Mercer

welcome to brighter

The CFO perspective on health

Survey results

2022

Introduction

As we enter the second quarter of 2022, the list of health care cost drivers is growing: Higher utilization due to "catch-up" care, claims for long COVID, the introduction of new gene and cellular therapies and the impact of avoided care are all exerting upward pressure on cost. Even more concerning, we're seeing the highest inflation we've experienced in 40 years in many sectors of the economy.

While health benefit cost growth accelerated somewhat last year, the full impact of inflation in the health care sector has been dampened by provider contracts that lock in prices for multiple years. As those renew, we could see truly eye-popping price increases — along with greater volatility in claims.

If you're like many CFOs, you've been paying more attention to your organization's healthcare expenses and cost mitigation strategies than in the past — or wondering if you should be. We designed this new survey to discover CFO perspectives on a range of issues related to health care budgets:

- Sustainable cost increases
- Margin levels and risk tolerance
- Evaluating cost-management initiatives
- When a move to self-funding makes sense

We hope you'll find these results to be as interesting as we did.

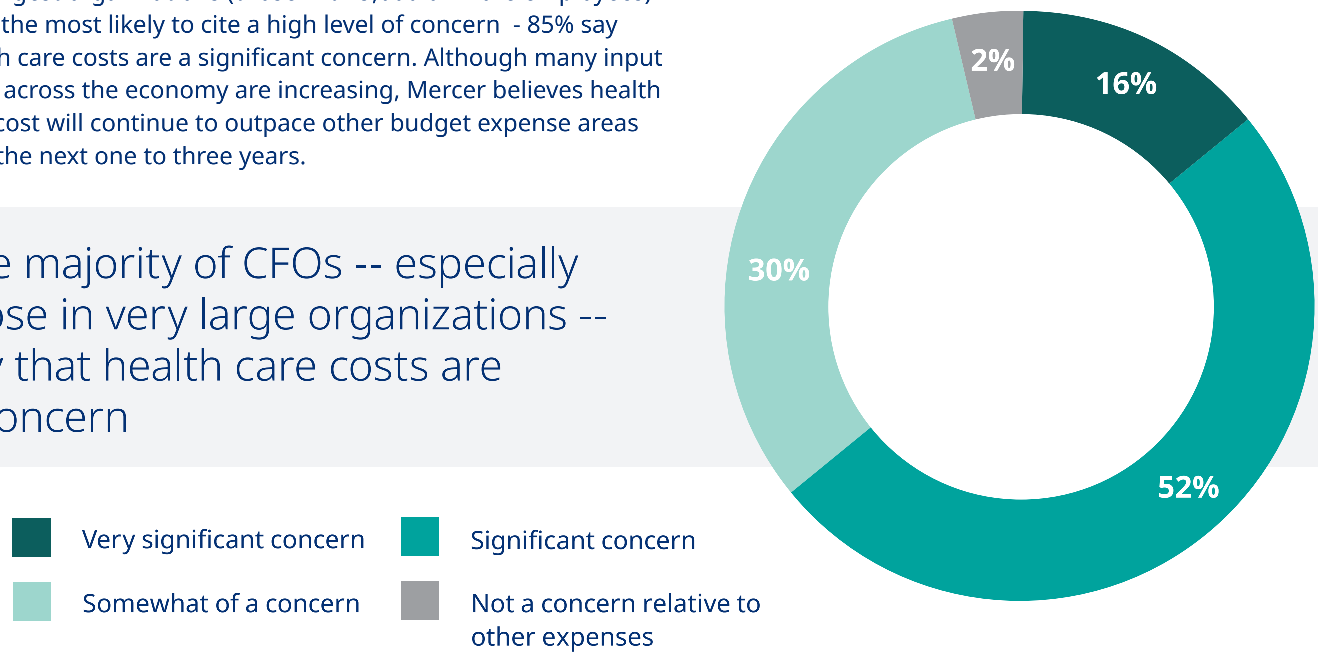
About the survey

The survey was fielded from late January to early March of 2022, and we received 105 responses. Most of the respondents (81%) are CFOs, or have a finance or accounting role with health care budget oversight (12%). About a third of the responding organizations have fewer than 500 employees, 47% have 500-4,999, and 19% have 5,000 or more. Just over half the respondents (54%) say that all or most employees are in a self-funded plan and 37% say that all or most are in a fully insured plan; 9% say employees are evenly divided between self-funded and fully insured plans. The survey included separate questions for employers using each type of funding.

