MERCER MARSH BENEFITS™

This Is Health | Point of View Series

04 Managing Risks in Employee Benefit Plans

MARSH & McLENNAN COMPANIES

Executive Summary

Given the enormous impact of talent on organizational success, we believe it is essential to understand, quantify and address the risks associated with the physical, emotional and financial health of the workforce and how employee benefits both mitigate these risks and bring new ones. Employee benefit plans can be a critical component of an employer's talent strategy and also enable a number of organizational goals around community and social responsibility, identity and performance. However, failure to manage these plans judiciously can lead to business disruption, unplanned costs or brand damage.

What's at risk

If benefits aren't appropriately managed for risk, companies can suffer from:

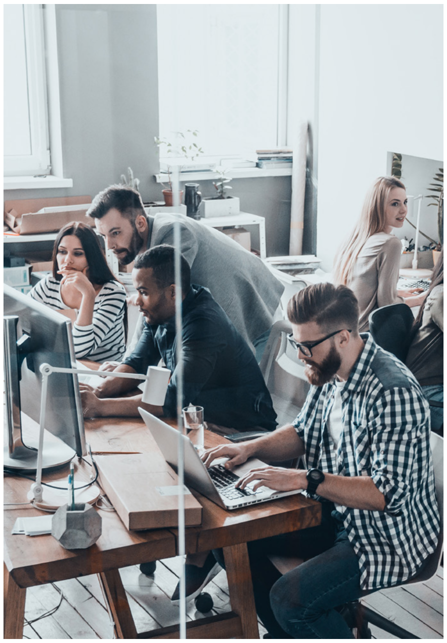
- Suboptimal productivity and business performance
- Damaged reputation
- Unexpected financial risks
- Rising costs
- Business disruption
- Safety incidents and violations
- Compromised data privacy
- Regulatory penalties

Keys to managing risk

Some preventative steps to mitigate risks in employee health and benefit plans include:

- Implement governance and centralize decision-making
- Build a risk registry for employee benefits
- Apply risk finance optimization
- Establish a regular cadence for reviewing benefits
- Choose vendors that can help address and mitigate risks
- Secure transmission of health and human capital management data
- Align benefits and health management strategy with talent strategy for optimal productivity and performance
- Communicate effectively so that employees understand, use and value their benefits

The multiple advantages of providing a benefit plan typically far outweigh the costs. However, as with any investment, it is critical that strong governance — including transparency, assigned responsibilities, use of experts for specialist support and sound decision-making — is in place.



Managing Business Risk Through Employee Health and Benefit Plans

Many successful companies have adopted an enterprise risk management approach to identifying and transforming risk into sustainable competitive advantage. Yet until recently — and despite the enormous impact of talent on organizational success — the risks related to an organization's people have continued to be viewed primarily as an HR concern.

As with any other risk, we urge risk management professionals to understand, quantify and address the risks associated with the physical, emotional and financial health of their workforce and how employee benefits mitigate these risks but also bring new ones to be tackled. Premiums from employee benefits insurance are on the rise, but so are the individual and corporate risks they protect against. Organizations should consider making health and risk protection benefits for employees critical elements of any risk management strategy. If nothing is in place or if these programs are poorly managed, risk managers may face business disruption, unplanned material costs or brand damage.

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Happily, today's risk managers are increasingly mindful of people-related risks and are working with HR to identify and mitigate them. This is increasingly critical as the risks and challenges are compounded by a number of converging megatrends, including:

- The **Fourth Industrial Revolution**, which is impacting the nature of work through the advent of artificial intelligence, the internet of things and robotics
- The explosion of **social media**, which has radically changed the way and the speed at which employees, customers and competitors get information
- **Changes in work** demanded by new generations of talent, including the desire for work/life balance, flexibility and mobility
- Employee **mental health** challenges ranging from depression and stress to alcoholism and drug addiction
- An **aging population** that is putting pressure on pension schemes and obligations, contributing to talent shortages in some geographies and industries, and demanding new and more flexible work arrangements that can keep people working later into life
- **Social and political upheaval**, including political polarization, social unrest and migration, which are creating new challenges for talent management

Applying a risk management lens to employee health and benefit plans

Employee health and benefit plans represent a material expenditure for the business — and can be instrumental in either exacerbating or mitigating people-related risks. For this reason, it is crucial that risk managers understand the risks inherent in these plans and how plan design, financing, administration and communication impacts their people and, ultimately, their business. If benefits aren't appropriately managed for risk, companies can suffer negative business outcomes, including:

1. Suboptimal productivity and business performance

Weak or poorly designed and managed employee health and benefit plans can undermine both health and engagement, hurting the bottom line. Obviously, employees who miss work due to illness are not contributing to company success. But even employees who do show up for work may not be giving their all if they are in poor health, either physically or psychologically.

