

INSURANCE JOURNAL[®]

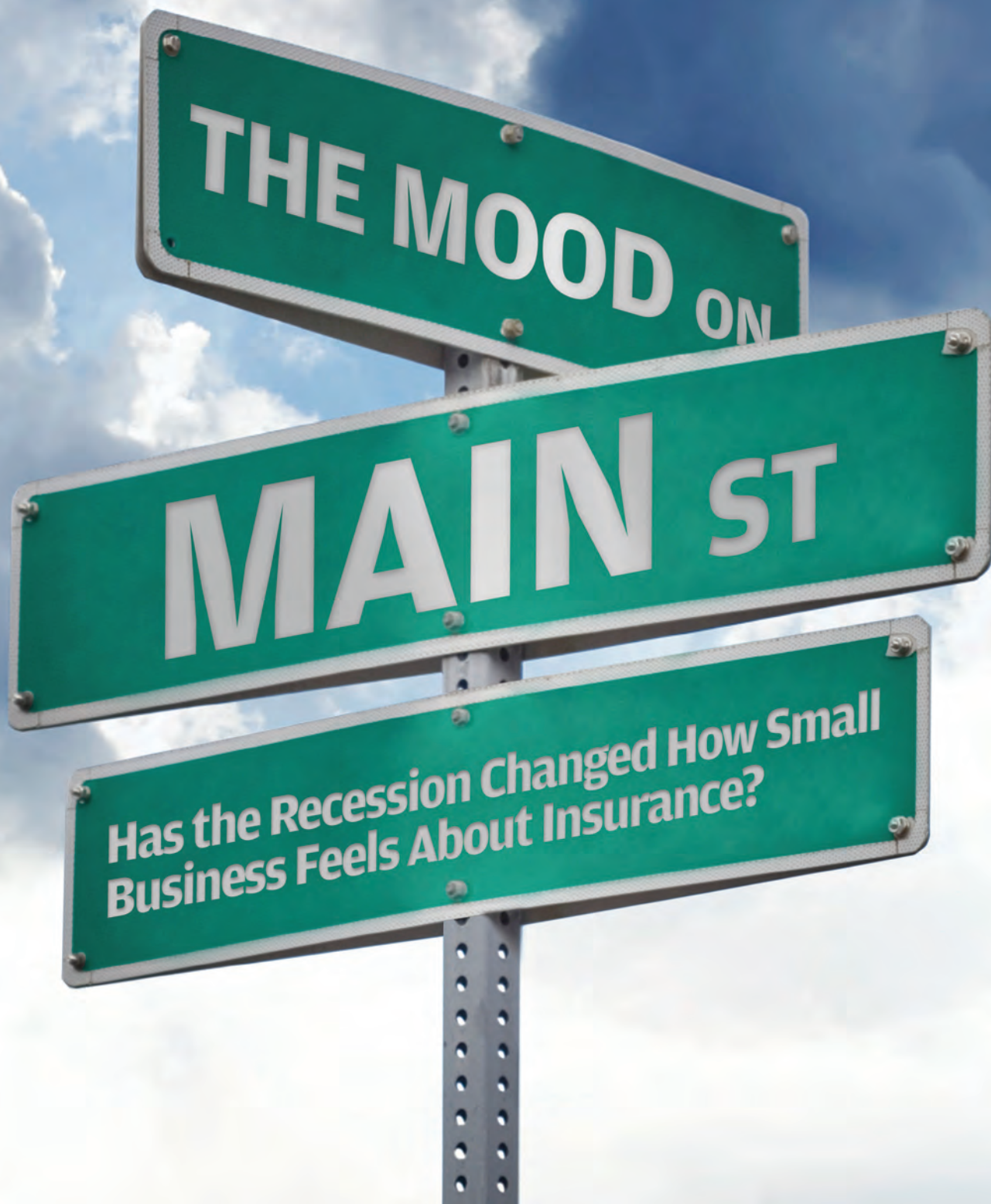
THE NATIONAL PROPERTY CASUALTY MAGAZINE

Soft Market Not Over Yet

Nonprofits Look Beyond Price

Obesity Adds Big Costs to Workers' Comp

Pre-empt Professional Liability Problems



Health Insurance

Lemons Into Lemonade:

Making the Best of the Medical Loss Ratio Squeeze

January 1, 2011 marked the beginning of a significant transformation for the nation's insurance brokers – one that, frankly,



By Mike Sullivan

didn't inspire celebration. Medical loss ratios (MLR) mandated by health care reform became effective, dictating what portion of premiums insurance carriers must spend on health care.