Health benefit expense

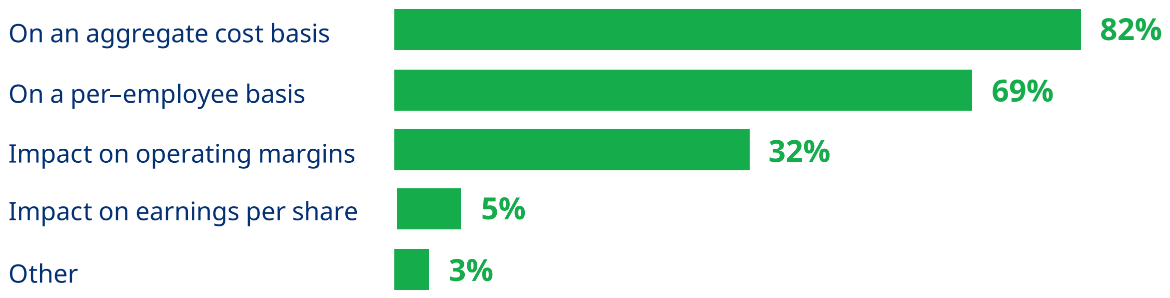
Given the persistently high level at which health care costs have trended relative to other goods and services and to wages, it's not surprising that over two-thirds of respondents (69%) indicate that health care costs are a significant concern – including 16% who say they are a very significant concern. Respondents from the largest organizations (those with 5,000 or more employees) were the most likely to cite a high level of concern - 85% say health care costs are a significant concern. Although many input costs across the economy are increasing, Mercer believes health care cost will continue to outpace other budget expense areas over the next one to three years.

The majority of CFOs -- especially those in very large organizations -- say that health care costs are a concern



Measures for tracking and evaluating health benefit expenses

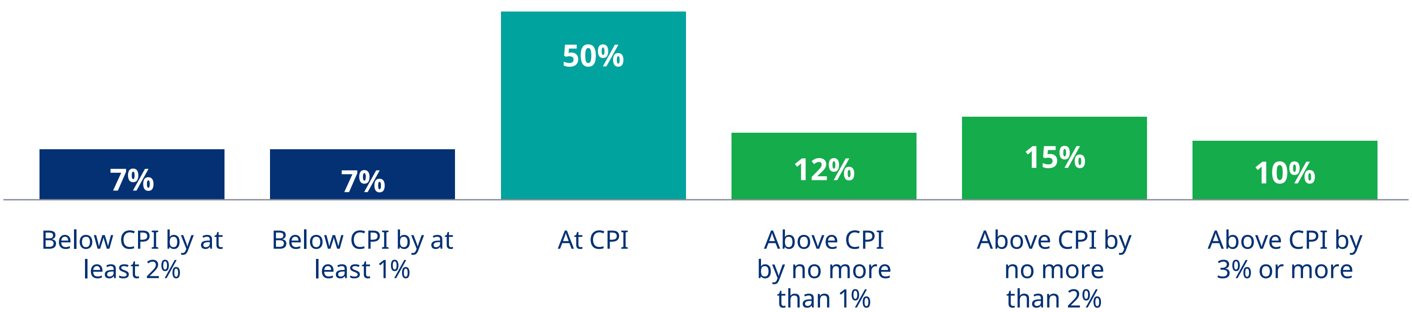
CFOs use multiple measures to track expenses, with most respondents using at least two. Most commonly, expenses are tracked on an aggregate cost basis and on a per-employee basis. About a third track the impact on operating margin, an important measure that can help put health care costs in context of the broader business dynamics and highlight its relative impact on a company's bottom line.



Sustainable **annual increase in health care cost over the next 3-5 years**

The survey was fielded after widespread reports of higher inflation across the economy. Against this backdrop, almost two-thirds of respondents said that a sustainable annual increase over the intermediate term was at or below CPI (with little difference seen between self-funded and fully insured employers). Given that the health care industry overall has had very limited success at managing cost to these levels, more aggressive actions will be needed to control expenses to keep health benefit cost growth at CPI or below. At the same time, cost-mitigation efforts will need to be balanced with the competitive pressures associated with a tight labor market.