For example, research from the UK found that 33 productive days per year are lost to moderate to severe depression by the 5.6% of employees who suffer from it, while 3.5 productive days per year are lost by employees with poor diets. The same research found that 10.6 days of lost productive time per employee per year could be recouped by improving the health of the average workforce.[1]

Disengagement is also a major problem, costing approximately $7 trillion in lost productivity globally, according to Gallup's *State of the Global Workplace* report.[2] Employee benefits that support individual well-being may help businesses recoup some of that lost productivity, given that 61% of employees rate health as a bigger concern than wealth or career in recent Mercer research.[3]

[1] Mercer. *Mind the Productivity Gap: Why We Can No Longer Ignore the Impact of Health on Productivity*, 2018, available at https://www.uk.mercer.com/our-thinking/productivitygap.html.

[2] Gallup. *State of the Global Workplace*, 2017, available at https://www.gallup.com/workplace/238079/state-global-workplace-2017.aspx.

[3] Mercer. *Global Talent Trends Study: Empowerment in a Disrupted World*, 2017, available at https://www.uk.mercer.com/our-thinking/global-talent-hr-trends.html.

2. Damaged reputation

A company's reputation and thus its competitive position in attracting both talent and customers can be dangerously weakened by oversights in employee health plans or by inconsistencies or inequities in the delivery of health benefits. Being viewed as an organization that is inconsistent, disorganized, unwelcoming or that compromises on quality and people investments could ultimately lead to higher hiring costs, operational problems and difficulties achieving growth plans.

Surprising coverage gaps (for example, lack of medical coverage during overseas business travel), clinically unsound benefit coverage (for example, promoting diagnostics, like x-rays, more frequently than clinically recommended), benefits that are perceived as discriminatory (for example, HIV exclusions), or untreated workplace mental health issues can lead to bad outcomes for individuals and bad press for companies while also hurting business performance.

Employers also run the risk of reputational damage when their employees misunderstand their entitlement to benefits or when benefit rules are applied inconsistently across the company. This is a particular danger for companies that operate internationally. While differing regulations, public benefits and social structures may call for variations in employee benefits around the world, global companies are increasingly facing pressure to ensure that employees have access to broadly similar coverage. For example, many progressive companies are seeking to ensure same-sex partner coverage is available even in places it is not currently market practice.

Poorly designed employee health and benefit plans can expose companies to significant unexpected financial risks.

3. Unexpected financial exposure

Poorly designed employee health and benefit plans can expose companies to significant unexpected financial risks. These can arise from overly generous benefits, including post-employment benefits. In fact, many companies, including those in the automotive sector during the financial crisis, have faced bankruptcy in part due to retiree medical liabilities. Those handling collective bargaining for the company should also consider the potential financial consequences of promising benefits that are uninsurable. The high cost of pharmaceuticals and other treatments, such as biologics, also creates significant financial risks.

For example, in Canada, controlling employer-paid pharmacy costs demands constant attention to healthcare reform legislation, prescribing trends, new drugs, innovative technologies and evolving

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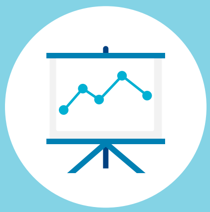
benefit program pricing methods. Furthermore, the arrival on the market of biologic and specialty drugs for rare diseases and the recent availability of targeted gene therapies for cancer could represent costs upward of US$1 million per year and is threatening the viability of some private drug insurance plans.

Insurer financial instability or business cessation of an employee benefits vendor can also leave companies open to unexpected cost, as can benefit financing methods that are misaligned to an employer's risk tolerance and budget process. For example, self-insuring life insurance for senior executives in emerging markets, which might be unstable politically or socially, may not be prudent. And digital health and well-being startups may be here one day and gone the next. Understanding the financial risks created by a company's employee benefits should be a core element of the merger-and-acquisition due diligence process as well.



4 . Rising costs

According to the Mercer Marsh Benefits' *Medical Trends Around the World 2019*, the global medical trend rate in 2018 was estimated to be 9.7% — close to three times that of economic inflation — and a similar increase is expected for 2019.[4] In the absence of using active plan management strategies, employers may need to allocate more and more of their remuneration budget toward benefits. This is at a time when the workforce is demanding a broader set of rewards.

Rising costs may ultimately impact an organization's bottom line. For example, in Brazil, the cost of a medical plan for a workforce dominated by professionals is approximately 8% of total labor cost. Assuming labor makes up 25% of the total operating budget, this means that medical plans are is about 2% of operating expenditures. While still a seemingly immaterial price to pay relative to the operational stability and positive labor relations benefits bring, a 10% increase to health costs translates to a 20 basis points reduction to profit margin.

