August 2012

Voluntary Benefits in a Post-Health Care Reform World

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Voluntary Benefits – plans that are offered through employers but selected and mostly paid for by employees – are becoming increasingly popular. What's driving the growing market demand? Let's examine some of the trends and how Voluntary Benefits can be valuable to employers and their employees – both today and in the future.

Macro Drivers
There are three major environmental trends driving the demand for Voluntary Benefits – cost shifting, health care reform and the economy.

1. **Cost shifting** – According to a Bain survey, employers won't be surprised to see their health care costs increase as much as 60% over the next four to five years.[1] In fact, by 2018, family premiums are expected to increase to $20,300 for large groups compared to $13,900 in 2008[2], a 46% increase. These rates of increase are far greater than the expected growth in real wages and overall inflation.

   Such an increase means that the trend toward shifting costs to employees will not abate any time soon. Strategies such as requiring employees to pay a greater percentage of their insurance premiums, increasing deductibles on conventional PPO plans, and migrating to high-deductible health plans (HDHPs) are now commonplace. Other actions employers have taken and will continue to take to hold down health benefits spending include:
   - 29% of employers are raising in-network deductibles[3]
   - 40% of employers are increasing employees' share of premium[2]
   - 28% are increasing employees' proportion of dependent coverage[2]

   Voluntary Benefits align well with a cost-saving strategy by allowing employers to expand and/or modify their benefits offerings without increasing their benefits budgets. For example, moving from a PPO insurance plan to a HDHP oftentimes can be challenging given the employee's increased out-of-pocket expense. By offering a lower premium cost Hospital Indemnity Plan, which pays a fixed cash benefit for each authorized admission, employers can offer their employees an affordably priced voluntary benefit of significant value to help offset the high deductibles, which in turn can help improve employee acceptance in moving from a PPO to an HDHP.

2. **Health care reform** – On the health care reform (HCR) front, a *Forbes* article noted that 70% of employers expect reform to lead to higher health care costs[4] largely due to factors such as expanded coverage for dependent children, new mandated benefits, the employer mandate and the enrollment of more than 30 million uninsured.

3. **Economy** – The state of the U.S. economy is also driving the demand for Voluntary Benefits. According to a SHRM survey, 77% of employers said the economy has affected their benefit plan offerings.[5] While

[1] Bain & Company, 2010.
[2] "Estimated Premium Impacts of Annual Fees Assessed on Health Insurance Plans," Oliver Wyman, October 31, 2011.
[3] "Health Care Reform: Employer Actions One Year Later," The International Foundation of Employee Benefits Plans, June 8, 2011.
[4] "Health Care Reform: How Companies Need To Worry," Forbes.com, November 29, 2010.
[5] "2011 Employee Benefits: A Research Report by SHRM," June 2011.

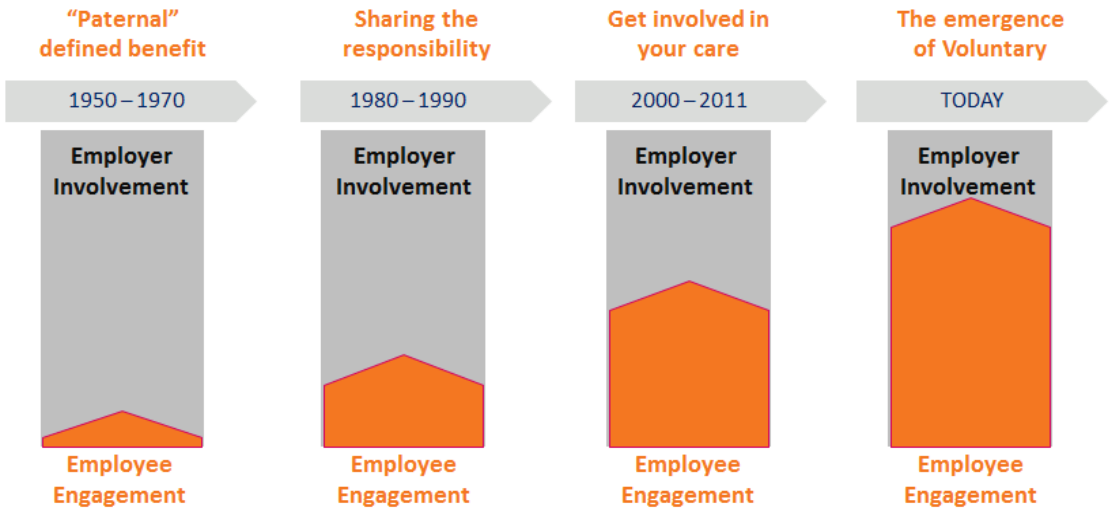
many have implemented cost-shifting and/or benefit reduction strategies, there also is a move by some employers to consider benefit enhancement strategies – like offering Voluntary Benefits.

