also tend to seek higher-priced medical care.
Lower-paid employees tend to have high turnover rates thus increasing administrative costs.
States that require unisex rates may result in lower participation in contributory plans.
11. **Industry**--Some industries have higher-than-average claims that can *not* be directly related to occupational hazards, while other industries are known for lack of stability and persistency. Changes in the economy may also affect certain industries more than others, thus creating unique underwriting difficulties.
12. **Geographic location**--Medical expenses and utilization differs from region to region. The Northeast tends to have higher medical expenses than does the South.
Urban and rural areas also differ in expense and utilization.
Companies with multiple locations present greater challenges, both administratively and from the insurer's service standpoint.

Obj 8. **ALTERNATIVE METHODS FOR FUNDING GROUP BENEFITS** will be discussed in Assignment 12.

The use of alternative funding methods does *not* eliminate the need to evaluate eligibility, benefit levels, and claims handling.

Obj 9. **VOLUNTARY BENEFIT PLANS** offer various types of coverages with the employee paying 100% of the cost.

The increased popularity of voluntary benefit plans is mainly due to employers' attempts to control the costs of employee benefits.

Other reasons for the increased popularity of voluntary benefit plans include the ease of payroll deduction, more liberal underwriting, portability, the employer's ability to offer increased benefits at little or no additional cost, **and** the increased availability of products.

Obj 10. **CHARACTERISTICS OF VOLUNTARY BENEFIT PLANS:**

1. **Types of products available**--include life insurance, dental insurance, disability insurance, prescription drug coverage, vision care, long-term-care insurance, and property-liability insurance.

Most insurers target employees in the mid-income range.

Most insurers enter the voluntary benefit market to sell life insurance.

2. **Underwriting**--is usually on a simplified or guaranteed-issue basis for group policies, but some types of insurance (especially property-liability) are underwritten individually.

Guaranteed issue is the underwriting category that provides coverage without evidence of insurability.

Simplified issue is the underwriting category that provides coverage **if** the applicant gives satisfactory answers to the questions on the abbreviated application form.

Modified guaranteed issue is the underwriting category that accepts most applicants, but declines some applicants based on the answers to a few medically-related questions.

3. **Cost and method of premium payment**--is usually borne 100% by the employee with premiums paid through payroll deduction.

4. **Portability**--lets an employee continue group coverage **after** termination of employment by paying premiums directly to the insurer.

The total premium usually remains the same, **but** premiums under direct billing may be paid less frequently than under payroll deduction.

Portability is automatic for individual products and often is available for group products.

Some plans cease upon termination of employment, but may be converted to individual coverage.