Mercer sees health care costs accelerating, perhaps with a lag, as increases in healthcare workers' wages and medical supplies are passed on through health plans over a multi-year re-contracting cycle. On top of underlying wage/unit cost inflation, trends are persistently pressured as new technology, an aging workforce, and other dynamics add to cost pressures.



Other benefits needing attention from a cost perspective

About two-thirds of CFOs are focused on at least one benefit area other than health care — most often, paid leave and retirement benefits. The costs for these plans are typically more predictable, and thus garner less attention than health care costs. However, paid leave plans are undergoing rapid changes that could have cost consequences for many organizations.

In a tight labor market, enhanced paid leave benefits may be necessary to compete for talent, and new state and local government mandates are generally expanding the scope of paid time off programs. If paid leave isn't an area of cost focus now, it may soon be.

% of CFOs focusing on these benefits:

39%	36%	20%	34%
Paid leave	Retirement	Disability	None of these

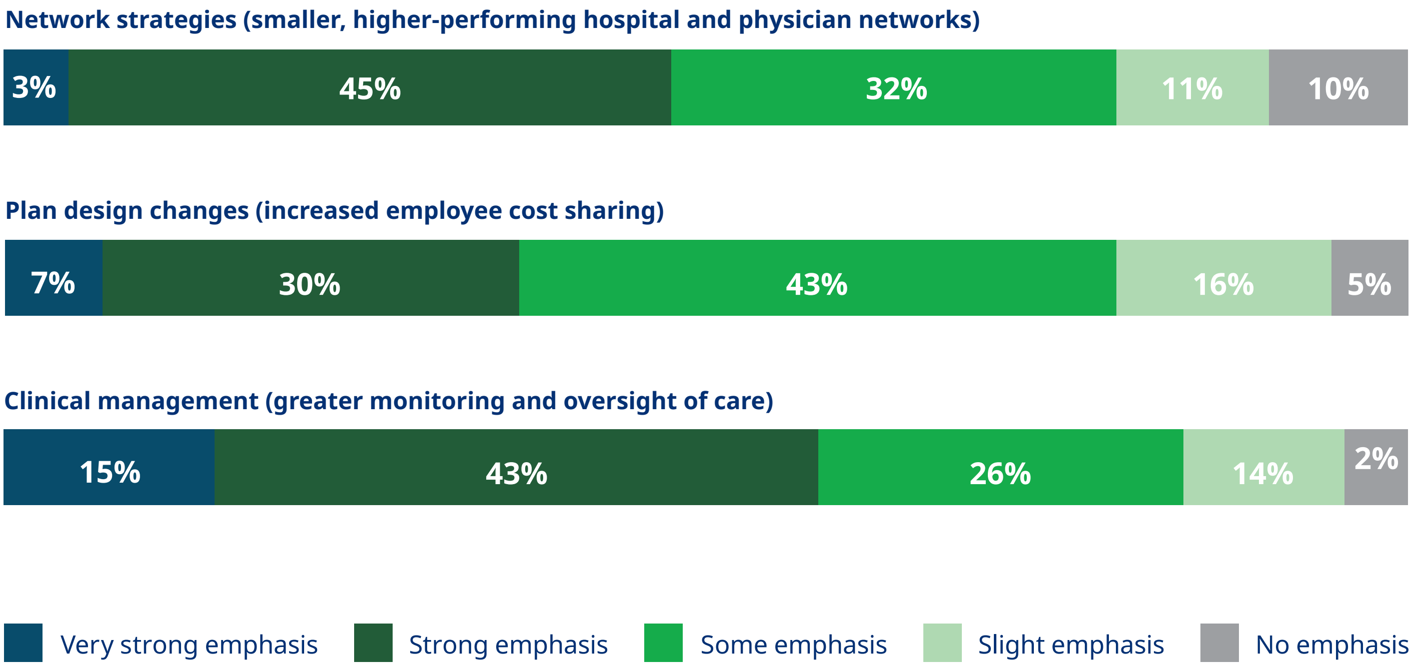
Are health benefit cost management strategies generating real savings?

Only 39% of CFOs felt very or reasonably confident that the long–term benefit cost management strategies being implemented are saving money, and nearly a fourth didn't feel they had enough information to say. The survey asked specifically about strategies that typically require some investment, such as well-being initiatives, clinical management programs, and specialized provider networks.