The Move Toward Voluntary Benefits

As health care costs continue to increase and shift to employees, it is no surprise that employees are becoming more engaged in their benefits. As employees increasingly shoulder more of their benefits costs, Voluntary Benefits are emerging as a solution that helps employees increase their sources of cash to defray rising out-of-pocket expenses.

As the graphic below illustrates, from the 1950s through the 1970s employers paid the majority of health care premiums – employees were, for the most part, disengaged and uninvolved. Beginning in the early 1980s and continuing through the 1990s, employers began initiating cost-sharing for both premiums and benefits. Since then, the "Get Involved in Your Care" movement has forced employees to become active purchasers of health care and to make better informed decisions. And the movement is working. A recent Aetna study revealed that members who are enrolled in its consumer-directed health plan (CDHP) receive access to recommended care at a higher rate than members enrolled in other plans options. Screenings for cancer and diabetes were higher for CDHP members compared to those in conventional PPO plans. At the same time, the employers offering these plans saw savings in their overall health care costs.[6]

Today, employees share a significant percentage of the premium cost of health insurance with their employer, as well as a significant percentage of the cost of benefits through deductibles and co-insurance. Even though the employer still decides which benefits to offer, employees are more engaged in health care than ever before, given the fact that they are responsible for paying more of the cost.



The Value of Voluntary Plans

Voluntary plans represent a viable solution for *increasing* benefits at a time when employees perceive their benefits are *decreasing* or, in some cases, being eliminated. According to a LIMRA survey, 77% of employers believe Voluntary Benefits improve employee morale and satisfaction.[7] Adding these plans to a benefits package

[6] "Aetna HealthFund Consumer-Directed Plans Continue to Reduce Health Care Costs for Employers," www.aetna.com, January 2012.
[7] "The Voluntary Benefits Report Card," LIMRA International, 2007. (this citation will be out of date at end of year. Citations cannot be older than 5 years. Will need to update or remove.)

can expand employees' choices and provide them with financial protection. And for the employer, these plans can be effective recruiting and retention tools.

Voluntary Benefits are becoming more popular with employers. In fact, the number and percentage of employers offering Voluntary Benefits has been on the rise. According to LIMRA, the trade group for insurance and financial services companies, more than 57 percent of U.S. employers now offer Voluntary Benefits to their employees.[8] The inverse of this metric is that 43 percent of U.S. employers do not offer Voluntary Benefits. There is potential for significant growth in the under-penetrated Voluntary Benefits market.

Growing Producer Community Interest

Interest in Voluntary Benefits is also growing among brokers. Many major medical carriers have reduced commissions in the wake of the health care reform provisions, driving more and more brokers to take a serious look at Voluntary Benefits (which are not subject to the same rules) to replace lost compensation. For example, brokers who help their clients select a medical plan which best meets the client's needs also have the opportunity to educate their clients on the value of adding voluntary financial protection plans to their benefits program as a way to offset high deductible medical plans.

With 30% of U.S. employers (with 10 or more employees) considering adding a new voluntary option within the next two years, there is plenty of opportunity for voluntary benefits growth in the market.[9]

Employee Choice and Financial Protection

Voluntary Benefits allow employees to be more involved and engaged in selecting options that fit their specific needs, as opposed to being offered a one-size-fits-all benefits package. Voluntary Benefits offered at the worksite on a group basis provide employees access to lower group rates and a wider array of choices.

Voluntary Benefits which provide financial protection offer coverage for things that traditional benefits weren't designed to cover and include products such as hospital indemnity, critical illness and accident plans. Research shows that consumers are not financially prepared for emergencies. According to HSBC, 61% of Americans lack the savings to cover 3 months of expenses.[10] And hardship withdrawals from 401(k) plans have risen to the highest level in 10 years.[11] Voluntary Benefits can help by providing cash benefits to cover everyday expense such as rent, daycare and groceries when an unexpected health or other life event occurs.

In addition to Voluntary Benefits designed to provide financial protection, other Voluntary Benefits provide medical coverage, such as currently-available fixed indemnity plans which are considered "excepted" and not subject to the provisions of the Affordable Care Act. Further, healthcare reform is likely to drive the insurance industry to develop new, innovative minimum essential coverage products in both the Exchange and the employer-sponsored markets.

