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Industry Report

Emerging Trends in Benefit Technology: Benefit Technology on the Rise

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Executive Summary

The powerful forces of technology, shifting regulations, and demographics are reshaping the health insurance and employee benefit distribution landscape. In particular, we believe that the employee benefit distribution market is ripe for disruption. In this second installment of our series on emerging trends in the benefit tech industry, we analyze opportunities in the $20 billion-plus employee benefit technology and brokerage/consulting market.

Traditionally, the market has been centered on the benefit broker/consultant who designed an employer's benefit plan, negotiated with insurance carriers, offered outsourced HR support, and advised on benefit technology vendor selection. However, we believe the center is shifting toward the technology vendors that provide software to carriers and employers to support benefits enrollment and administration functions that have become increasingly complex since the rise of consumer-directed health plans. Although brokers/consultants will likely retain a larger share of the overall market and remain key gatekeepers and decision-makers in the middle market and large group employer space, we expect that benefit technology vendors are better positioned to experience faster growth.

Using insights from industry leaders, we established a framework for benchmarking growth in attractive sectors. While the overall employee benefit distribution market will likely grow at a low-single-digit pace through 2027, we estimate that ***the market opportunity for employee benefit technology vendors is poised to grow high single digits and reach $5.5 billion by 2027. In addition, we estimate that layering in the incremental opportunity for transaction revenue from voluntary benefits would add between $0.2 billion and $1.3 billion to our 2027 base-case estimate.***

Stocks to Watch

- **Benefitfocus (BNFT; Market Perform):** Over the past two years, Benefitfocus has reaccelerated revenue growth from 0% in 2017 to our estimate of mid- to high-teens growth in 2019. The company has benefited from revamping its go-to-market strategy to improve its indirect broker sales channel, which has over 300 brokers in its Premier Broker Program at the end of the first quarter, up from 100 at the end of February. BenefitsPlace, the company's marketplace for voluntary benefit products (e.g., critical illness, group auto, student loan refinancing) has seen good early participation by carriers/specialty product suppliers (44 at the end of the first quarter) and consumers ($600 million in premiums sold in 2018). While the long-term opportunity is compelling, there is less visibility in the near term.

Private Companies to Watch

- **Benefit Technology Vendors:** Alight Solutions, Benefit Express Services, Businessolver, bswift (part of CVS Health), Corestream, Empyrean Benefit Solutions, Hodges-Mace, Maestro Health, PlanSource, Winston Benefits, Zenefits

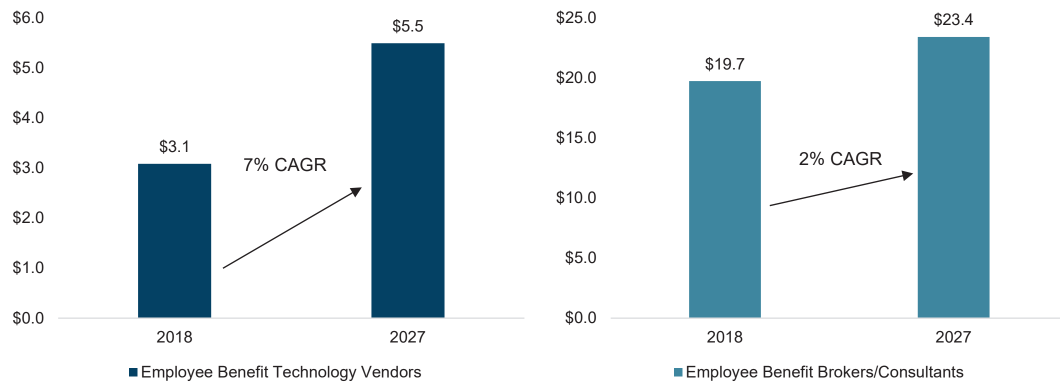
- **Benefit Brokers/Consultants:** BenefitMall, Buck, Milliman, NFP

In this report, we highlight three key industry growth drivers (cost, complexity, and consumerization/convenience) followed by a closer look at trends impacting our bottom-up estimates for the two key market participants: 1) benefit technology vendors and 2) benefit brokers/consultants.

- For employee benefit technology vendors, we estimate the market will grow at a 7% compound annual rate through 2027, increasing from $3.1 billion in 2018 to $5.5 billion. Our market analysis can be found on page 8.

- For employee benefit brokers/consultants, we estimate the market will grow at a 2% compound annual rate through 2027, increasing from $19.7 billion in 2018 to $23.4 billion. Our market analysis can be found on page 13.

Exhibit 1
Employee Benefit Distribution Market Size
($ in billions)



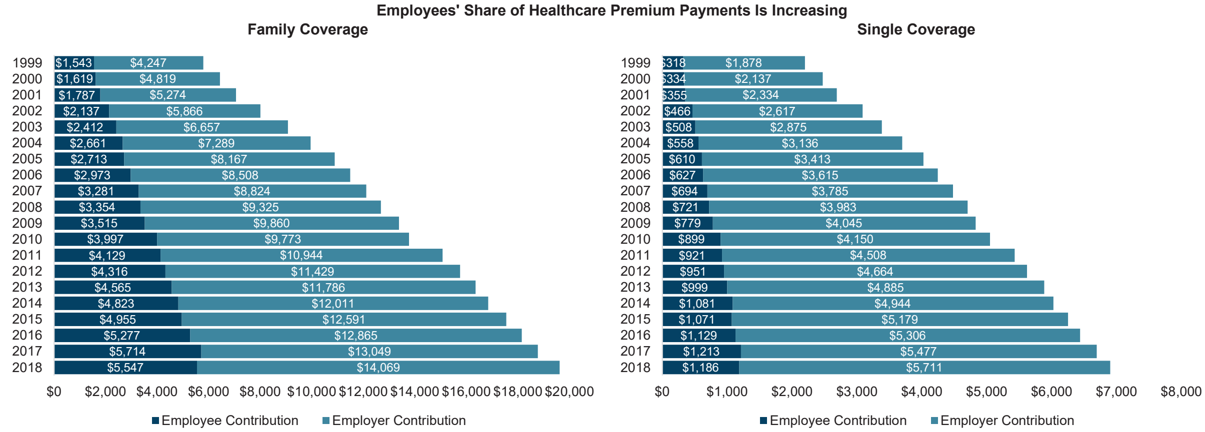
Sources: U.S. Bureau of Labor Statistics, U.S. Census Bureau, U.S. Department of Health and Human Services, Kaiser Family Foundation, William Blair estimates