Furthermore, the true, and holistic, "cost of risk" (premium + retained loss + claims handling) from a benefit plan and healthcare cost perspective can often be hidden. The retained risk loss component may be particularly ambiguous, as money spent could be tracked inconsistently. For example, special exceptions to approve denied personal claims in unique circumstances could fall under an employee

[4] Mercer Marsh Benefits. *2019 Medical Trends Around the World*, 2019, available at https://www.mercermarshbenefits.com/en/intellectual-capital/2019-medical-trends-around-the-world1.html.

relations budget while provision of onsite medical services could fall under occupational health. Adding up the different components of spend on medical and risk protection benefits, and actively managing these, is a worthwhile exercise, and likely will make the business case for investing in prevention programs more meaningful.

5. Business disruption

Employee benefits that do not adequately protect against risks like talent shortages and absenteeism due to sickness or injury can leave companies without the people to get the job done, endangering business continuity. According to a recent Marsh risk management benchmarking study for Latin America, talent availability, including attraction and retention, is one of the top risks cited by employers in the region.[5] With talent shortages intensifying in many geographies and industries, companies need to deliver a compelling employee value proposition, including competitive benefits, to win the war for talent.

Other challenges that can disrupt operations include outbreaks of infectious diseases such as typhoid, influenza, H1N1 or SARS. For example, an increase in outbreaks of dengue fever in Southeast Asia beginning in 2017 caused many companies without appropriate health coverage to have to rush to put it into place to ensure accessible care for employees and a swift return to work.

6. Safety incidents and violations

Unmanaged health risks, such as lack of sleep, can result in safety incidents that hurt the business. According to the National Sleep Foundation, sleep deprivation increases the likelihood of a workplace accident by 70%.[6] One review of various studies suggests workers with sleep problems had a 1.62 times higher risk of being injured than workers without sleep problems.[7] Not only do performance and communication deteriorate significantly in people who are tired, but so too does the ability to focus, think flexibly and moderate behavior. At the same time, lack of sleep causes increased errors on the job, greater risk-taking and driving impairments that mimic the effects of alcohol.[8]

[5] Marsh Risk Consulting and RIMS. *Reimagine Risk: Capturing Opportunities in a World of Risk*, 2018, available at https://www.marsh.com/pr/en/insights/research/the-global-risks-report-20181.html.

[6] National Sleep Foundation. "The Relationship Between Sleep and Industrial Accidents," available at https://www.sleepfoundation.org/excessivesleepiness/content/the-relationship-between-sleep-and-industrial-accidents.

[7] Uehli K, Mehta AJ, Miedinger D, et al. "Sleep Problems and Work Injuries: A Systematic Review and Meta-Analysis," *Sleep Med Rev*, Volume 18, Issue 1 (2014): pp. 61–73.

[8] Smith S. "The Ten Dangers of Sleep Deprivation for Workers," *EHS Today*, November 24, 2015, available at https://www.ehstoday.com/safety/ten-dangers-sleep-deprivation-workers.

7. Compromised data privacy

Employers today have the opportunity to capture vast amounts of data related to employee health and benefits. Analysis of this “big data” holds tremendous promise for optimizing the ongoing sustainability of benefit plans by understanding health cost drivers and implementing targeted programs to improve employee wellness — and thereby boost productivity. But without the proper administration and controls, the privacy of this treasure trove — not to mention basic personal information used to manage benefits like name and salary — is at risk.

In the US, data breaches are growing increasingly common, with more than 176 million health records hacked between 2009 and 2017.[9] This carries reputational risk that can translate into troubles attracting and retaining both employees and investors. Furthermore, it can result in financial penalties for failing to meet regulatory standards. For example, penalties for violating the European Union’s General Data Protection Regulation, which went into effect in 2018, can be stiff. Maintaining the security of employee health and human capital management data is critical. IBM Security found that inadvertent breaches from human error were the root cause of 49% of data breaches studied. The global average cost of a data breach increased to $3.92 million in 2019, with lost business the biggest contributor to data breach costs.[10]

Antiquated manual administration processes that are heavily dependent on vendor capabilities and resources also increase the risk of financial exposure. This setup is ripe for errors, such as losing medical claim forms and data leakage through activities such as sharing files containing sensitive information like salary, government ID number, bank account number or health status that is not password protected.

8. Regulatory penalties

Employee health and benefits are not only heavily regulated in most regions, but those regulations can vary considerably from location to location. This leaves employers vulnerable to substantial non-compliance issues and potential regulatory penalties. For example, companies may have to pay if their plans are not meeting governmentally established minimum requirements, such as those for annual screenings in Japan, onsite clinics in Mexico or health coverage in Abu Dhabi and Dubai.