Broker commission structures, which already have been squeezed, are now being further reduced, eliminated or restructured, depending on a carrier's new or evolving policy. At the same time, employers are demanding more service, particularly smaller companies with minimal internal resources. The typical Main Street property/casualty agency selling health insurance faces monumental obstacles to continued success in this environment. Of course someone always turns lemons into lemonade. Innovative firms actually will thrive by turning this challenge into an opportunity.

MLR Market Overview

First, a look at the economics. The MLR rate is 85 percent of premium revenue for large group plans and 80 percent for small groups. The remaining 15-20 percent encompasses profits and administrative costs, including broker commissions. As Michael McCallister, chairman of the board and chief executive officer of Humana, pointedly said in an investor conference call last April: "There's not room in the economic model for the commission system as we know it today to continue to exist."

Most health insurance carriers already have substantial changes in process. In the most dramatic announcement to date, Aetna Inc. eliminated commis-

sions from its sales structure for groups of 51 or more employees, forcing brokers to seek direct compensation from their customers. Others plan less drastic measures, such as switching from a percentage of premiums to a per contract per month basis.

In the future, experts predict that health and ancillary carriers will work only with select brokers. This will seriously impact competitive dynamics among brokers. Over time, health insurers may develop a distribution model that is not open to all brokers and will be available to those that have been authorized by the carrier. One influencing factor could be volume of business with a specific carrier. Commissions will vary significantly based on size of blocks and growth rates. This is not unheard of today, but will become increasingly important to

agency profitability downstream.

Consolidation of blocks of business and agencies and compensation is a forgone conclusion. Over time, some predict that health insurers will

develop captive agents who exclusively sell their products, as opposed to using a brokerage channel. If these models look familiar

to P/C agents, it's because the employee benefits business is beginning to mirror what has already occurred in that industry.

The Hidden Driver: Efficiency

While MLR is seemingly the culprit in this chaos, it has actually become a scapegoat for industry changes that were going to happen anyway. The cost of health care (and coverage) rose in the last two decades at an inflated rate far out of proportion to the Consumer Price Index. Because brokers received a set percentage of premiums, they benefited greatly from this system. But as rates became less affordable to employers, carriers began questioning this time-honored model. MLR has provided the catalyst for change.

Yet it is not just carriers that are demanding change; there is another side to this complicated equation. At the same time the market is driving compensation down, employer needs are expanding. Clients require support that was unfathomable even five years ago. The smaller the employer, the more help they require with compliance assistance, tax credits, direct employee communication and even accounting and legal advice. They will need guidance regarding how to navigate exchanges. Brokers must



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work even harder for less money, and the smart ones are examining new ways to deliver service.

Patrick O'Keefe, vice president and general manager of Empire Blue Cross Blue Shield's Downstate New York Commercial Business, says one thing

is certain: "All carriers are looking at their distribution models to drive more efficient processes."

Efficiency has indeed become the focal point of emerging solutions to control costs for carriers, providers, employers and agents. Brokers will have to lower their cost structure in delivering value to employers just to drive enough margin to survive. For most P/C firms providing coverage to small- to mid-sized businesses, this means aligning or partnering with outside companies to gain greater leverage and resources they cannot afford independently.

Partnerships Drive Value

Mike Reese, Jr., president of Reese, Yeatman and Associates, a P/C agency based in the Washington, D.C. area, began exploring partnership opportunities a few years ago. Last fall he selected his partner, Digital Insurance, my firm. I'll let him explain his motives and the advantages of his arrangement.