Summary of Industry Growth Drivers

In our view, overall growth in the employee benefit distribution market is being driven by three factors: 1) higher healthcare costs, 2) increased complexity for employers and employees to manage benefit choices since the rise of consumer-directed health plans, and 3) greater demands for convenience supported by technology, which dovetails with the general trend of consumerization.

First, we examine the state of employer-based healthcare costs. Over the past 20 years, health insurance premiums for both single and family coverage have grown at a roughly 6.5% compound annual rate, with growth for the average employee's share closer to a 7% compound annual rate.

Exhibit 2
Employees' Share of Healthcare Premium Payments Is Increasing

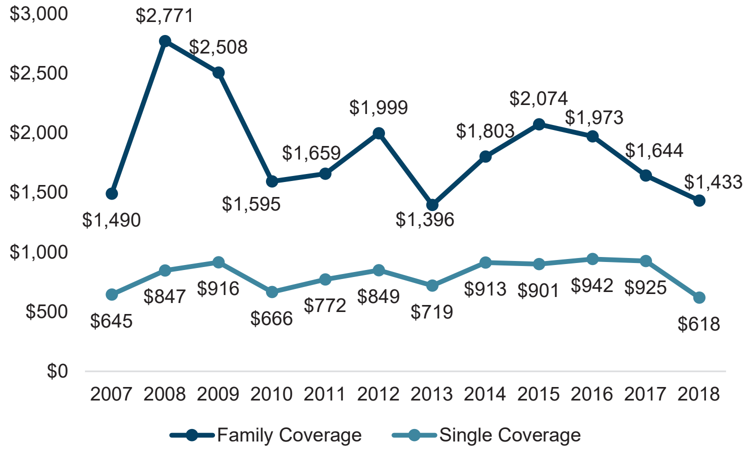


Source: KFF Employer Health Benefits Survey, 2018

As a result, both employers and employees are seeking ways to control costs. For employers, this means 1) working with brokers/consultants to offer more relevant benefits to employees as well as steering employees to lower cost alternatives and 2) using technology to become more efficient at administration and HR functions while also increasing engagement among employees for existing benefits. For employees, this means opting for more flexible arrangements of consumer-driven health plans such as combining a lower premium high deductible health plan (HDHP) with a health savings account (HSA). On average, HDHPs are more affordable in terms of premiums, with annual savings ranging from $600 to $1,400 depending on level of coverage. Assuming savings are split between employers and employees in line with overall premium costs, this translates into annual savings of roughly $100 to $400 for employees.

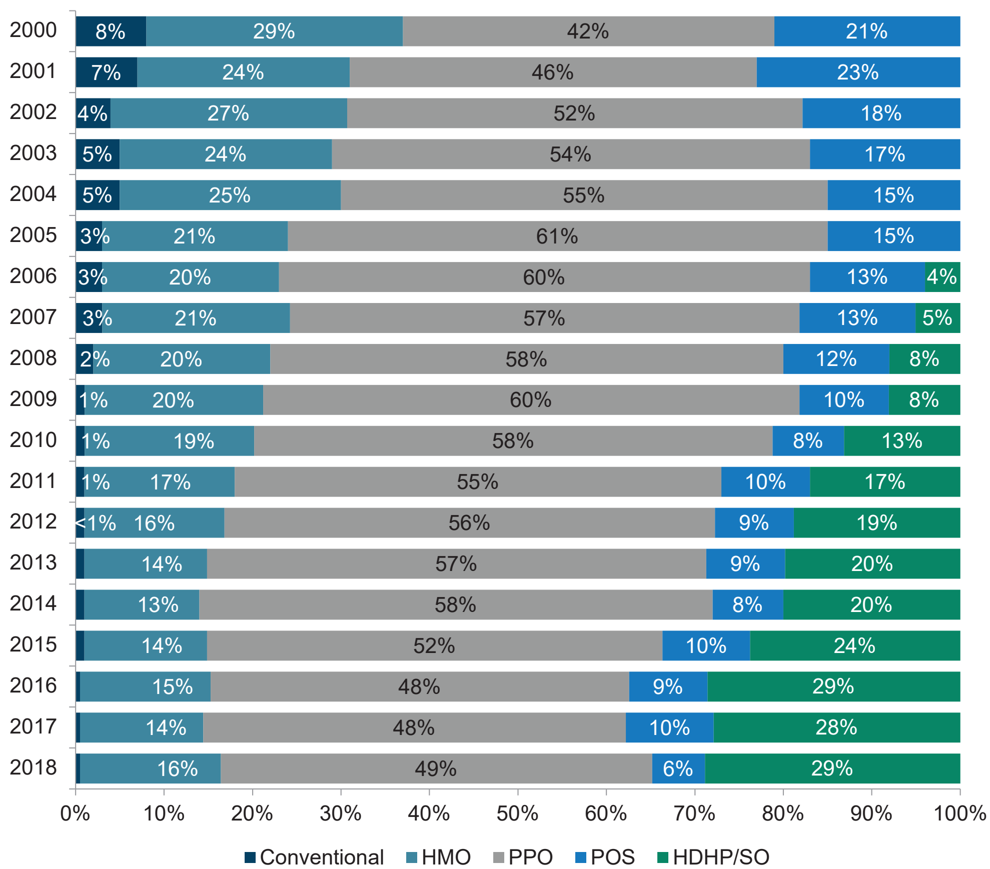
Unsurprisingly, given the savings to employers and employees, enrollment in HDHPs has grown rapidly over the past 12 years, rising from 4% in 2006 to 29% in 2018. While preferred provider organizations (PPOs) remain the most popular plan type, enrollment has fallen from 60% in 2006 to 49% in 2018. According to the Kaiser Family Foundation, availability of HDHPs is high among firms offering health benefits, with 58% of firms offering HDHPs, second only to PPO availability (73% of firms). Middle-market and large firms (200-plus employees) are slightly more likely to offer HDHPs, with 64% availability compared to 42% at small firms (less than 200 employees). However, small firms that have adopted HDHPs are more likely to steer employees to these plans, with 63% of small firms that offer HDHPs making these plans the only type available.

