The Value of a Benefits Plan

Finding the right employee benefits plan can be a win-win for both employer and employee

By Christopher Gory

Why introduce an employee benefits plan? Why not just give each staff member a raise? Economically, a benefits plan provides a win-win for both the employer and the employee, as benefits have distinct cost and tax advantages. For this illustration, we will look at an employee who requires single coverage (no dependants), and the differences between providing the employee with a raise of $1,050 and paying $1,050 in benefits premiums.

For an employer, giving the employee the raise also means making an Employment Insurance contribution, a Canada Pension Plan contribution, and paying payroll tax, which would increase the cost to the employer from $1,050 to approximately $1,143. If the employer also pays worker's compensation, this amount rises to approximately $1,166 (based on an industry average of 2.19%). Conversely, if the employer were to put the $1,050 towards an employee benefits plan, the only cost would be provincial sales tax. For the employee, a raise of $1,050 is subject to Employment Insurance deductions, Canada Pension Plan deductions, and Income Tax deductions, which reduces the after-tax value of the raise to approximately $620. Conversely, the $1,050 paid in premiums translates to $1,050 in benefits.

In 2006, Employee Benefit News conducted a survey of individuals covered through a benefits plan, and asked if participants would choose a lump sum of $15,000 or their benefits plan. 63 percent said that they would choose the plan over the lump sum. Participants were also asked which benefit(s) they were willing to give up. Only:

- 2% would give up their drug plan;
- 3% would give up their long term disability;
- 7% would give up their dental plan;
- 9% would give up their life insurance;
- 11% would give up their vision care;
- 21% would give up their semi-private hospital coverage; and
- 27% would give up their paramedical coverage.

More and more employers are realizing the value of a benefits plan. A report from the Canadian Institute for Health Information (CIHI) says that Canada's health care spending continues to rise, and is expected to reach $160.1 billion in 2007, up from $150.3 billion in 2006. Of this 6.6% increase, 3.2% was due to inflation, and 3.4% was due to new employee benefits plans being introduced.

Now that we see the value of a benefits plan, let's compare the different types of plans. There are the traditional employee benefits plans that most people are familiar with, Health Care Spending Accounts (HCSA's or HSA's), a blend of a traditional benefits plan and an HCSA, and Administrative Services Only (ASO) plans. Most common are traditional employee benefits plans, which can include a combination of life insurance, dependant life insurance, accidental death & dismemberment coverage, dental coverage, disability coverage, and extended health care coverage (which includes among other things, drug coverage, semi-private hospital coverage, travel coverage, paramedical coverage, and medical appliances).

With traditional benefits plans, there are two ways in which the plans can be set up, both with advantages and disadvantages:

1. A master plan for all employees covering both head office and each franchise location.
2. Separate plans for each franchisee and franchise location.

A Master Plan

The Advantages

1. Higher Total Loss Ratio (TLR). When determining the premium for a benefits plan, the insurance company sets something called the Total Loss Ratio. This determines the amount of money the insurance company is willing to pay for each premium dollar collected. For example, a TLR of 83% means that the insurance company is willing to pay out up to 83 cents on the dollar. A number of factors go into determining the TLR, including among other things, claims experience, trends, inflation, utilization and aging, demographics of the group, offloading of provincial plans, erosion of deductibles, and risk. Because there's a larger pool of employees when all franchise locations are under the same plan, the TLR would be higher than if each franchisee were to obtain benefits on their own. For example, a franchise with 5 full-time employees would have a TLR of approximately 67%, whereas a master plan

for all franchise locations covering 120 employees would have a TLR of approximately 82%.

2. Lower Rates. Simply put, the higher the number of employees in the benefits plan, the lower the premiums. Insurance is all about "spreading the risk," and with more people in the plan, the risk is spread across a larger employee base. For example, if a franchisee with 5 employees were to obtain their own benefits plan, they can expect to pay approximately 30 – 40% more than if a master plan were set up through the franchisor, which covered 100 employees (exact figures are dependant on the employees' demographics and the number of employees).