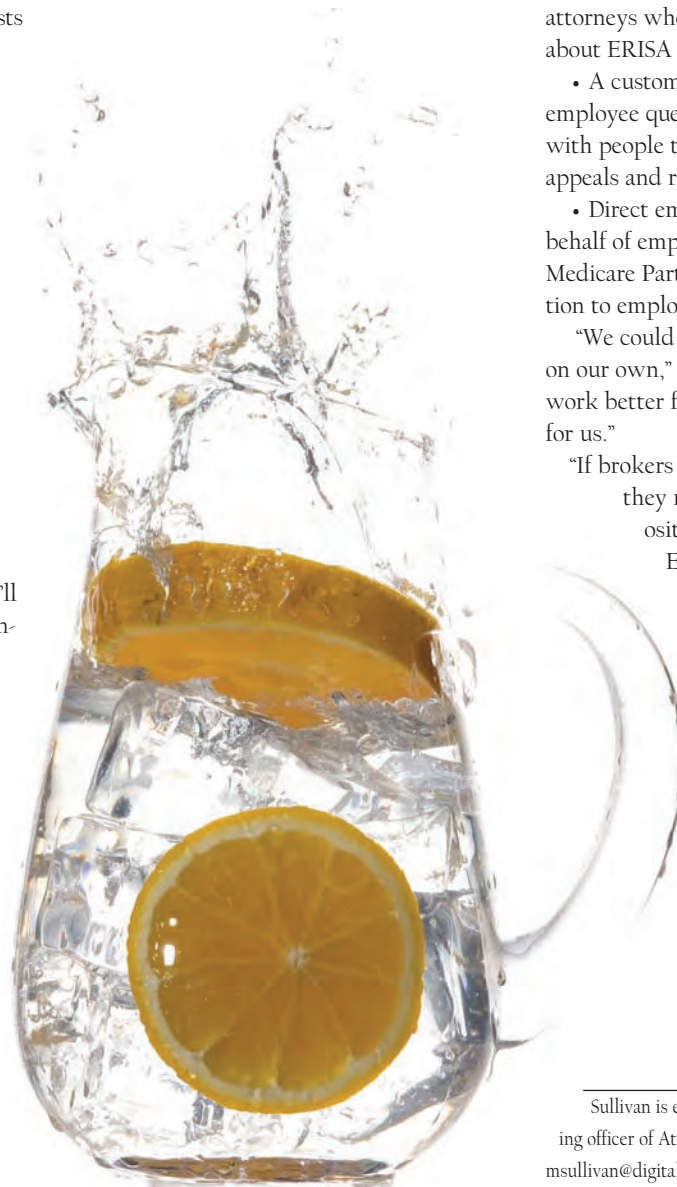
Established in 1964 by his father, Reese Yeatman has grown to become a \$2.75 million business, experiencing its best year in 2010. Many of the firm's clients appreciate "one-stop shopping," and the agency's producers have cross-sold employee benefits to about 40 percent of customers, accounting for more than half of the company's revenues.

In his mid-40s, Reese has no interest in retiring or selling his business. "I was seeking solutions to elevate our market status and a way to achieve long-term stability," he says. Altogether, he says he talked with 10

organizations, so he believes he got a good idea of the variety of available options.

"As an independent agency, we couldn't afford to invest in the types of services our clients will need in the future," he says. "There is no way that I can be a compliance specialist, a customer advocate and an insurance agent, while simultaneously being an expert in insurance markets, products and pricing. With our partnership arrangement, we can now sell

Partnering with outside companies brings greater leverage and resources.



health benefits to clients, split the commissions and our partner delivers the enhanced infrastructure, support and services that dramatically changes our value proposition."

Advantages Gained

Among the assets he gained:

- Health care reform resources and compliance expertise.
- An automated health care reform compliance product, including biweekly client communications with regulatory updates, plus webinars.
- An "ask the expert" service that includes attorneys who can answer specific questions about ERISA and other topics.
- A customer advocate center to handle employee questions and concerns, staffed with people trained in claims processing, appeals and resolving grievances.
- Direct employee communications on behalf of employers for such things as Medicare Part B creditable coverage notification to employees, retirees and dependents.

"We could never do something like this on our own," says Reese. "Other models may work better for some firms; this one works for us."

"If brokers want to remain competitive, they must examine their value proposition and cost structure," says Empire's O'Keefe.

Brokers will find that justifying fees becomes much easier when they are able to deliver exactly the services, infrastructure and resources their clients need to navigate a new era of health care reform.

The next year will be critical in terms positioning for future success. Savvy firms are already exploring opportunities.

Are you among them? 

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