Exhibit 3
Average Annual Premium Savings of HDHP Compared to Non-HDHP



Source: KFF Employer Health Benefits Survey, 2018

Exhibit 4
Distribution of Health Plan Enrollment for Covered Workers, by Plan Type

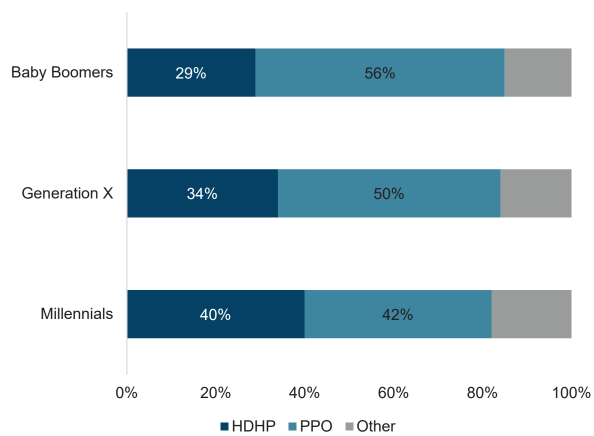


Source: KFF Employer Health Benefits Survey, 2018

We believe that HDHPs could overtake PPOs in terms of enrollment over the next 10 years. Although HDHPs generally make employees more responsible for healthcare utilization costs such as higher deductibles and cost sharing, the up-front premium savings are attractive to younger, healthier employees. A survey by Benefitfocus found that 40% of millennial employees enrolled in HDHPs. We expect millennials will likely remain in HDHPs rather than migrate to PPOs over time given their greater familiarity with and acceptance of these plans early in their careers. By 2027, we estimate 63% of the labor force will be Generation Z or millennials (up from 45% in 2018).

Exhibit 5

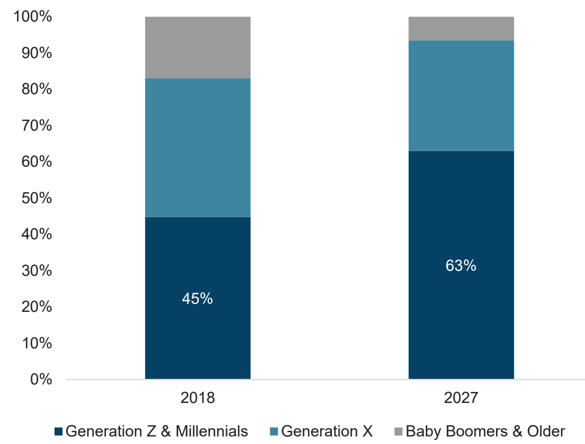
Employee Health Plan Participation by Age Group



Note: Generation Z born after 1998; Millennials, 1980 to 1998; Generation X, 1961 to 1979; Baby Boomers, 1949 to 1960

Source: Benefitfocus State of Employee Benefits 2018

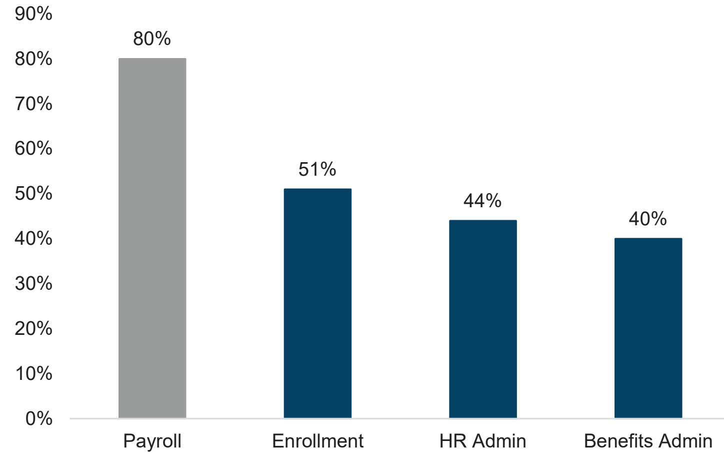
Generation Z & Millennials Will Make Up 63% of Labor Force by 2027



Sources: U.S. Bureau of Labor Statistics, William Blair estimates

Second, the shift to HDHPs and other consumer-driven health plans as an attempt to control costs is resulting in increased complexity for employers and employees. According to a survey by Guardian Life Insurance, 58% of employers in 2017 said managing benefits is increasingly complex, up from 52% in 2015. Further, employers that offered HDHPs were more likely to respond that managing benefits had become increasingly complex. For employers, this is driven by greater responsibilities in terms of managing benefit offerings and administration and maintaining compliance with disparate state and federal regulations. For employees, there is increased complexity in terms of understanding and enrolling in a more individualized à la carte benefits plan. Both issues will drive growth in spending on benefit technology, which remains an underinvested category of business technology relative to other core functions (e.g., ERP, HCM, and payroll). A survey by Guardian found that while 80% of employers use software for their payroll function, only 40% to 50% used software for core benefits functions such as enrollment and administration. However, we expect investments in benefit technology will increase since over 50% of employers surveyed planned to increase their benefit technology budgets over the next three years, especially among lower middle-market firms (100 to 1,000 employees).

