Healthcare BUSINESS STRATEGY™

ASO Products for Self-Insured Companies Continue to Surpass Fully-Insured Options

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Nationwide more than 91 million people are covered by administrative services only (ASO) agreements with health insurance carriers as of June 2010, compared to 86 million who are covered by commercial fully-insured (risk) arrangements. ASO enrollment has declined slightly since 2009, when it initially surpassed commercial risk-based enrollment. However, the decline is significantly less than that experienced by risk-based, fully-insured plans. In fact, over the last five years, while commercial risk enrollment fell -13%, administrative services business increased 11%. Newer markets are driving much of the membership growth for administrative services products as growth in the traditional markets remains stable.

This brief presents key findings from Mark Farrah Associates' review of third party administrators, and in particular the administrative services only business for health insurance carriers. Trends impacting the growth in this business line are also discussed.

TPAs Big Business

An employer has several options for financing their employees' health benefit plans – fully-insure, self-insure or hybrid options. If the company chooses to self-insure they usually enlist a Third Party Administrator (TPA) to manage this business for them. Many health insurance carriers offer both fully-insured and third party administrative services, which are often called administrative services only (ASO) often performed under an administrative services contract (ASC). Health insurance carriers and their subsidiaries provide most of the administrative services for enrollment covered under TPA agreements for health benefits.

According to the Society of Professional Benefit Administrators (SPBA) there are eight major markets for TPAs.[1] Taft-Hartley union management for multi-employer plans, public and religious plans, and large employers have traditionally made up the client base for TPAs. Some medically-related establishments, including health maintenance organizations, physician-hospital organizations and preferred provider groups or hospitals have acquired or hired TPAs to bring the payor and provider sides closer together for self-insured entities. Some Blues plans or other health insurers have chosen to outsource administrative services to external or subsidiary TPAs to reduce administration costs. An emerging market for TPAs is small to mid-sized employers. Faced with tougher underwriting restrictions and higher health care costs, many are choosing to self-insure the health benefits they provide to employees. As stop-loss coverage and reinsurance becomes more readily available, smaller employers are more willing to engage in self-insuring their employees either alone or through trade associations. Another market, although rare for TPAs, is human resource consulting and personnel related service companies. These entities may choose to purchase or partner with TPAs to expand their service options. A final and new market is companies developing consumer-directed or individual choice plans with health savings accounts. These organizations may choose to outsource to a third party the administration of these products. With traditional markets for TPAs stable, the newer markets are driving much of the industry's gains.

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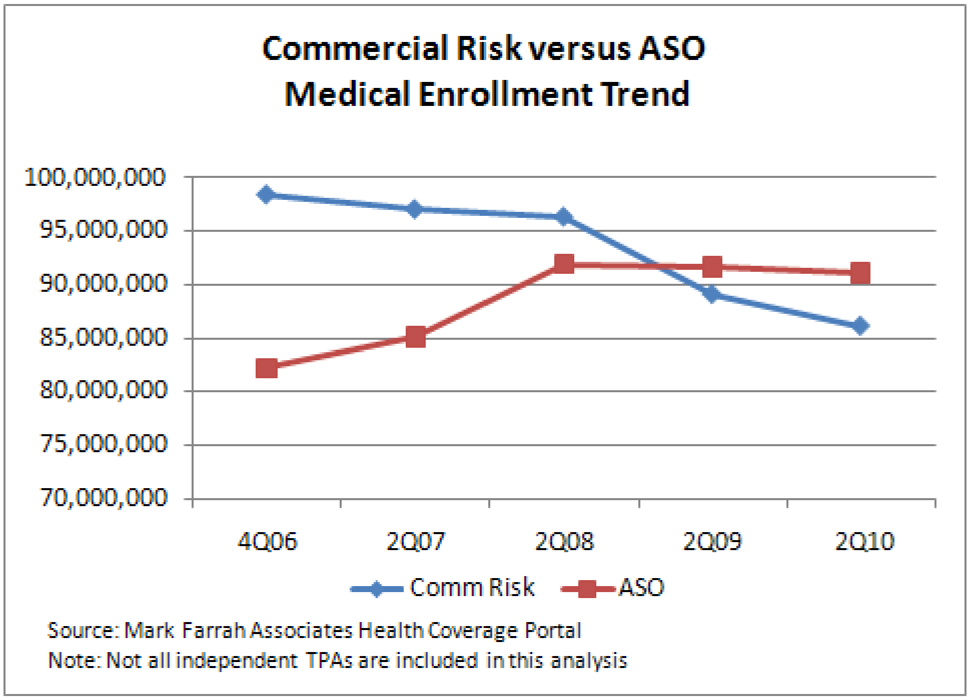
[1] "What's the Size, Role & Future of TPAs' Marketplace?" by SPBA President Frederick D. Hunt, Jr. — April 2008

