top issues

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Strategy
Group insurance and the rise of exchanges

The insurance industry in 2015

pwc

Group insurance and the rise of exchanges

In the past, carriers often specialized in health, life or property and casualty. Group insurance was viewed as a good strategic asset, but because it was possible to generate profits without it, group insurance business units typically were underfunded and operated with antiquated systems. However, as the group insurance market continues to grow and evolve, carriers are now making significant investments in it.

Considerable change has accompanied this market growth. Group insurers traditionally have offered group life, short-term disability, long-term disability, dental and vision coverage. However, their product offerings have grown to include accident and health products such as critical illness, accident, hospital indemnity, and pet insurance.

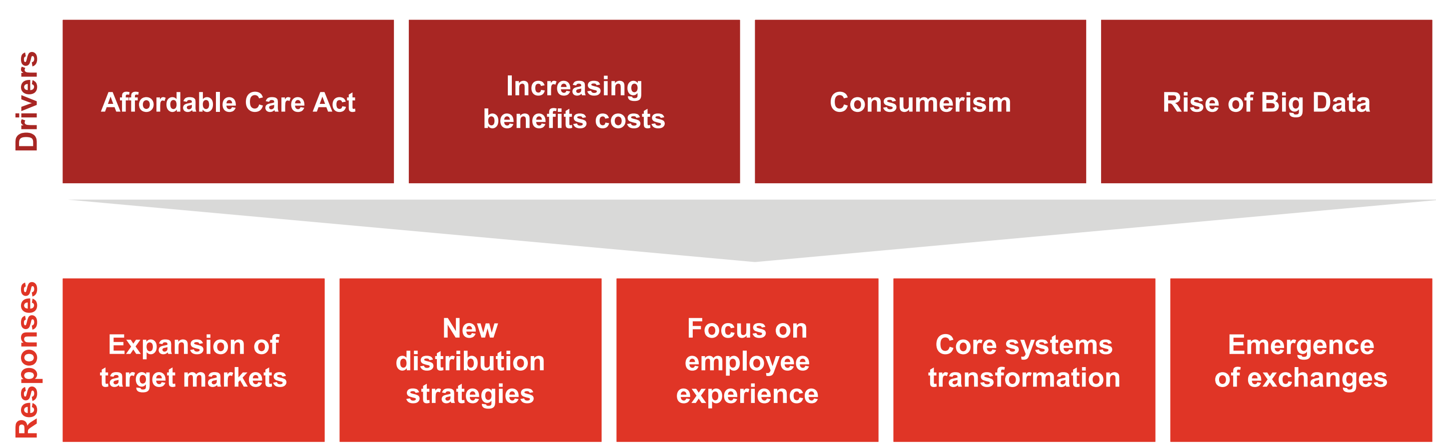
Distribution is also changing. Carriers have traditionally sold to customers through a competitive bid process controlled by national brokers/benefits consultants, regional brokers and independent, local brokers. Recently, this sales landscape has been affected by the emergence of captive/worksite and exchanges, which have become viable alternative distribution channels. In the worksite model, carriers utilize a captive agent force that sells employees group insurance products at the workplace.

Lastly, as group insurance products and distribution channels increase, carriers face the challenge of adopting their current operating models and legacy systems to these new ways of doing business.

Market drivers & disruptors

Four dynamic market trends and disruptors are having significant impact on the group insurance industry: 1) the Affordable Care Act and other government regulation, 2) increasing benefits costs, 3) consumerism, and 4) the rise of big data. In response, carriers are 1) expanding their target markets, 2) developing new distribution strategies, 3) focusing on the consumer experience, and 4) upgrading or replacing core systems.

Figure 1: Market trends & carrier response



1. **Affordable Care Act (ACA) –** Since its introduction in 2011, the ACA has had profound effects on healthcare and has indirectly impacted the group space through the enactment of employer shared responsibility provisions and the introduction of public healthcare exchanges. First, employer shared responsibility provisions require employers with 50 or more employees to provide a minimum level of healthcare coverage or pay a fee in lieu of providing coverage. Because of this, the ACA is causing employers, especially small to mid-size businesses, to re-think the way they provide employee benefits. Additionally, employers with 50 employees or less are eligible for the Small Business Health Options Program (SHOP) plans on the government's public healthcare exchange, healthcare.gov. The introduction of the exchange model has gained traction with brokers and technology companies now offering their own private exchanges to employers of all sizes.