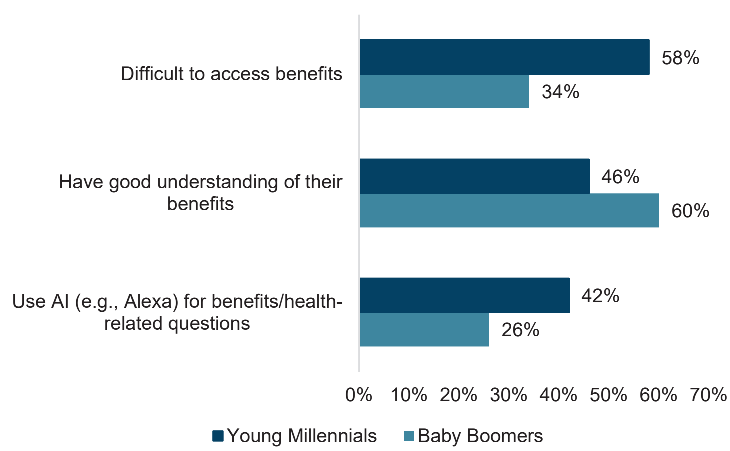
Exhibit 6
Percentage of Firms Using Systems/Software for HR Functions



Source: 5th Annual Guardian Workplace Benefits Study, 2017

The third trend that we believe will drive spending on benefit technology is greater demand for convenience in terms of enrollment and support. While the trend is partly demographic, we believe it reflects the general shift toward tech-enabled convenience in all aspects of life (e.g., on-demand services, one-day shipping, focus on UI/UX design). The usability of these consumer services is a far cry from the capabilities of the legacy human capital management (HCM) systems, which were not built to handle the complex range of offerings of the new benefits ecosystem. Younger employees are more likely to report difficulty getting access to or understanding their benefits. They are also more likely to participate in more complex consumer-driven health plans like HDHPs. We believe employers will likely invest in benefit technology to better support the soon-to-be largest demographic in the labor force.

Exhibit 7
Younger Employees Demand Increased Convenience



Note: Young millennials includes ages 22 to 29.
Source: 5th Annual Guardian Workplace Benefits Study, 2017

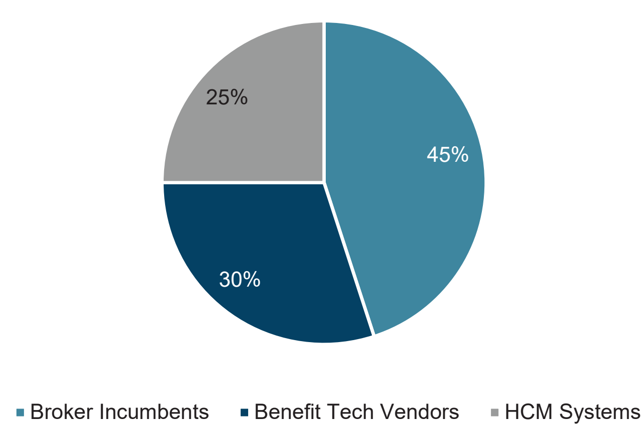
Bottom Line
Higher health costs have pushed employers to offer and employees to enroll in consumer-driven health plans. These plans result in up-front premium savings to both parties with the trade-off of higher cost sharing. Another element of these plans is giving employees a greater range of options, both in terms of benefit selection and other elections (e.g., contribution amounts to HSAs). This creates greater complexity in terms of administration for employers and usability in benefit selection and support for employees. We believe this complexity will drive greater investment toward benefit technology, an area where employers remain significantly underinvested relative to other corporate software.

Employee Benefit Technology Vendors

Employee benefit technology vendors provide software to handle various functions including back-end administration and compliance for employers and front-end enrollment and decision support for employees. A key element of benefits systems is their ability to move data among stakeholders by integrating into the wide range of systems at employers (e.g., payroll, ERP, and HCM systems) as well as the systems at insurance carriers. Vendors typically have a SaaS business model with per-employee per-month (PEPM) pricing.

Among companies using software for benefits administration and enrollment, we believe that the market is split between three groups: 1) broker incumbents (e.g., Alight [formerly Hewitt], Marsh's Mercer segment, and Willis) offering proprietary technology tools representing 45% of the market, 2) benefit technology vendors representing 30%, and 3) HCM systems with add-on benefit administration capabilities (e.g., ADP, Workday) representing 25%. Conversations with industry participants suggest that solutions provided through HCM systems are not as robust as software provided through either specialized benefit technology vendors or broker incumbents; it was also suggested that service quality is typically lower. As a result, a notable industry trend has been for large employer clients (10,000-plus employees) to move off HCM systems. We expect this trend will continue especially as benefits administration becomes increasingly complex given the shift toward consumer-driven health plans, which should drive market share toward specialized benefit technology vendors or broker incumbents over the next 5 to 10 years.

Exhibit 8
Benefit Technology Vendors Likely to Take Share From HCM Systems



Source: William Blair estimates

We estimate that the employee benefit technology market will grow at a 7% compound annual rate through 2027, increasing from $3.1 billion in 2018 to $5.5 billion. Our base case estimate focuses on the market opportunity for benefit technology software and services (e.g., outsourced call center support) for employers and does not include the potential market opportunity from transaction revenue on voluntary benefits. In 2018, we estimate that there were roughly 85 million employees (excludes covered dependents of employee) who were eligible for and participated in employer-sponsored benefits programs. Based on conversations with market participants, we estimate that on average 56% of firms use specialized benefit technology vendors to manage their benefits process (e.g., enrollment, compliance, administration), with the remaining using either general payroll/HCM software (e.g., ADP, Workday) or other legacy methods (e.g., paper-based). We expect usage of specialized benefit technology is higher among larger firms with participation rates closer to 70%. Overall, we estimate average PEPM of roughly $5. Pricing is likely lower among public sector clients and in the small to lower middle-market private sector. We believe PEPMs are meaningfully higher among upper middle-market and large group clients, primarily because of increased services such as call center support, new employee onboarding, and additional compliance add-ons, which are typically incremental to the $3 to $5 PEPM of the core benefits software, which handles functions like enrollment and eligibility.