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In addition, those offering non-admitted insurance coverage may find that what is legal in one country is either prohibited or permitted only subject to certain conditions in others. Local authorities are the final arbiters of the legality of non-admitted insurance, and employers need strong benefits governance combined with specialist advice to ensure compliance and avoid penalties.

[9] Healthcare Data Breach Statistics,” *HIPAA Journal*, available at https://www.hipaajournal.com/healthcare-data-breach-statistics.

[10] IBM Security. *2019 Cost of a Data Breach Report*, 2019, available at https://www.ibm.com/security/data-breach.

Keys to managing risk in your health and benefit plans

Working with external advisors and internal stakeholders, those responsible for managing employee benefit plan risks can undertake a multitude of preventive measures. To mitigate the risks inherent in employee health and benefit plans, consider the following strategies:

- **Implement governance and centralize decision-making.** Clearly assigning responsibility for key decisions related to the design, delivery and financing of programs using benefits centers of excellence can help you improve visibility of programs and make more informed, consistent decisions so that you can reduce the number of unexpected surprises. For some risks, this may include a committee made up of stakeholders from functions including Risk, HR, Employee Relations and Tax to meet regularly to review programs and make joint recommendations to the business regarding the organization's risk tolerance.

- **Build a risk registry for employee benefits.** This registry can allow you to have a view of all essentials related to your benefit offerings, including the benefits offered, how they are financed, the cost and utilization of each program, whether the benefit is a regulatory requirement, the risks that may be inherent in the administration processes, and the methodology you are using to assess the short-term and long-term potential risk. This should enable you to develop a common understanding of what is classified as "risk" by type of benefit program and how to assess this on a proactive basis.

- **Apply risk finance optimization to maximize the value of benefits while protecting against unexpected financial exposure.** Risk finance optimization can help you structure insurance programs in the most economically efficient manner while also meeting the organization's risk-tolerance goals. Will your business and your employees be best served by joining a stop-loss insurance pool that gives you more financial protection but less design control? Or would a captive insurance arrangement linked to your P&C arrangements better allow you to pool risks across countries without spending money on risk premiums? Through this process, you can also consider whether a defined contribution health plan is the right approach to help you defend against uncontrolled medical inflation.

- **Establish a regular cadence for reviewing benefits to ensure cost drivers are being managed and benefits are aligned with desired competitive positioning.** Periodic reviews by independent specialists can help companies eliminate blind spots, ensure compliance and avoid regulatory penalties. The frequency of review should depend in part on market development, since areas like technology and health interventions are changing rapidly. For organizations operating in multiple markets, it is important to ensure that every market is reviewed on a regular schedule.

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- **Choose vendor partners that can help address and mitigate risks — and be sure to monitor them over time.** This means choosing proven, financially stable providers who comply with company information security requirements and negotiating the best terms possible. For multinationals, it may also include having global programs in place for business travel accident, evacuation and employee assistance plans so that crisis support is easy to access for all when needed.

- **Secure transmission of health and human capital management data.** Online benefits platforms like Darwin™ can provide a safe means of sending eligibility information back and forth between payroll and benefit providers.

- **Align your benefits and health management strategy to your talent strategy for optimal productivity and performance.** Benefits and health plans that fail to meet employee needs and expectations can sabotage recruiting, undermine employee engagement, contribute to presenteeism and absenteeism, or leave your workforce ill-prepared — ultimately hurting business performance. To ensure that benefits are optimally supporting the talent strategy, you can define a benefits philosophy and strategy — spelling out the benefits important to the organization (for example, mental health, women's health or preventive care) and confirming with leadership that it bests supports the business strategy. This can then allow you to complete a gap analysis and develop a roadmap to reach your vision.

- **Communicate effectively so that employees understand, use and value the benefits you provide.** After all, the goal is to provide health and benefit programs that employees actually engage with, help them stay well and boost engagement and productivity. Benefits are often complicated, and employee misunderstandings can not only cause unpleasant surprises for employees but harm your employer brand.

Again, the multiple advantages of providing a benefit plan typically far outweigh the costs. However, as with any investments, it is critical that strong governance — including transparency, assigned responsibilities, use of experts for specialist support and sound decision-making authority — is in place.

For further information, please contact your local Mercer Marsh Benefits office.

About Mercer Marsh Benefits

Mercer Marsh Benefits provides clients with a single source for managing the costs, people risks and complexities of employee benefits. The network is a combination of Mercer and Marsh local offices around the world, plus country correspondents who have been selected based on specific criteria. Our benefits professionals, located in 135 countries and servicing clients in more than 150 countries, are deeply knowledgeable about their local markets. Through our locally established businesses, we have a unique common platform that allows us to serve clients with global consistency and locally unique solutions. Visit us at www.mercermarshbenefits.com or mercer.com

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