Measuring outcomes is more difficult in health care than for many other expense areas. However, benefit managers can share cohort analyses, ROI estimates, and key indicatory analyses with the finance department to demonstrate that the investments being made are delivering returns. Measurement should ideally occur at three levels: the health plan level, to show how overall cost is trending; at a segmented level, to show (for example) how cost for individuals with chronic conditions is trending; and at the individual program level, to show whether a specific intervention is providing value.

Most CFOs would prefer to emphasize cost management strategies that don't shift cost to employees

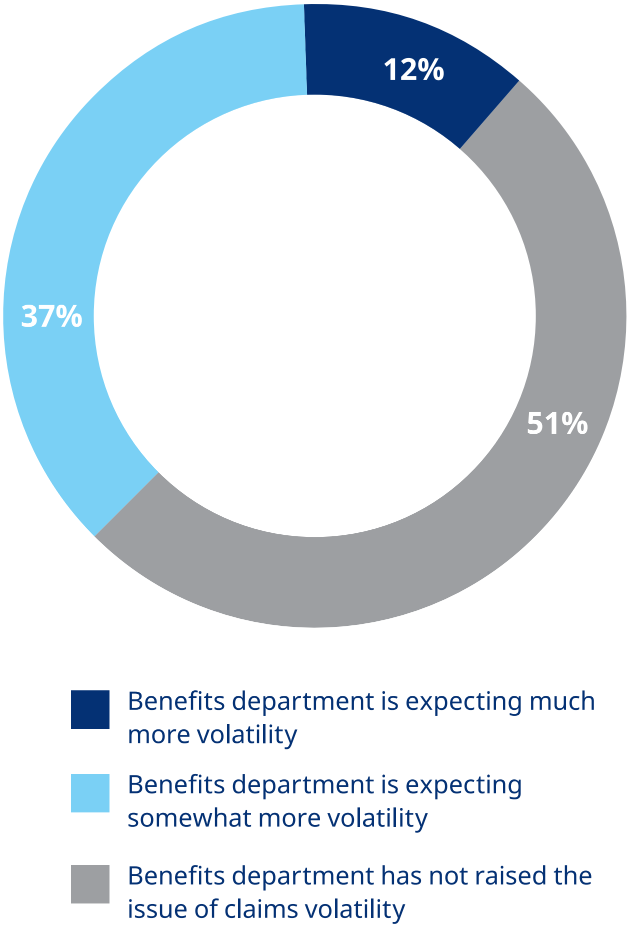
The survey asked about three broad categories of cost-management strategies: Provider network strategies that steer employees to smaller, high-performing providers; plan design strategies that shift more responsibility for healthcare cost to employees; and clinical management programs that provide greater monitoring and oversight of care (typically for higher-cost claims). While the majority of CFOs indicate that all three strategies are needed at least to some extent, clinical management received the strongest support, followed by network strategies. Notably, clinical management typically involves few tradeoffs for employees and thus poses the least potential for disruption — which, given the tight labor market, may make it especially attractive to company leadership. Network strategies, which could involve member disruption (although not necessarily), still garnered a high level of interest. Clinical management and network strategies both provide opportunities to create a financial win for both employees and the employer. Plan design changes that cut cost for the employer typically result in higher out-of-pocket costs for employees, which organizations may want to avoid at a time when inflationary pressures for other goods and services likely are already weighing on the workforce.



Self-funded employers

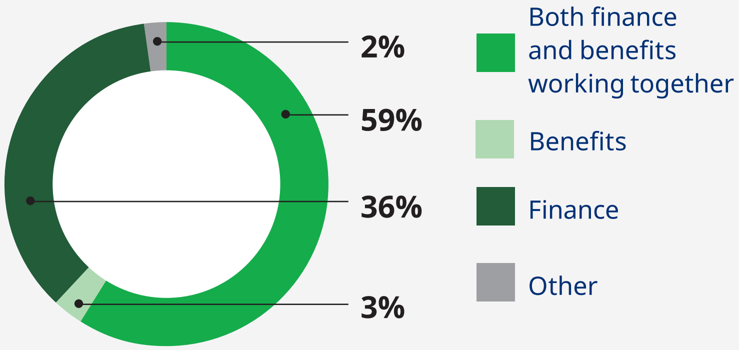
Regular communication between benefits and finance is always important, but as the rising incidence of high-cost claims makes health care costs more volatile, and inflation drives up the health care cost trend, CFOs may need to monitor health costs more closely. The survey found that most (70%) but certainly not all CFOs are confident that the finance department is receiving the information needed to monitor health program costs effectively. However, about half say that the benefits department has not raised the possibility of higher claims volatility in the future.