2. **Increasing benefits costs –** Originally, group insurance had a central tenet that employers guaranteed certain types of coverage to employees. This defined benefit model was the mainstay for decades, even as insurance premiums continued to rise. Now, as healthcare spending accounts for almost 18 percent of US GDP[1], employers are searching for strategies that will allow them to support their employees but at lower cost. In response, most employers have moved to a defined contribution model, where employees contribute payroll deductions to fund part or all of their benefits. This model usually gives employees more choice in the benefits they want, and has resulted in the growth of accident, hospital indemnity and critical care group insurance products.

3. **Consumerism –** Thanks to the rise of online shopping, consumers now expect one-click shopping for a multitude of products they can easily research to determine lowest cost options. Accordingly, the increased availability of information and emergence of online decision-making tools on employee benefits have led to an increased focus on selling to individual employees.

4. **Rise of Big Data –** With the transition from paper and pen management to online enrollment and benefits administration, insurance carriers have a wealth of previously uncaptured data they can use to gain greater insight into the market. With consumerism, the data from decision-making tools and other enrollment functionalities has exponentially increased. Carriers have increasingly used this data to perform analytics and gain a better understanding of areas such as claims conversion and broker segmentation, as well as to increase their knowledge of individual employees.

Increasing benefits costs and the ACA are the two of the most obvious drivers of change in the group market, but increasing consumerism (which primarily benefits customers) and a concurrent increase in data about customers (which primarily benefits carriers) are playing an increasingly important role in the transformation of the group industry.

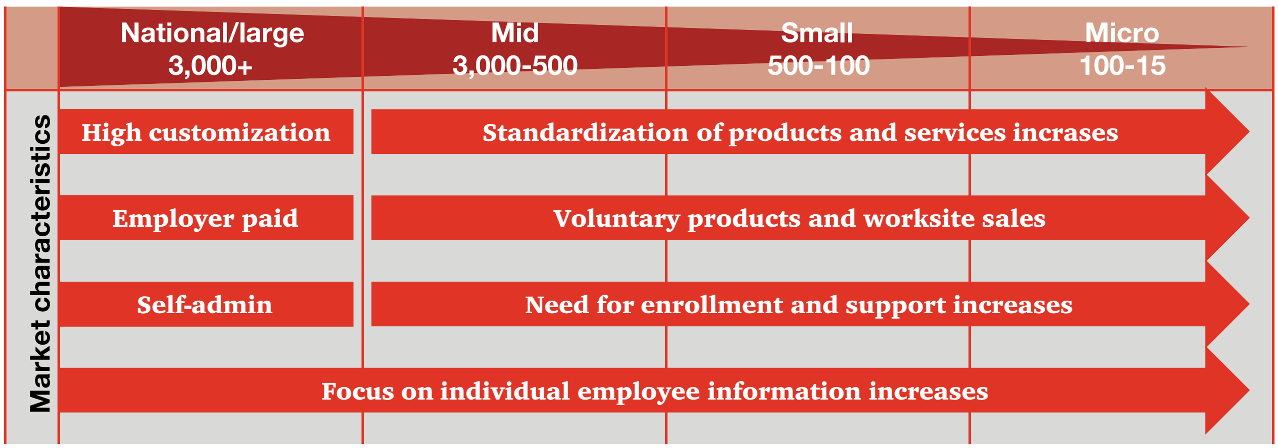
Carrier responses and actions

In response to the trends we describe above, carriers are focusing primarily on four things: 1) expansion of target markets, 2) new distribution strategies, 3) employee (i.e., customer) experience, and 4) transforming core systems.

1. **Expansion of target markets –** As the group insurance space becomes increasingly concentrated, carriers are looking to expand their target market size in order to grow. Specifically, carriers targeting large and national size employers (3,000 + employees) are experiencing less growth opportunities in the segment and have begun shifting their focus down-market. Concurrently, carriers who target the micro and small markets (0-500 employees) are starting to enter mid-sized to large markets. The unique needs and characteristics of the each segment mean that carriers have to build additional capabilities to successfully enter them.