The Disadvantages

1. Collecting Premium. As there is one master policy, premiums are to be paid with one cheque, or one pre-authorized chequing (PAC) withdrawal for the entire policy. In order to avoid the issue of collecting premiums from each franchisee, many franchisors that have a master benefits plan for all employees include the premiums in the monthly franchise fees.

2. Coverage Selection. While it is possible to have separate classes of coverage, there is a limited amount of flexibility when it comes to benefits selection in a master plan.

Separate Plans

The Advantages

1. Insurance Company Selection. Currently, there are approximately 16 different life insurance companies in Canada that provide benefits plans, and each insurance company has geographical regions across this country in which they are more competitive than others. As well, they also have certain industries in which they are more competitive. An insurance company that might provide the best benefits package in Nova Scotia might not be the best option for a franchisee in British Columbia.

2. Coverage Selection. Each franchisee can tailor the benefits for their own staff. Deductibles, annual maximums, coverage, and plan type can be customized by franchisee.

3. Premium Payment. As each franchise location is responsible for their own benefits plan, they are also responsible for paying their own premiums, and this does not become the responsibility of head office.

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The Disadvantages

1. Lower Total Loss Ratio (TLR). As mentioned in the Advantages section of "A Master Plan," with a smaller pool of employees, the TLR is set at a lower level, leaving fewer premium dollars to pay claims.

2. Higher Rates. The smaller the group of employees, the smaller the pool of employees to absorb the risk. Consequently, the rates for dental coverage and extended health coverage are higher with a smaller group — as illustrated above, up to 40% higher.

However, there are alternatives to traditional employee benefits plans. In a Health Care Spending Account (HCSA or HSA), the plan sponsor (whether it be the franchisor or the franchisee), contributes a defined amount of funds into the HCSA for each eligible employee. These funds are then used to pay for health and dental expenses, and can also be used for items not traditionally covered by a benefits plan, such as dentures, guide and hearing–ear dogs, artificial limbs, and other items. The Canada Revenue Agency (CCRA) has specified in the Income Tax Act what qualifies as a Medical Expense Tax Credit, and that can be reimbursed by an HCSA. Some plan sponsors are now blending HCSA's in with a traditional benefits plan. Co-insurance levels are being lowered, and the employee has the option of using their HCSA to pay for the deductibles or remaining co-insurance payments, expenses in excess of maximum coverage amounts, or for other items, as approved by the CCRA.

Administrative Services Only (ASO) plans are similar to HCSA's in that they are "Private Health Services Plans," as defined by the CCRA. However, with an ASO, the plan sponsor has the ability to manage benefit costs by specifying certain restrictions and limitations on coverages. ASO plans provide similar coverage to a traditional benefits plan — to an employee, the difference is transparent. However, what makes ASO plans very appealing to some plan sponsors is that unused premiums dollars are not lost at the end of the year. Instead, they carry over to the following year and can be used to lower premiums.

"Large-scale" employers often use ASO plans as a means to pay claims more cost-effectively. For example, they would pay claims less than $20,000, and would have stop-loss insurance in place to cover claims exceeding $20,000. For an employer with 120 or fewer employees, this wasn't an option in the past — having to pay a $20,000 claim would be financially devastating. Fully-pooled ASO plans are now available to all employers, regardless of size. Stop-loss insurance limits can be set as low as $1,000, with any claims exceeding the stop-loss being absorbed by the entire pool. ASO plans can also offer pooled benefits, such as life insurance, dependant life insurance, accidental death and dismemberment insurance, travel insurance, and disability insurance. As is the case with an HCSA, premiums are fixed, and are not subject to TLR's and rates — HCSA and ASO providers charge a fixed administration fee (10%-15%, depending on the company).

A quality employee benefit plan is one of the best methods of attracting and retaining good employees. The plan can be properly designed to deliver value to your employees at an affordable premium to you. For a company without an existing plan, it is worth the investment of your time to look at your options and see the return you can receive from offering your employees a quality plan.

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