Exhibit 9
Employee Benefit Technology Vendors Market Scope - 2018
($ in millions, except PEPM)

		Private Sector					
	Public Sector	**Small Group**	**Lower Middle Market**	**Upper Middle Market**	**Large Group**	**Total Private Sector**	**Total**
Employee Range		*< 50*	*51 to 500*	*501 to 10,000*	*> 10,000*		
Total # of Employees (millions)	22.4	34.2	26.6	30.4	37.5	128.7	151.1
% of Employees	15%	23%	18%	20%	25%	85%	
% at Firms Offering Health Insurance	100%	57%	95%	100%	100%	88%	
Total Employees at Firms Offering Benefits (millions)	22.4	19.5	25.3	30.4	37.5	112.7	135.1
% of Employees Eligible for Benefits	85%	83%	80%	80%	75%	79%	
Eligible Employees (millions)	19.0	16.2	20.2	24.3	28.2	88.9	107.9
Take-Up Rate	85%	75%	75%	80%	80%	78%	
Participating Employees (millions)	16.2	12.1	15.2	19.5	22.5	69.3	85.4
% at Firms using Benefit Technology[A]	60%	30%	50%	60%	70%	56%	
Employees using Benefit Technology (millions)	9.7	3.6	7.6	11.7	15.8	38.7	48.4
PEPM	$3.50	$4.00	$4.50	$5.50	$7.00	$5.77	$5.32
Annual Per Employee Cost	$42.00	$48.00	$54.00	$66.00	$84.00	$69.29	
Benefit Technology Vendor Market Size	**$407**	**$175**	**$409**	**$771**	**$1,324**	**$2,679**	**$3,086**

Note A: % at firms using benefit technology only reflects specialized benefit technology point solutions and excludes firms using general HCM software to manage benefits
Sources: U.S. Bureau of Labor Statistics, U.S. Census Bureau, Kaiser Family Foundation, and William Blair estimates

Our 2027 estimate assumes an overall labor force CAGR of 0.7% (inclusive of 0.8% private sector growth and 0.3% public sector growth) and constant assumptions for percentage of firms offering benefits, employee eligibility, and participation rate among eligible employees. We believe that usage of specialized benefit technology vendors will rise to 73%, increasing at a 3% CAGR through 2027. We believe PEPM can expand at a 3% CAGR through 2027 given 1) expanding the scope of services provided (e.g., automated Affordable Care Act [ACA] compliance, COBRA administration, billing and payment processing); 2) more “white glove” outsourced support such as call center support, new employee onboarding, and on-site benefits counseling during open enrollment; and 3) potentially greater pricing power as benefit technology vendors become more entrenched and critical to employers.

Exhibit 10
Employee Benefit Technology Vendors Market Scope - 2027
($ in millions, except PEPM)

		Private Sector					
Employee Range	**Public Sector**	**Small Group** *< 50*	**Lower Middle Market** *51 to 500*	**Upper Middle Market** *501 to 10,000*	**Large Group** *> 10,000*	**Total Private Sector**	**Total**
Total # of Employees (millions)	23.0	36.9	28.3	32.5	40.4	138.0	161.1
% of Employees	14%	23%	18%	20%	25%	86%	
% at Firms Offering Health Insurance	100%	57%	95%	100%	100%	87%	
Total Employees at Firms Offering Benefits (millions)	23.0	21.0	26.9	32.5	40.4	120.8	143.8
% of Employees Eligible for Benefits	85%	83%	80%	80%	75%	79%	
Eligible Employees (millions)	19.6	17.4	21.5	26.0	30.3	95.2	114.8
Take-Up Rate	85%	75%	75%	80%	80%	78%	
Participating Employees (millions)	16.6	13.1	16.1	20.8	24.2	74.2	90.9
% at Firms using Benefits Technology[A]	75%	50%	70%	75%	85%	73%	
Employees using Benefits Technology (millions)	12.5	6.5	11.3	15.6	20.6	54.0	66.5
PEPM	$4.60	$5.20	$5.90	$7.20	$9.10	$7.41	$6.88
Annual Per Employee Cost	$55.20	$62.40	$70.80	$86.40	$109.20	$88.93	
Benefit Technology Vendor Market Size	**$689**	**$408**	**$800**	**$1,346**	**$2,249**	**$4,804**	**$5,493**

Note A: % at firms using benefit technology only reflects specialized benefit technology point solutions and excludes firms using general HCM software to manage benefits

Sources: U.S. Bureau of Labor Statistics, U.S. Census Bureau, Kaiser Family Foundation, and William Blair estimates

Voluntary Benefit Market Opportunity

Another trend to watch in the benefit technology space is the potential expansion of the market if vendors move beyond core benefits and into distribution of voluntary benefits and other supplemental products (e.g., accident, critical illness, student loan refinancing). The bull case is that given the shift to consumer-directed health plans, employees are better able to individualize their benefits. For example, rather than simply selecting the PPO, an employee would select an HDHP and reallocate the savings from lower premiums to other products that best fit the employee's personal circumstances. Given the role of benefit technology vendors in the enrollment process, they would essentially function as the "app store" for the entire voluntary benefits and supplemental product market.