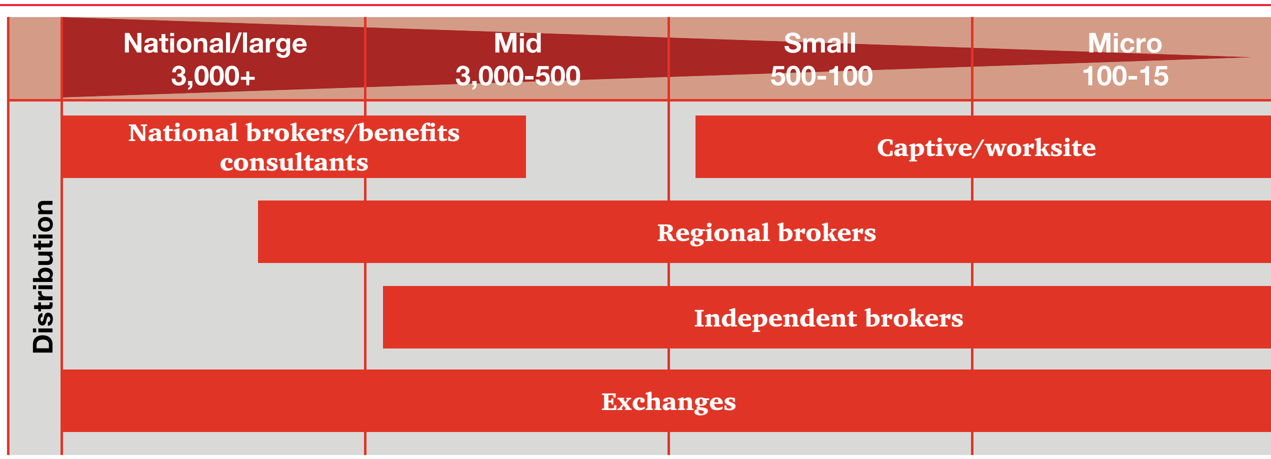
1 Please see http://data.worldbank.org/indicator/SH.XPD.TOTL.ZS

Figure 2: Market characteristics by company size



2. **New distribution strategies** – Brokers and other channels tend to serve specific employer sizes and segments. Accordingly, as they move into new markets, carriers are developing new distribution relationships. Carriers also are considering new distribution channels, specifically the worksite model and exchanges. For these alternate distribution channels, carriers may need to adapt their operating models and mobilize teams in support of new relationships. Moreover, increased use of analytics has enabled carriers to closely examine their current broker relationships and perform broker segmentation, leading to the development and launch of profitability-focused broker compensation schedules.

Figure 3: Company size & distribution



3. **Focus on employee experience** – As employees gain more decision-making power, carriers have increased their focus the employee experience. Specifically, user-friendly enrollment platforms – typically employee portals – feature sophisticated decision-making tools to help educate employees throughout the enrollment process. In turn, carriers can use the data these platforms generate to gather more data and information on their end-customers.
4. **Core systems transformations** – As we describe earlier in this publication, in order to support expansion, new distribution strategies, and increase focus on individual employees, carriers are conducting IT transformations to increase automation and scale. Specifically, group carriers are investing heavily in policy administration transformation because their legacy systems have become antiquated and a patchwork of customization can no longer handle scale or expansion into new products and markets.

The increasing prominence of private exchanges

Private exchanges have the greatest potential to impact the group space. They can provide a combination of increased consumer power, data capture, and high tech capabilities to drive growth.

Private exchanges are a reaction to changes affecting the industry, most importantly the ACA. Exchanges are a new distribution channel that promotes consumerism with user-friendly online platforms and empowers employees to become more informed shoppers. The market has already demonstrated an interest in exchanges, and brokers and employers alike have started to adopt the model. And, while no dominant exchange model exists today, it is clear that exchanges are a viable distribution channel. Private exchanges utilize the same concept of the public healthcare.gov exchange, which President Obama has said facilitates purchasing insurance "the same way you shop for a TV on Amazon." [2]