We expect that increasing claims volatility is likely to create challenges for employers in the near term. Driving this risk is a host of factors. To begin with, there are many unknowns related to COVID-19, including the extent to which deferred care come back, the impact of long COVID on costs, and simply what the 'new' baseline of claims is going to look like. In addition, we already see emerging high-cost therapies, especially in the Rx space (gene & cellular), impacting claim experience, and significant wage inflation in the medical service sector seems likely. Beyond implementing strategies to mitigate risks, it is important to communicate these risks to key stakeholders such as CFOs. While the past is often a good predictor of the future, this adage may not hold up as it relates to health care costs over the next 1-3 years.



Department that calculates the actual budget that is booked

About three-fifths of respondents (59%) say that finance and the benefits department collaborate when setting budgets that are booked, while 36% say finance alone takes on that responsibility. This is likely a function of organizational processes, corporate culture and other dynamics. That said, best practices would include collaboration, given the distinct expertise in each group and recognizing the overlap in terms of accountability.



Margin used in setting rates

The decision of whether to use a margin to reduce the risk that actual health claims experience exceeds the budget, and the level of the margin used, is tailored to a company's tolerance for risk. About half of respondents use a margin, most commonly 3%-5%. A small minority (5%) assume a negative margin, accepting a higher risk that the budget won't be met. Regardless of the margin assumption employed, it is important to review the likelihood of experience varying from budgets. Many finance professionals are surprised by how high the probability is that health care budgets will be missed by 5% or more, even in very large self-funded plans.

42%
Don't use margins

11%
Use 1%–2% margin

29%
Use 3%–5% margin

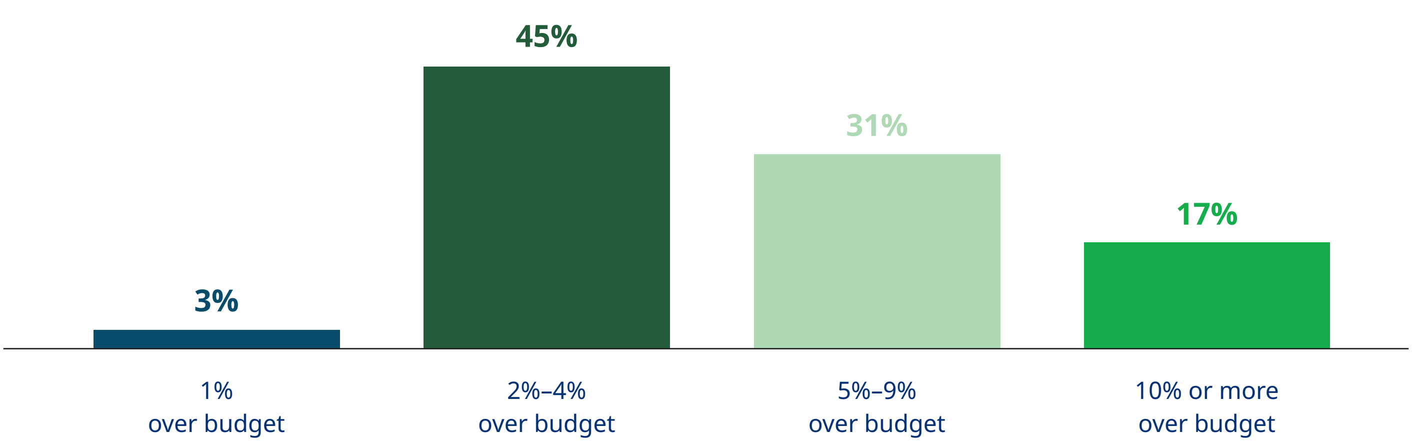
5%
Use margin of 6% or higher

5%
Use a negative margin (i.e., accept a higher risk that budgets aren't met)

Level of deviation from budget that would have a material impact on business results

About half of CFOs (48%) believe that business results would be materially impacted if actual health claims experience is over budget by 4% or less. Given their relatively low risk tolerance, it is somewhat surprising that so many of the responding organizations don't use margins in setting budgets. To the extent companies would like to lower their risk, they should pay close attention to their margin assumptions and use of risk mitigation strategies such as stop loss insurance. Benefits departments may be well served by knowing their finance departments' point of view on this question before making other relevant decisions.