In our view, becoming the "app store" for voluntary benefits is an attractive long-term opportunity for employee benefit technology vendors in which they could earn an incremental recurring revenue stream by fully monetizing the consumers on their benefits enrollment platforms. According to Eastbridge Consulting Group, total voluntary benefits premiums were $37.3 billion in 2014, inclusive of new annual sales of roughly $7 billion. In addition, Eastbridge found that benefit brokers (which typically sell group benefits products) are taking share from agents (which typically sell individual benefits products), with benefit brokers capturing 56% of voluntary product premiums in 2012, up from 52% in 2010. In general, we expect benefit technology vendors will not disintermediate brokers and receive full commissions on voluntary products, but rather carriers would pay benefit technology vendors a marketplace take-rate for facilitating transactions. For example, Benefitfocus has said that it gets paid a single-digit percentage of product premiums for certain Aflac products sold through BenefitsPlace, its voluntary benefit marketplace.

Assuming premiums for the voluntary benefits market grow at a 4.5% annual rate through 2027 (roughly in line with new sales growth from 2004 to 2014), we estimate total premiums by 2027 would reach $66 billion. With benefit brokers' market share reaching 65% and a marketplace take-rate of 0.5% to 3% of premiums, we estimate that the voluntary benefits market represents an incremental $0.2 billion to $1.3 billion market for benefit technology vendors by 2027.

Exhibit 11
Employee Benefit Technology Vendors - Voluntary Benefit Market Scope - 2027
($ in billions)

	Base Case	Bull Case
2027 Voluntary Premiums	$66.1	$66.1
% Broker Market Share	65%	65%
Benefit Tech Voluntary Premiums Transaction Volume	$43.0	$43.0
Benefit Tech Take Rate	0.5%	3.0%
2027 Benefit Tech Voluntary Benefits Market Size	**$0.2**	**$1.3**

Sources: Eastbridge Consulting Group and William Blair estimates

However, it is still early days in terms of both employers offering these benefits and employees enrolling in them. A 2018 survey of over 500 middle-market to large employers (more than 1,000 employees) by Benefitfocus found that only 42% of employers offered at least one of either accident, critical illness, or hospital indemnity plans. Further, even at companies that offered these benefits, 75% of employees did not enroll in any of them. For more niche specialty voluntary products (e.g., legal insurance, identity protection, and pet insurance), employer and employee participation rates are even lower. For example, in 2018, just 18% of employers offered legal insurance, and at the firms that offered this benefit just 14% of employees enrolled. Similarly, a 2018 survey of over 1,000 U.S. adults by the Employee Benefit Research Institute found that just 12% of employees enrolled in voluntary benefits.

Stocks to Watch

- **Benefitfocus, Inc. (BNFT; Market Perform)** provides a cloud-based benefits platform and private healthcare exchanges to employers and insurance carriers to facilitate plan shopping, enrollment, and benefit management. The company's target market is employers with over 1,000 employees. As of 2018, the company had 1,000-plus employer clients and 57 carrier clients, with over 13 million benefit plan participants using its software for benefits enrollment. Over the past two years, Benefitfocus has reaccelerated revenue growth from 0% in 2017 to our estimate of mid- to high-teens growth in 2019. The company realigned its direct salesforce into key market verticals and has landed large wins in the state government space. Although the public sector is highly price sensitive, industry conversations suggest that public market demand and adoption is picking up steam. Benefitfocus has also benefited from 1) revamping its go-to-market strategy to expand its indirect broker sales channel through its Premier Broker Program and 2) the launch of BenefitsPlace, a marketplace for voluntary benefits products (e.g., critical illness, group auto, and student loan refinancing), which provides the company with recurring commission revenue.

Private Companies to Watch

- **Alight Solutions** provides cloud-based HR and benefits administration software used by over 3,000 business clients (including roughly 50% of the *Fortune* 500) and their 23 million current and former employees. Alight has a SaaS model and generates recurring revenue by charging clients a per benefit plan participant per period (e.g., monthly or annual) fee to access its enrollment and benefits administration platform. In 2018, the company had revenue of $2.4 billion (of which $1.2 billion was generated by its benefit technology solutions). In 2017, Blackstone, a private equity firm, acquired Alight from Aon, a global insurance broker, for $4.8 billion. While the company has historically maintained a large footprint among large employer clients (10,000-plus employees), industry conversations suggest that the firm is trying to gain share in the upper middle market (to companies in the 5,000 employee range).

- **Benefit Express Services**, founded in 2001, provides cloud-based employee benefits enrollment and administration software and outsourced benefits support. The company also licenses its technology platform to brokers and other resellers as well as provides à la carte software solutions such as its BeneFITwise decision support tool.

- **Businessolver**, founded in 1998, provides cloud-based employee benefits administration technology and services to middle-market to large employer clients. Industry conversations suggest that the company typically competes for similar clients as vendors such as bswift and Empyrean Benefit Solutions. In addition to offering HR services (eligibility/enrollment, consumer account administration, COBRA, payroll, and billing), Businessolver also provides extensive member experience services to employees (decision support tools, recommendation engines, offboarding solutions, and a call center). In 2018, Warburg Pincus made an investment in Businessolver to support growth opportunities.

- **Bswift (part of CVS Health)**, founded in 1996, provides cloud-based employee benefits enrollment and administration software and outsourced enrollment support services to over 50,000 employer clients and their 10 million members. In 2014, the company was acquired by Aetna, a health insurance company, for $400 million. In 2018, bswift was acquired by CVS Health as part of CVS's acquisition of Aetna. Bswift is a market leader in the middle market with industry conversations suggesting that the company has maintained good momentum in winning new business.

- **Corestream**, founded in 2006, provides a cloud-based voluntary benefits enrollment and administration platform to employers. Corestream works with over 500 different brokers and its platform supports 125 different types of voluntary benefits spanning supplement health (e.g., critical illness), lifestyle (e.g., student loan refinancing), discount programs, and group auto insurance. The company's platform is used by over 1.2 million employees representing over $100 million in premiums in 2017.

- **Empyrean Benefit Solutions**, founded in 2006, provides cloud-based employee benefits enrollment and administration software for its 400-plus clients and their 3 million-plus benefit plan participants. Empyrean also offers fully outsourced benefits administration services through its three U.S.-based service centers. The company is a key player in the upper middle market. The company's go-to-market strategy includes both a direct employer and carrier sales channel and an indirect sales channel through employee benefits consultants and brokers. The Empyrean Platform supports integrations with leading payroll, HCM, and ERP providers such as ADP, Workday, and Ultimate Software.

