Healthcare Reform Impact on Incentive Compensation Practices

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On January 1, 2011, many of the provisions of the Patient Protection and Affordable Care Act (PPACA), a.k.a. Healthcare Reform, go into effect. From the standpoint of incentive compensation professionals, the most significant piece of the legislation is the Medical Loss Ratio (MLR) requirement. It specifies that in the Large Group market, 85% of premium must be spent on medical expenses. In the Small Group and Individual markets, the number is 80%. The rest can go to administrative expenses, profit, marketing, and…direct sales, account management, and broker compensation. Adding to the complexity is the fact that the Obama administration has yet to issue formal guidelines regarding how MLR is to be calculated. And there has been much lobbying around what is to be included and excluded.

Nevertheless, companies that are already near or below these minimums or who may be at risk of being below them are considering a variety of steps to help ensure compliance. For sales and marketing organizations, this means taking cost out without decreasing overall productivity.

How Are Health Insurance Sales Organizations Reducing Overall Compensation Cost?

1. Lowering Broker Costs

Commissions to brokers are perhaps the most significant line item, but hard to affect. No insurer wants to be the first to make an across-the-board reduction in broker commission rates, particularly during a time of change and uncertainty, when employers are relatively open to change and reliant on the guidance of their brokers. Nevertheless, there appears to be a consensus that rates will come down, particularly in the individual and small group markets, where MLRs are generally farther from their targets than in the large group market. One change that has already been implemented by some insurers is moving from a commission that is a percent of premium to a flat commission per new member.

But for many companies, cutting administrative costs related to brokers, particularly those that are less important to the company or less dominant in their markets, is a less risky approach. To lower broker costs, companies are examining their portfolios to see where they can de-commission underperformers with minimal impact. They are analyzing which brokers are really growing the business and which are maintaining or potentially even eroding it.

2. Lowering Direct Sales Costs

By the same token, an across-the-board reduction in total cash compensation to the direct sales force is seldom a winning strategy. It causes the best performers to leave and de-motivates the rest. More effective and less damaging steps include re-aligning coverage, modifying compensation performance measures, and increasing the pay-for-performance orientation of the plans.

a. Changing Coverage

Cost reduction from changes in coverage come from moving coverage responsibility to lower cost channels (e.g., inside sales) for certain segments, reducing the number of specialized sales roles and increasing the product responsibility of generalists, and reducing field force headcount. There are few health insurers operating at peak sales force efficiency, and healthcare reform is providing the motivation to get there. And when headcount goes down, the goals and commission rates need to be carefully re-calibrated to guard against windfalls and ensure equitable incentive opportunity.

Cost pressures are also pushing insurers to give up the notion of trying to cover the entire universe. They are abandoning some segments entirely so they can focus more resources on those where they have an advantage. For sales operations groups, that means identifying and prioritizing accounts, brokers, and consultants within the attractive segments, determining the level of sales force effort required, and sizing and deploying the sales force accordingly.

b. Modifying Performance Measures

Although changing performance measures is seldom seen as a way to lower costs, many companies have found that changing the performance measure definitions can be useful. For example, some companies have recently moved from paying a commission on premium to paying a commission on contracts. When premiums go up due pricing changes, and commission rates are not adjusted, there is increased compensation cost for the same level of performance.

c. Increasing the Pay-for Performance Orientation of the Plans

Even without changing the compensation budget, paying more to top performers and less to lower performers will generally result in a decrease in overall compensation cost as a percentage of revenue. In recent years, base salaries have drifted upward relative to incentive pay, and the below-target part of the payout curve has in some cases been flattened, to retain individuals who might have suffered during the economic downturn. But with heightened cost pressure brought on by the MLR requirements, more companies are saying they cannot afford that and are taking a good look at thresholds and payouts below 100%. Others are looking for ways to lower fixed pay over time, perhaps with the use of temporary draws, to make a tighter alignment between pay and financial results.

3. Reducing Compensation Administration Costs

A final area worth mentioning is plan administration cost. Gathering and validating performance data, making adjustments, calculating payouts, getting sign-offs, communicating payment, and processing corrections multiple times per year can require significant administrative man-hours in a company with multiple channels, products, and customer segments. Few companies do this as efficiently as they could and most understand that if they did things differently, significant administrative cost could be taken out…"but we can't think about that right now, we're too busy calculating commission payments!"

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