Business results would be impacted if health cost is....

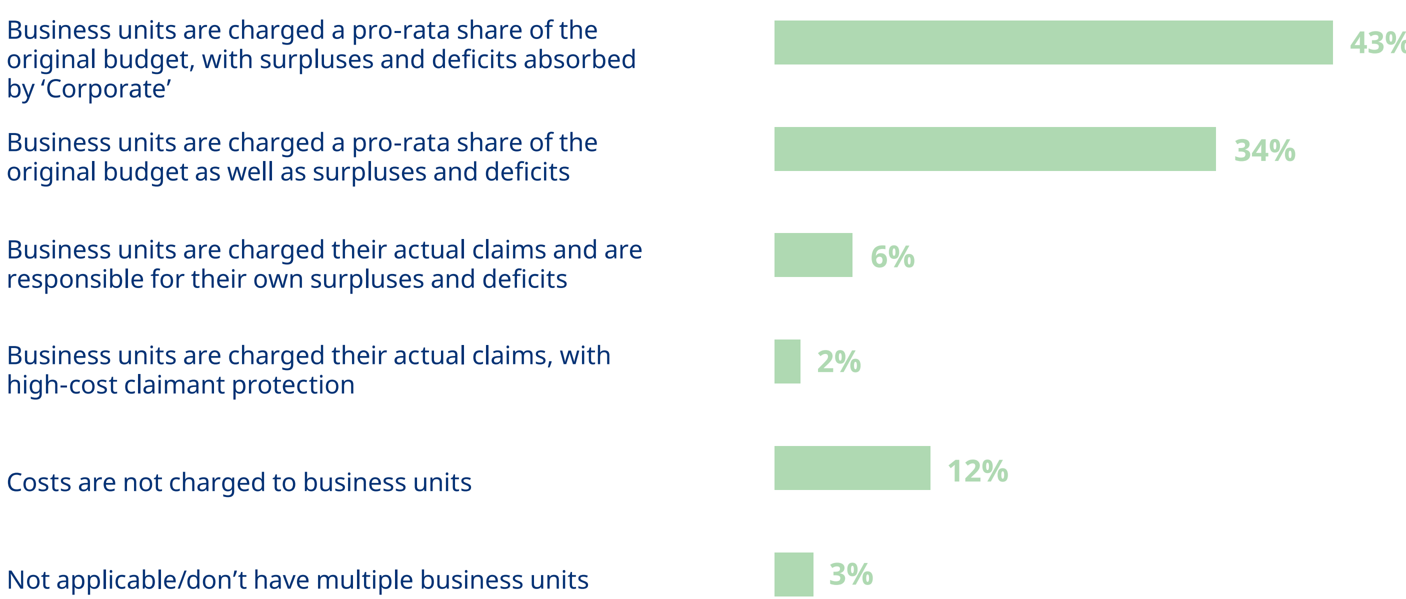


Reforecasting claims experience

Nearly two-thirds (63%) of CFOs reforecast claims at least twice per year. In the largest organizations, it is not uncommon to reforecast four times or more each year — about two-fifths of respondents with 5,000 or more employees do so. We believe it is important to reforecast experience periodically — while keeping in mind that health claims are seasonal and can be volatile, especially month-to-month. Once reforecasts are performed, possible next steps could include updating forecasts, keeping current forecasts, or reflecting some of the new experience, but not giving it full credibility.

Handling of internal expense allocation for health benefits

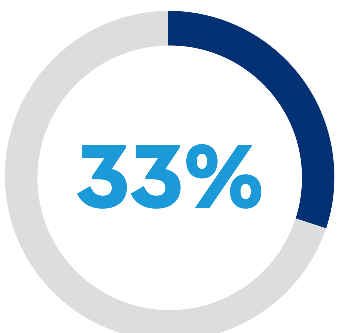
Over two-fifths of CFOs (43%) act as a stop-loss insurer of sorts, with individual business units allocated the original budget, but surpluses and deficits absorbed by Corporate. As long as Corporate has planned for unforeseen deficits, the businesses are likely to appreciate having this uncertainty taken off the table.