The Impact of Health Care Reform

The passage of the Affordable Care Act (ACA) – and the historic Supreme Court decision on June 28, 2012 upholding most aspects of the Act – are action-forcing events, catalysts for change that will drive greater innovation among all stakeholders toward achieving a more effective and efficient health care system. However, there are serious challenges that need to be addressed. Market conditions may change, but fundamental problems of access, cost and quality persist.

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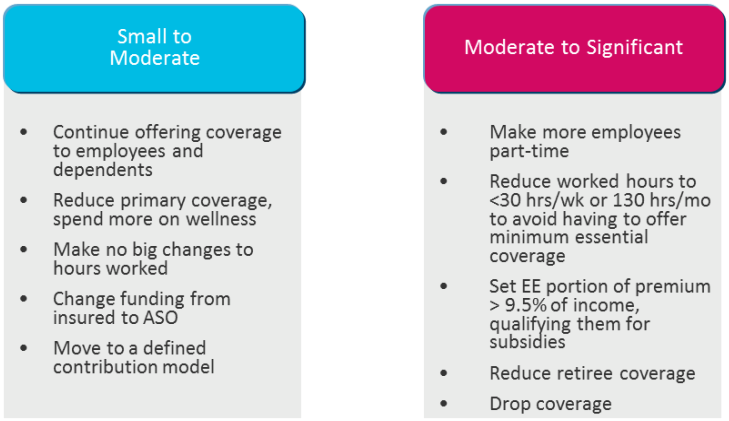
[8] "Voluntary Worksite Benefits: Penetration and Market Potential," LIMRA, 2011.
[9] "Voluntary Worksite Benefits: Penetration and Market Potential," LIMRA, 2011.
[10] "HSBC Survey: Americans Saving More But Still Not Enough," September 2009.
[11] "401(k) Withdrawals Spike," CNNMoney.com, August 2010.

As the new health care reform legislation is phased in over a period of years, the landscape will continue to change. A number of mandates have already taken effect, such as elimination of annual and lifetime dollar limits, required coverage for dependents through age 26, and elimination of pre-existing condition exclusions for children up to age 19. In 2014, major insurance market reforms will be implemented that will require most Americans to have "minimum essential" health care coverage.

Potential Responses to the Employer Mandate

The ACA provisions that are most likely to have the biggest impact in the health insurance marketplace starting in 2014 include: new taxes and fees, expanded Medicaid coverage, Exchanges, premium and cost-sharing subsidies for people whose incomes are between 133% and 400% of the Federal Poverty Level (FPL) who buy Exchange coverage, the employer mandate and the individual mandate. Employers' responses will range from small to significant.



Large employers – defined as having more than 50 full-time equivalent employees – may be required to pay penalties for either:

(a.) offering no coverage, in which case the penalty is $2,000 per employee, minus the first 30, or

(b.) offering coverage that fails to meet the so-called "two-prong test" where the coverage must

- not exceed 9.5% of the employees W-2 wages and
- have an actuarial value not lower than 60% of allowed dollars paid by the health plan.

The penalty is $3,000 for each employee who receives subsidized coverage on an Exchange if coverage does not meet either of these prongs.

An important nuance of the law is that large employers won't actually have to pay penalties unless either the (a.) or the (b.) condition described above exists **and** a full-time employee receives subsidized coverage through a state or federal Exchange (not counting the first 30 employees if no coverage is offered). This poses an interesting set of scenarios for employers. For example:

As noted in the graphic above, some employers, reasoning that is less costly to pay a $3,000 per employee penalty than to contribute to employer-sponsored minimum essential coverage, may offer minimum essential coverage which is unaffordable where the premium exceeds 9.5% of income as a strategy to drive employees to purchase Exchange coverage..

Further, some employers may reason that offering no coverage, where they will be liable for paying a $2,000 penalty per full-time employee (not counting the first 30) in the event *any* employee purchases subsidized Exchange coverage, is the way to go in terms of reducing benefits costs.

Which leads to the next possible scenario – an employer, reasoning that they will only be liable for paying *the lesser of* either the $3,000 per employee penalty for any full-time employee who receives subsidized Exchange coverage or the $2,000 per employee penalty for all employees if the employer offers no minimum essential coverage, may decide to offer minimum essential coverage that is *neither* affordable nor of a minimum 60% actuarial value.