- **Hodges-Mace**, founded in 2004, is a leading provider of employee benefits enrollment and administration software and outsourced benefits enrollment support and concierge services focused on the U.S. large employer market. The company's go-to-market strategy includes both a direct employer and carrier sales channel and an indirect broker sales channel. Hodges-Mace's SmartBen Platform manages all aspects of enrollment, administration, eligibility, compliance, and employee communications.

- **Maestro Health** provides employee benefits enrollment and administration software as well as self-funded benefits support (utilization review/case management, third-party administrator [TPA] services, pharmacy benefit manager [PBM] services, provider network options) through its integrated mobile and web platform, maestroEDGE. Maestro offers several tiers with bundled offerings as well as the ability to customize technology solutions and services such as on-site enrollment, call center support, COBRA, and customer communications. The company was founded in 2013 and raised $53 million in a series A funding in 2016 before being acquired by AXA Group, a multinational insurance firm, for $155 million in 2018.

- **PlanSource**, founded in 2008, provides cloud-based benefits administration and HCM software to small and large U.S. employers and their roughly 4.5 million benefit plan participants. In March 2018, Vista Equity Partners, a private equity firm, acquired the company (deal terms were not disclosed). In 2018, the company grew annual recurring revenue 25% and added 750 new clients.

- **Winston Benefits** provides outsourced benefits administration services. Its integrated software suite includes solutions for enrollment, benefit communications, and ongoing employee engagement. The company also provides voluntary benefit consulting services to employers.

- **Zenefits**, founded in 2013, provides a full range of cloud-based HR software to over 11,000 small and midsize companies. The Zenefits platform includes solutions for benefits, payroll, HR, compliance, and time management. The company originally positioned itself as an insurance broker generating revenue from commissions while providing its software for free. However, as a result of regulatory challenges that this model violated anti-rebating laws, Zenefits has pivoted to become a pure technology company with a SaaS pricing model for its software with an indirect broker distribution channel.

Employee Benefit Brokers/Consultants

Historically, employee benefit brokers maintained a transactional relationship with their employer clients, where they served as an expert advisor in negotiating insurance coverage and rates with carriers in return for a commission based on premiums (typically 2% to 4%). However, now several changes have shifted the relationship and pushed brokers to adopt a more consultative relationship with clients, with a greater focus on helping clients manage their healthcare costs (through benefit plan design and analytic insights on utilization and claims data), as well as technology (either supplying in-house systems or integrating/auditing systems from third-party benefit technology vendors) and other services such as third-party claims administration.

First, in the small employer market, ACA provisions restricted insurance rate setting at the employer level. As a result, the added value of using a broker to negotiate pricing was significantly diminished. Second, the trend toward self-funded plans continues. In 2018, 61% of covered employees were in self-funded plans, including 90% of covered employees at employers with 1,000 or more employees. The shift by employers to self-funded plans eliminates the need for a negotiator between employer and carrier and de-couples commission growth from premium growth. Third, the rise of fee-based arrangements is putting downward pressure on brokers' ability to grow with the premiums/healthcare costs.

As a result of these changes, the traditional employee benefit brokers have largely rebranded as consultants. Their focus includes not just traditional benefit brokerage but also providing 1) advice backed by data/analytics to clients to help them understand coverage gaps in employee benefit options and manage their employee healthcare utilization and spending, 2) benefit technology or assessing and advising on different benefit technology and engagement/wellness software vendors, and 3) outsourced support such as claims administration for self-funded plans. Contrary to fears that the industry will be entirely disintermediated by technology, we believe that the benefits consultants are secure in their role as gatekeepers for any benefit technology vendor, especially those competing in the upper middle market and large group employer space given the regulatory complexity of the benefits landscape. Nonetheless, while employee benefit brokerage/consulting is unlikely to disappear, we expect it to remain roughly flat or grow low single digits over the coming decade.

We estimate that the employee benefits consulting market will grow at a 2% compound annual rate through 2027, increasing from $19.7 billion in 2018 to $23.4 billion. Although the market has shifted away from a commission-based revenue model, we base our estimate on a blended fee/commission percentage of healthcare premiums. We estimate premiums by multiplying the roughly 70 million employees that participate in employer-sponsored insurance and average premium rates based on the mix of single and family coverage. For our blended fee/commission percentage of premiums, we estimate higher commissions of roughly 3% to 3.5% at lower middle-market (51 to 500 employees) and upper middle-market employers (501 to 10,000 employees) given the lower percentage of firms having self-funded plans. Within small and large group employers, we estimate a 1% to 1.5% rate given the prevalence of fee-based engagements.

Exhibit 12
Employee Benefit Consulting Market Scope - 2018
($ in millions, except premiums)

Employee Range	**Small Group** *< 50*	**Lower Middle Market** *51 to 500*	**Upper Middle Market** *501 to 10,000*	**Large Group** *> 10,000*	**Total**
Participating Employees (millions)	12.1	15.2	19.5	22.5	69.3
% enrolled in Single Coverage	64%	55%	45%	45%	
% enrolled in Family Coverage	37%	45%	55%	55%	
Avg. Single Coverage Annual Premium	$6,800	$6,850	$6,900	$6,950	
Avg. Family Coverage Annual Premium	$18,700	$18,800	$19,500	$19,750	
Total Annual Premiums	$135,190	$185,367	$269,111	$315,124	
Employee Benefit Broker Fees/Commission %	1.5%	3.5%	3.0%	1.0%	
Benefit Consulting Market	**$2,028**	**$6,488**	**$8,073**	**$3,151**	**$19,740**

Sources: U.S. Department of Health and Human Services, Kaiser Family Foundation, and William Blair estimates

Our 2027 estimate assumes an overall labor force CAGR of 0.7% (inclusive of 0.8% private sector growth and 0.3% public sector growth) and constant assumptions for percentage of firms offering benefits, employee eligibility, and participation rate among eligible employees. We expect 3% annual premium growth will be partly offset by the continued trend toward fee-based engagements, which will drive down our blended commission/fee estimate among middle-market brokers.