2 Please see: http://www.whitehouse.gov/the-press-office/2013/09/26/remarks-president-affordable-care-act

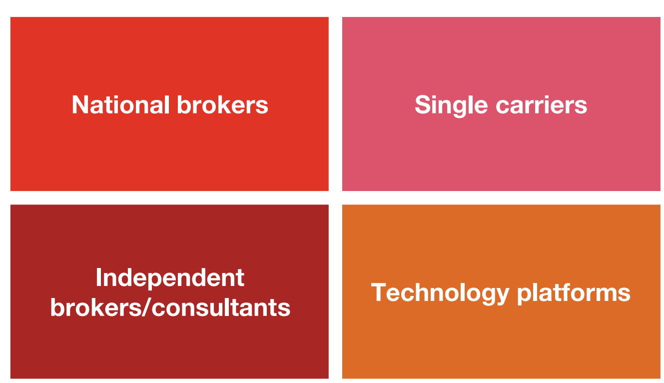
Unlike public exchanges, private exchanges have attempted to expand the exchange model from just health and dental products to other group products, as well. While public exchanges are capped at 50 employees, private exchanges have no defined range, and cover businesses with as few as five employees and as many as 200,000. The main difference between types of private exchanges is who ultimately has the power to choose. One type has "employer choice," in which the employer chooses to work with one carrier. The exchange offers variations of products, and employees can select from those insurer's offerings. In contrast, "employee choice" exchanges are more like online shopping; employees can choose between and among competing carriers' products to tailor their plan designs.

Private exchanges can offer both employers and employees much wider coverage choices than they have enjoyed in the past, and also can help carriers reach much wider markets than they have hitherto.

Private exchange models

We have observed four distinct private exchange models, each of which have a different value proposition.

Figure 4: Private exchange models



National brokers **–** National brokers have been able to strengthen their ties with clients by offering the broad range of services typical of an exchange. They cater predominantly to larger employers, and feature carriers who specialize in products for companies with 3,000 or more employees. The exchanges offer products from several carriers, creating a competitive marketplace in which employees can comparison shop for types of coverage. Because the national brokers have existing relationships with many large employers, data integration requirements are relatively easy to meet, especially when the brokers are serving a client's benefits administration.

Independent brokers/consultants **–** In contrast to large brokers, regional and independent brokers work on a regional scale. This regional focus typically limits client size to companies with between 100 and 1,000 employees – generally too small for most carriers to offer a truly competitive marketplace. Therefore, independent exchanges typically carry only one insurer's products, though as exchanges as a whole become more prevalent, more insurers may be forced to remove employer size restrictions. Technology standards vary widely between these brokers' exchanges, as most create their exchanges as premium products in order to differentiate themselves from other local competitors.

Single carriers **–** In order to combat multi-carrier exchanges, some insurers have developed their own exchanges in order to more effectively market their products. These exchanges act as a defense mechanism by preserving exclusive contracts the carriers already have. In essence, the "exchange" is merely a new platform by which employees make selections for their coverage. The single carrier model originated with health insurers who were trying to compete with public exchanges, but group carriers are now beginning to follow suit.

Technology platforms **–** Much of the innovation and disruption occurring in private exchanges results from technology companies that have built the platforms which enable the exchanges to operate. To date, many carriers and brokers looking to establish or support exchanges have partnered with these technology providers to whitelabel their systems. More recently, technology providers have begun offering their own products on what amounts to independent exchanges. This high degree of technological sophistication and flexibility has made these providers key targets for acquisition for both brokers and carriers looking to quickly grow their exchange acumen.

While each of these four models has benefits and challenges, partnering with any type of exchange will necessitate changes to an insurer's value chain. Exchanges act as an entirely new distribution class, and carriers must be careful to match their existing channels' capabilities with the ones an exchange requires. Underwriting also will have to deal with significant impacts, and carriers will have to rethink the traditional enrollment process.

Implications

While private exchanges are a relatively new concept, employers and carriers alike have shown a great deal of interest in them. Group carriers looking to establish or enter into exchanges should be aware that:

- Partnering with national brokers will require change and compromise on behalf of carriers, as well as the acceptance of increased competition within the exchange because brokers will want to create a highly price-sensitive marketplace.
- Insurers looking to enter the small and mid-size market should assess the independent broker model. While national brokers moving down market will attract attention, independent brokers maintain high levels of business through relationships and therefore are likely to remain competitive.
- Carriers looking to develop their own exchanges must choose between "buy or build," though both options will require heavy investment.
- The speed at which technology platforms are emerging make them ideal candidates for partnerships, and allow insurers to stay at the forefront of sophisticated technology standards.

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