While no one knows for certain which of these, or other, scenarios ultimately will "play out," we do know for certain that it will be interesting to watch all this unfold.

Health Care Reform and Limited Medical Plans

According to the Centers for Medicare & Medicaid Services (CMS), 3.4 million workers remain in limited medical plans that have received waivers to continue operating until 2014.[12] Also known as "mini-med" plans, limited medical plans can provide affordable coverage for un-benefitted part-time and seasonal workers.

Based on the June 28, 2012 Supreme Court ruling, we now know with certainty that mini-med plans with annual dollar limits cannot be renewed after December 31, 2013 and expire officially on their anniversary date in 2014. As a result, a large number of mini-med enrollees could be driven to exchanges if (a.) a private-market, employer-based option is not available which satisfies the ACA's definition of "minimum essential coverage" for the purpose of complying with the Individual Mandate, or (b.) if employees are unwilling to purchase "excepted benefit" plans, such as Fixed Indemnity Plans, as an alternative to minimum essential coverage.

Fixed Indemnity Plans are an interesting option. They pay fixed dollar benefits for a wide range of medical services (including surgical and non-surgical inpatient and outpatient services, emergency room visits, office visits, prescription drugs and more); have no deductibles, co-pays or co-insurance; and are very affordably priced, with weekly group rates in the $15 - $20 range. In many cases, particularly for employees whose income exceeds 250% of the Federal Poverty Level, Fixed Indemnity Plans can cost the employee ***less*** than ***either*** non-subsidized major medical coverage or premium subsidized major medical coverage bought on a state or federal Exchange … even when associated individual penalties ($95 or 0.5% of taxable income in 2014, $325 or 1.0% of taxable income in 2015 and $695 or 2.0% of taxable income in 2016) are included. These plans can be 100% employee paid or partially employer subsidized, and can be offered on either a payroll-deducted or an employee direct-pay basis.

This is yet another example of how Voluntary Benefits can potentially address coverage and funding issues.

Health Insurance Exchanges

Last year, Health and Human Services (HHS) released the first regulations related to Exchanges. The initial regulations outline the states' responsibilities in creating and managing Exchanges, providing a fair amount of flexibility to the states on how they are developed. All states will be required to have functioning Exchanges by January 1, 2014. In the event that a state has not shown the ability to establish an Exchange by January 2013, the federal government will implement one.

Eligibility for premium tax credits and cost-sharing subsidies will be available only through the Exchanges for those individuals whose taxable income level falls below 400% of the Federal Poverty Level.

The Individual Mandate

In 2014, nearly all Americans will be required to have minimum essential coverage that conforms to key ACA requirements, such as:

- Excludes annual dollar limits

[12] "Annual Limits Policy: Protecting Consumers, Maintaining Options, and Building a Bridge to 2014," www.healthcare.gov, posted June 2011; updated August 19, 2011.

- Conforms to MLR requirements
- Covers dependents through age 26
- Prohibits exclusions or limitations for pre-existing conditions
- Provides a minimum actuarial value
- Covers preventive and emergency health services with no cost sharing.

Insurance purchased on an Exchange (which is for individuals and small groups) is further required to cover all Essential Health Benefits (ambulatory care, emergency room, inpatient, lab, obstetrics, psychiatry, pediatrics, prescriptions, preventive and wellness, and rehabilitation) and is subject to annual out-of-pocket maximums.

If employees cannot obtain minimum essential overage through their employers, then most employees will be put in a position to seek coverage through the newly created Exchanges. Individuals whose taxable income level falls between 133% and 400% of the Federal Poverty Level will be armed with federal subsidies such as premium tax credits and cost-sharing assistance to help them pay the premiums and offset out-of-pocket costs.

The "New Buyers"
Health care reform legislation means a whole new segment of the population will enter the health benefits marketplace. Let's consider one potential scenario.

Cost-conscious shoppers who can't get coverage at the workplace will likely shop for the cheapest Exchange policy that meets the minimum essential coverage definition. This likely means high-deductible health plans (HDHPs).

Even though HDHPs may meet the minimum standard, there will be significant consumer cost sharing. In fact, a recent Mercer study[13] suggests that these plans will have:

- Deductibles of $2,000/$4,000 in network and $4,000/$8,000 out of network
- Coinsurance of 50% across the board
- Out-of-pocket maximums of $11,900 (family coverage/in network) and $23,800 (family coverage/out of network).

