

Focus on... Brokers

The Secret that Benefits Brokers Do Not Want Employers to Know

By Jim Edholm

Group insurance/benefits brokers often present themselves as totally allied with their client. They claim to be working to generate the best possible coverage, at the best possible price, with the best possible service. And that is frequently true. But there are hidden forces in play which may result in the client getting advice that works better for the broker than it does for the company he or she purports to serve. This article explains the “dirty little secret” about bonuses that brokers probably would prefer their clients did not know, and offers five steps companies can take to make the best-informed and most cost-effective benefits choices.

Working with group insurance benefits brokers usually makes sense. The benefits broker is an independent, knowledgeable consultant who, by and large, shares the company’s interests. The broker is often familiar with the available carriers for all lines of coverage: health, dental, life, disability, long-term care, and voluntary benefits. A group insurance benefits broker can provide quotes from multiple carriers with varying plan designs

and different risk-sharing ideas. They usually have knowledge of each carrier’s contractual language and what impact seemingly small changes will have on a company’s plan provisions and costs. Benefits brokers can set forth all of the options and assist companies in making the best possible choices.

Best of all, the broker’s services come “free,” at least for smaller accounts. Many, if not all, states have some form of small group health insurance with state-approved rates. Those rates include a broker’s commission—whether or not the services of a broker are utilized. So, if a firm is paying the cost, it may as well take advantage of the broker’s advice and experience. Larger accounts can waive the commissions, giving them the freedom to either deal directly with the carrier and save the cost of a broker, or retain the broker on a fee basis and eliminate the commission. Brokers compete for business on both a cost and a service delivery basis.

So on the face of it, it is a perfect scenario: the broker’s interests are



Jim Edholm is President of Business Benefits Insurance (BBI), an employee benefits planning firm in Andover, MA. He has worked with employers for more than 25 years and can be contacted at (978) 474-4730, via his website (www.bbibenefits.com), or via e-mail jedholm@bbibenefits.com

seemingly congruent with those of the business. But that may not always be the case. Conflicting interests beset the benefits broker, and some of those interests are not necessarily the same as the company the broker is advising.

Commissions Versus Bonuses

Brokers are generally paid two ways: commission and bonus. The commission is largely coincident with that of the business. It rewards the broker for keeping the company happy, servicing the account, resolving questions, and

expediting claims settlement, where necessary.

The commission is usually “graded,” *i.e.*, the carrier pays larger percentage commissions on the first dollars of an annual premium and scales back the commission as the amount of the premium grows. That affords the smaller accounts access to the broker’s knowledge by making them at least somewhat profitable for the broker. At the same time, by scaling back the commissions as the premiums grow, the carrier avoids an oversized cost for the larger employer. Thus, almost irrespective of the firm’s size, the broker works to keep the firm situated with the best carrier at the best price and is rewarded for helping the firm meet its goal of cost effectiveness.

Bonus Programs Reward Brokers for Helping Carriers, Not Clients

The bonus programs from carriers, however, are different breeds of cat. Bonus programs have very little to do with the company’s interests and a lot to do with the insurance carrier’s interests. While carrier bonus incentive programs vary widely, in general, they reward the broker for three things:

- **Placing business with the carrier.** Bonuses are usually calculated on the broker’s number of, and total premium from, new cases the broker sold for the carrier during the year. The more products and accounts sold in a given year, the bigger the broker’s bonus.

Table 1

Line	Carrier	Commission	Bonus	Premium
Dental	A	5,330	6,787	123,648
Health	A	18,589	6,953	1,016,853
AD, Evacuation	C	2,591	-	34,875
AD&D	R	4,769	1,002	47,693
Vision	X	887	-	
Total Amounts		32,166	14,742	1,223,069
Percentages		2.6%	1.2%	

- **Total business with the carrier.** The bonus is usually also contingent upon the total business the broker has with that carrier, *i.e.*, the number of cases and the total premium. The more business, the larger the bonus, both in amount, and as a percentage of total premiums. All else being equal, the broker with six million dollars in premiums is paid more than twice the bonus of the broker with three million dollars in premiums.
- **Percentage of last year’s business renewing with the carrier.** The greater the share of a carrier’s business the broker renews, the greater the bonus, both in dollars and percentages.

Here’s an example—purposely extreme—which dramatizes the effect of a bonus program. Let’s assume that a broker sold a reasonable number of new cases in a year, placed 100 percent of them with one carrier, and renewed all of his or her existing clients with that same carrier. This broker would maximize her possible bonus in all three of the areas described. Now, think about the dynamics of the situation.

What would happen to the broker’s income if she were to move a case to a different carrier?

Because most carriers’ commission structures are similar, the broker’s *commission* income would be about the same. There might be a first-year, “new case” commission incentive from the new carrier, but her bonus would disappear, leaving nothing to replace it. It is difficult to get large bonuses from two competing carriers.

Granted, this example was exaggerated—no one places all of their business with one carrier. But, will there be enough income-enhancing incentive in “real life” to entice that broker to keep a company with the existing carrier?

5500 Form Reveals Vital Information

Fortunately, thanks to federal disclosure laws, one can evaluate these “real life” numbers. Carriers must furnish every employer larger than 100 employees with a 5500 Form. This form shows both the commissions and bonuses the carrier paid to the broker servicing the account. Unfortunately, many employers

pay scant attention to the information in this form, so they never know just how biased their broker might be.

In this actual example, Table 1 clearly illustrates the broker's conflicting interests. The employer in question is a high-tech firm with 185 to 195 employees in the year reported. The group is very young; all lines were fully insured.