Exhibit 13
Employee Benefit Consulting Market Scope - 2027
($ in millions, except premiums)

Employee Range	**Small Group** *< 50*	**Lower Middle Market** *51 to 500*	**Upper Middle Market** *501 to 10,000*	**Large Group** *> 10,000*	**Total**
Participating Employees (millions)	13.1	16.1	20.8	24.2	74.2
% enrolled in Single Coverage	64%	55%	45%	45%	
% enrolled in Family Coverage	37%	45%	55%	55%	
Avg. Single Coverage Annual Premium	$8,872	$8,938	$9,003	$9,068	
Avg. Family Coverage Annual Premium	$24,399	$24,530	$25,443	$25,769	
Total Annual Premiums	$190,203	$257,451	$374,901	$442,381	
Employee Benefit Broker Fees/Commission %	1.0%	3.0%	2.5%	1.0%	
Benefit Consulting Market	**$1,902**	**$7,724**	**$9,373**	**$4,424**	**$23,422**

Sources: U.S. Department of Health and Human Services, Kaiser Family Foundation, and William Blair estimates

Stocks to Watch

- **Aon (AON; Market Perform)** is the second-largest global insurance broker. Through its Health Solutions business, Aon provides employee benefits consulting to large group employer clients and manages private healthcare exchanges for employers' current and retired employees. In 2018, the business, which has had 5%-plus organic growth over the past few years, placed more than $30 billion in health premiums and generated $1.6 billion in revenue (15% of total revenue).

- **Arthur J. Gallagher (AJG; Outperform)** is the fourth-largest insurance broker. Through its benefits and HR consulting practice, the company offers a full range of services (e.g., health, pharmacy, voluntary, wellness, retirement, technology, and data/analytics) to businesses ranging from middle market to the lower end of large group, with the segment generating roughly $1.1 billion in revenue in 2018.

- **Brown & Brown (BRO; Market Perform)** is the fifth-largest publicly traded insurance broker with a focus primarily on domestic middle-market clients. In November 2018, Brown completed a $705 million acquisition of The Hays Group, the 22nd-largest broker with roughly $205 million in revenue. The deal expanded Brown's employee benefits business by over 35%, with the combined business expected to generate roughly $435 million in 2019.

- **Marsh & McLennan (MMC; Market Perform)** is the largest global insurance broker. Through its Mercer consulting segment, the company provides a full range of employee benefits consulting services (e.g., plan design, administration, vendor audits) for middle-market and large group clients. Mercer operates the Mercer Marketplace 365 private exchange for clients' current employees and retirees. In 2018, Mercer's health business generated $1.7 billion in revenue, and has grown organically by roughly 3.5% over the past five years.

- **Morneau Shepell (MSI-TSE)** is a Toronto-based human resources consulting and technology company providing employee benefits consulting services (e.g., benefits administration, pension administration, employee assistance, and wellness programs) to over 24,000 organizations and their 7 million-plus plan participants. The company had 2018 revenue of over C$720 million, up 14% in local currency. The United States and other international markets represented roughly 26% of revenue in 2018.

- **Willis Towers Watson (WLTW; Market Perform)** is the third-largest global insurance broker formed through a merger of equals between Willis Group and Towers Watson in 2016. Through its Human Capital and Benefits (HCB) segment, Willis provides employee benefits consulting services primarily to large U.S. clients. In 2018, the business generated roughly $1.2 billion in revenue and maintains roughly 95% client retention.

Private Companies to Watch

- **BenefitMall**, founded in 1979, provides employee benefits, payroll, HR, and employer services to over 200,000 small and medium-size businesses through its network of 20,000-plus independent brokers and accountants. The company's BenefitMall Individual Exchange website is used by brokers to distribute individual and senior health products. In 2017, The Carlyle Group acquired BenefitMall (deal terms were not disclosed).

- **Buck** provides HR and employee benefits consulting and administration services and proprietary technology solutions to over 165 clients covering roughly 1.15 million plan participants in North America. The company is able to offer clients service flexibility ranging from bundled fully outsourced HR and administration services to tech-only solutions. In August 2018, Buck was acquired by H.I.G. Capital from Conduent, a business process outsourcing company.

- **Milliman**, founded in 1947, is a leading global actuarial and consulting firm offering a range of services in the areas of employee benefits and retirement, healthcare, P&C insurance, and risk management. In 2016, the company generated over $900 million in revenue.

- **NFP** is a P&C insurance broker and corporate benefits consultant in employee and executive benefits, HR services, and retirement. The company also offers a range of individual solutions to high-net-worth clients such as wealth management, estate planning, life insurance, and other long-term care insurance. In 2013, NFP was taken private by Madison Dearborn Partners for $1.3 billion.

The prices of the common stock of other public companies mentioned in this report follow:

Aflac Incorporated	$54.95
Aon plc	$193.25
Arthur J. Gallagher & Co.	$86.20
Automatic Data Processing, Inc. (Market Perform)	$165.52
Benefitfocus, Inc.	$25.29
The Blackstone Group L.P. (Outperform)	$44.19
Brown & Brown, Inc.	$33.17
Conduent, Inc.	$8.89
CVS Health Corporation	$53.68
Marsh & McLennan Companies, Inc.	$98.61
Morneau Shepell Inc.	C$29.60
Willis Towers Watson Public Limited Company	$192.31
Workday, Inc. (Not Rated)	$204.52

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DOW JONES: 26548.20
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NASDAQ: 7884.72

Additional information is available upon request.

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Market Perform (Hold)	32	Market Perform (Hold)	8
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