The high cost to the consumer associated with HDHPs is likely to accelerate the growth of Voluntary Benefits, as well as give rise to Private Exchanges. For example, employees can purchase their minimum essential coverage on a state or federal Exchange, and then supplement that coverage with Voluntary Benefits on a private exchange. Even those employers that choose to stop offering minimum essential coverage to their full-time employees – facing potential penalties of $2,000 per employee (minus the first 30) if *any* employee purchases subsidized coverage on a state or federal Exchange – could still offer group Voluntary Benefits.

Making the Transition
The health insurance benefits industry is focused on transitioning to the new, direct-to-consumer world that lies ahead. There will be strong elements of re-tooling, re-thinking and re-positioning as HCR transforms our industry. We anticipate a "new normal" – a future state where:

- Some employers may decide to opt-out of providing health care benefits entirely and instead give their employees a "defined contribution" to buy coverage through a public and/or private Exchange.
- Tens of millions of consumers – including those who historically obtained health coverage through their employer – will shop for coverage on public and/or private Exchanges.
- Other consumers who feel they don't need – or simply can't afford medical coverage, even with subsidies – may elect to buy lower-cost Fixed Indemnity Plans, especially when they "do the math" and realize that

[13]Mercer 7th Annual Health Care Benefits Show & Conference 2011

the combined cost of the premium plus the associated tax penalties will, in many cases, be less than the combined cost of subsidized medical coverage premium plus the associated deductibles.

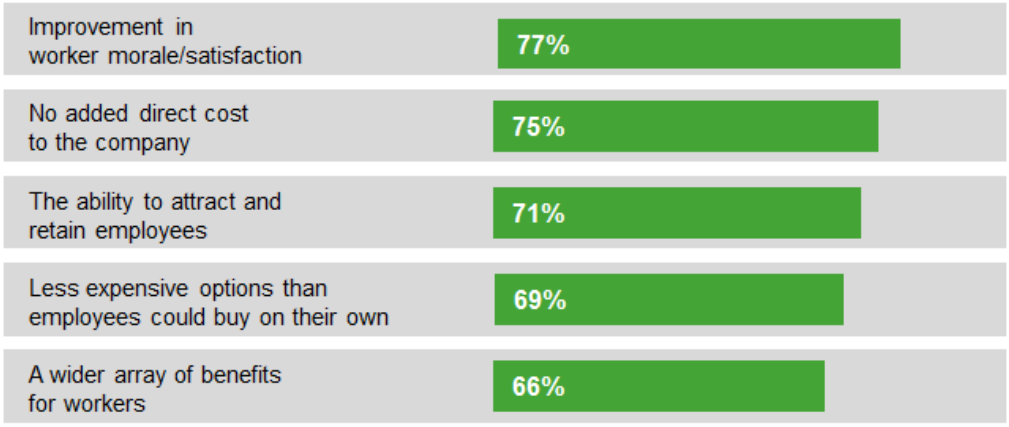
- Voluntary insurance plans that provide income protection and allow employees to tailor benefits that best meet their individualized needs will proliferate.

Each phase of health care reform will challenge the health insurance benefits industry to expand their product offerings, service and administrative capabilities to meet new demands.

What Employers and Employees Think about Voluntary Benefits

Voluntary plans are mostly employee paid, do not increase the employer's costs, and are perceived by employees as increasing choice and adding value. At least two-thirds of employers surveyed believe Voluntary Benefits add significant value – ranging from 66% of employers who believe Voluntary Benefits increase employee choice, up to 77% of employers who believe that Voluntary Benefits can increase employee satisfaction with their benefits.[14]

Employers believe that Voluntary Benefits offer[15]:



Employees also value voluntary offerings. In fact, 90% say they value the ability to match benefit choices to their individual needs.[15] And 89% of employees feel it is important to have choices in their benefits package.[16]

Voluntary Benefits are a win-win and will play a significant role in the post-health care reform world. Employers pay little, if any, of the cost, while offering a broader array of benefits to their employees. And employees have access to products that give them income protection at less expensive group rates.

In short, Voluntary Benefits are poised to play a major role in the world of post-health care reform. The outlook for Voluntary Benefits is bullish and the market is well positioned for explosive growth.

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[14] "The Voluntary Benefits Report Card," LIMRA International, 2007.(same comment as above regarding this citation)
[15] "Goldilocks and the Voluntary Benefits," BenefitsSellingMag.com, December 2009.
[16] "Voluntary Benefits Allow Employers to Strip Down Core Offerings to Trim Costs," Employee Benefits News, June 1, 2009. Article includes results from a Watson Wyatt Worldwide study.