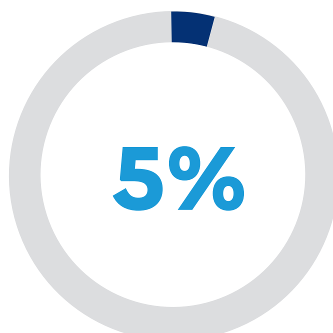
Insured employers

CFOs with fully insured plans considering different funding mechanisms

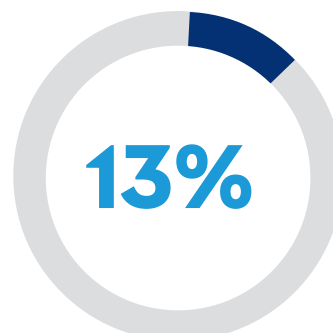
Fully-insured health coverage is generally the most expensive funding arrangement, with the tradeoff being that it offers the greatest certainty in terms of costs. Actuaries typically estimate that it costs 3%-5% more to be fully insured than self-insured, although the difference can vary depending on the employer's specific situation. Survey results suggest that some CFOs with fully-insured plans are more likely to overestimate than underestimate the potential savings to be gained from converting to self-insurance — 51% say they would expect to save 5% or more. Thus it's not surprising that half of fully insured respondents are currently considering converting to a different funding mechanism, and more than a third have considered it in the past.



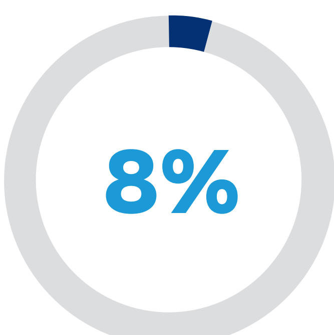
Considering self-funding with stop loss



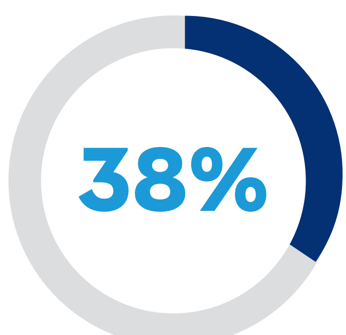
Considering self-funding without stop loss



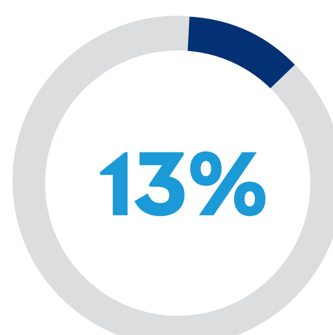
Considering a hybrid arrangement such as minimum premium, level funding