The commission income this broker received was fairly standard for the lines of insurance covered; the big difference is in the bonus. Total bonuses are 45.8 percent of the commissions. That is significant. There is precious little chance that the broker got to that level of bonus without concentrating coverages with one carrier for any given line of insurance. Specifically, look at the bonuses for the health and dental coverage (Carrier A). The bonuses equal 57.4 percent of the commission. And look at the dental numbers. The bonus is 123.7 percent of the commission! How likely is it that this broker will suggest the employer change dental carriers?

It is impossible to know if another carrier would be more competitive than the existing carrier, so the client may be with the correct carrier. That said, it does not appear likely that the broker would shop the case unless the client asked him to do so. Even if the business was shopped elsewhere, the broker might very well play down any competing carrier's strengths. Remember, bonus levels this large only occur when the broker places the bulk of his business with a particular

carrier to the virtual exclusion of other carriers. The broker in this example is already biased toward Carrier A and probably extols its virtues while minimizing the virtues of other carriers.

It is also likely that this employer may be overspending, at least a little, with its current carrier. And, with nearly \$1.2 million in premiums, overspending a "little" can mean some sizeable waste.

The impact of the bonus arrangement extends beyond just carrier choice. It also affects plan selection. Recall that the employer in this example is insuring a relatively young group of workers. Though the exact age range is unknown, the average age of the firm's employees is probably about 30 to 33; very young. In general, the younger the employee population, the lower the claims. Of course, especially in health insurance, low claims made are desirable.

Why Not Self-Fund?

All coverages are *fully insured* at this firm. With 190 employees, average age of 30-something, why not partially self-fund the health insurance? There are few cancers, heart attacks, or bypasses in a group this young. Maternity is a consideration, but most deliveries do not cost all that much. This group is very low-risk, yet they are fully insured. Perhaps the management philosophy discourages certain kinds of risk taking. But it is difficult to imagine this company not being a prime candidate for partial self-funding.

So why aren't they doing it? According to a 2003 Mass

Division of Health Care Finance and Policy study, anywhere from 41 to 45 percent of Massachusetts firms of this size do partially self-fund. Could it have something to do with the fact that the *health insurance carrier in question does not pay bonuses on self-funded plans*? Maybe, maybe not. But this employer ought to ask its broker some tough questions.

For firms with fewer than 100 employees, the difficulty of knowing whether they are overspending on insurance is compounded. Federal law requires that for all firms with over 100 employees, the carrier *must* show both the premiums paid and the claims incurred so that the employer can better negotiate with the carrier. Smaller firms, however, do not receive 5500 Forms, so they do not really know what their broker earns servicing them, nor do they have access to their health claims, so they do not know whether they ought to consider partial self-funding (which is possible for firms as small as 50 employees).

The smaller firms could—and generally do—ask their brokers to shop the case for them. However, as the old saw goes, "Figures don't lie, but liars can figure." With smaller employers, the plethora of plan design options from various carriers allows "liars to figure." That is, most carriers offer multiple plan variations that are separated by relatively small price differences. An unscrupulous broker can easily show the slightly more expensive options from competing carriers so as to make his favorite carrier look as good as—or at least pretty close to—the competitive options.

Five Simple Steps for Protecting Your Firm

What about your firm? Are you perhaps being misled? How can your company ensure that it is not being “steered” inappropriately to a carrier or a coverage that is more expensive than necessary? Take these five steps:

- **Step One:** Ask your broker this simple question: “What percent of your total income do bonuses, as opposed to commissions, represent for your business?” What should that number reasonably be? Our company’s bonuses, for example, account for less than three percent of total revenues. If your broker mainly serves larger clients, expect bonuses to be larger, as a percentage of total income, than what is experienced with somewhat smaller clients.
- **Step Two:** Look back at how long you have been with your current carriers (for health insurance in particular, but also dental, disability, and life). If it seems like you almost never switch, perhaps the bonus, even if seemingly small, is inappropriately influencing your broker’s advice to your firm. Keep in mind that a broker moving one or two cases out of their entire book of business, which may be scores of cases, can be enough to impact the *entire* bonus from that carrier.
- **Step Three:** Periodically have another broker compete for the business. It is probably unwise to have multiple brokers quoting every year: when there are two brokers quoting, your ability to get price concessions is limited, because carriers will give every broker identical quotes for a given case. Therefore, a carrier will hesitate to reduce your price when asked by your current broker because they will be forced to do the same for the competing broker. But every fifth year or so, it is probably worth angering your current broker by bringing in the competition. Generally, the more employees, the more disadvantageous it is to switch carriers too often.
- **Step Four:** If you have more than 100 employees, examine your 5500 Form reports from the last couple of years. Look at both the absolute bonus amount and the growth trend. If you are insuring fewer than 100 lives, ask your broker what his/her commissions and overall bonuses were. The broker will not be able to tell you what the bonuses were on your specific case (carriers do not break it out by employer group except in the 5500 Form for larger employers), but the broker will know the figures for his/her entire book of business.
- **Step Five:** Companies can opt to compensate the broker directly, via a fee, and request that the plan is quoted commission-free. Most carriers do not pay bonuses when there are not any commissions paid. This may not always be a money-saver, however. Some carriers, including one leading carrier, quote exactly the same rate with or without commissions. So despite paying your broker/consultant a fee, you will not get any plan price reductions to compensate you for your troubles. You will short-change your broker without saving any money.

Knowing the brokerage industry’s best-kept secret, your company now has the tools needed to assure that the carrier you are using and the price you are paying are appropriate. Remember, average health insurance costs are as large as \$8,500 per employee, per year, in many parts of the country, so a three to five percent difference in cost represents real money.