Considering some other arrangement



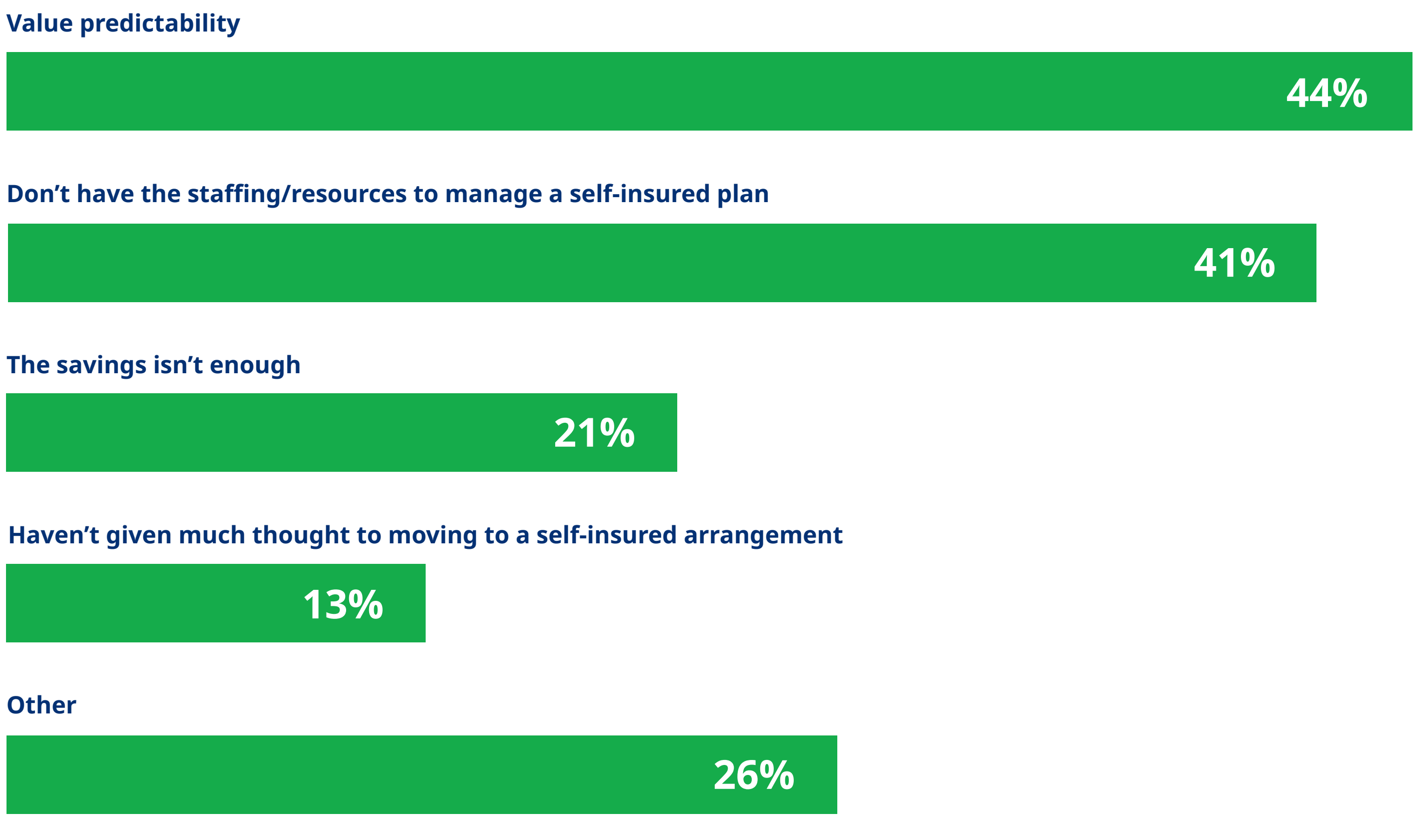
Not converting, but have considered in the past



Not converting, and have never considered

Reasons for remaining fully insured

"Valuing predictability" is the most common reason cited for not pursuing a self-insured arrangement, and predictable cost is indeed a very important benefit of being fully insured. Nearly as many CFOs say they don't have the staff or resources to manage a self-insured plan. While a move to self-insurance is likely to increase the workload at most employers, savings from a self-insured arrangement might be used to offset the cost of additional staff at least to some degree.



To weather health care cost inflation and claims volatility, play both defense and offense

Higher inflation is likely to heighten interest in new, and perhaps more aggressive, health benefit cost management strategies. If employer health plan sponsors don't index cost-sharing amounts to inflation (e.g., for copays, deductibles, and OOP maximums), it will result in benefit cost increases that are even higher than the underlying medical trend. At the same time, employees may struggle to afford health care if medical costs rise faster than their own wages. We learned during the last financial crisis that health care is an economically sensitive service and that some people will forego important care when they feel they can't afford it. Thus, the downstream implications of affordability — and today tight labor market, in which benefits must help attract and retain workers — will need to be balanced with more immediate cost management concerns.

Not taking action is not a good option. Rather, employers need both to defend their budgets with sound management processes while mounting a strong offense against rising costs.

Play defense

- Monitor medical and prescription drug costs versus budget more frequently
- Introduce or raise budget margins to prepare for greater claims volatility
- Start renewals earlier so there's enough time to understand and negotiate pricing components in the light of COVID experience and current economic environment

Play offense

- Reining in cost growth without shifting cost may require trade-offs, such as offering employees lower-cost plans with smaller provider networks.
- Virtual services can improve access and save employees money by eliminating the cost of transportation, childcare, or time off from work when seeking care.
- Model the impact of rising costs on employees — both payroll contributions and out-of-pocket costs. In today's tight labor market, cost management must be balanced with attraction and retention goals

Contact your Mercer consultant today to learn more.

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