Rise of ASO

Nationwide more than 91 million people are covered by ASO agreements with health insurance carriers as of June 2010, compared to 86 million who are covered by fully-insured (risk) arrangements. ASO enrollment has declined slightly (-1.2%) since first quarter 2009, when it surpassed commercial risk-based enrollment, however the decline is significantly less than the -4.7% experienced by fully insured plans during the same time frame. In 2006, risk-based commercial membership was 98.4 million, 54% of total commercial enrollment, and 82.2 million people were covered by ASO products. As of second quarter 2010, commercial risk-based enrollment is 86.1 million, 48% of total commercial enrollment. Over the last five years while commercial risk enrollment fell -13%, administrative services business increased 11%.



Outlook

As the economy struggles to recover, enrollment growth is expected to continue in the ASO sector of health benefits business. While union or Taft-Hartley business declines and attrition in large companies occurs, growth is expected in small business as more third party administrators reach out to companies dissatisfied with fully-insured premium increases. Employers in the 75 to 3,500 employee size are viewed as especially good targets for TPAs according to Fredrick D. Hunt Jr., president of the Society of Professional Benefit Administrators1. As state and local fiscal pressures continue to impact budgets, solutions to rising health premiums for government workers may compel more municipalities to self-insure or join state plans that are already using TPA services.

Self-funded plans were not previously held to the same level of regulation as health plans but with health reform, this is starting to change. National health reform legislation began impacting plan sponsors on September 23, 2010 with such provisions as dependent coverage for children under age 26, enhanced patient protections, mandated preventive health services, pre-existing condition limitation prohibitions, bans on lifetime and annual limits on certain services, and appeals process requirements. Mental health parity benefits enacted earlier this year also impacted self-insured plans. Many employers opted for self-insured health benefits to avoid state mandates that included many of the same benefits employers are now required to include. The impact of federal regulations may impede potential ASO growth.

One of the key factors influencing growth in the self-insured market is the availability and cost of stop-loss and reinsurance coverage. Reinsurance and/or stop-loss coverage is an important component for self-insurers to mitigate risk of high cost claims. A tightening of the availability of stop-loss coverage would result in more companies moving toward fully-insured plans. Current concerns include the impact of health reform initiatives, particularly bans on lifetime and annual limits on certain health benefit services, on stop-loss premium rates. Increasing loss ratios for many reinsurers and stop-loss carriers will result in tightening of underwriting, possibly restricting access to this type of coverage for some clients. To mitigate rising stop-loss premiums some carriers are suggesting customers carry specified or critical illness policies in addition to their health benefit policies. This requirement will increase the overall cost of self-insuring.

Not long ago the self-insured route was recommended only for companies with 500 or more employees; now self-funding is an option for companies with as few as 51 employees. This shift is impacting the fully-insured market by more than just membership losses. It is skimming the healthier and better risk membership out of the fully-insured pool. With only higher cost customers remaining in fully-insured plans both medical cost trends and health insurance premiums increase. Escalating risk-based health insurance premiums may incent more companies to opt out of fully-insured products. This could result in making some risk products too expensive for health plans to retain. This scenario is very much like what happened to the former indemnity-style health benefits model.

Currently there is little oversight of the self-insured market or of third party administrators. Though it's difficult to size this segment, Mark Farrah Associates consistently analyzes ASO indicators from a variety of sources to maintain reasonable state membership estimates by carrier. The National Association of Insurance Commissioners (NAIC) now requires carriers to include ASO/ASC enrollment in their annual statutory filings and this is one of the sources used by Mark Farrah Associates (MFA) in its proprietary ASO database. Carriers often report reimbursements by uninsured plans in the Underwriting and Investment Exhibit: Analysis of Expenses and Net ASO reimbursements and Gross ASC reimbursements in the Notes to the Financial Statements sections of the Health Annual Statements submitted to the NAIC. If this information is of interest to you, let us know. MFA continues to evaluate data to identify additional sources of information on the broader TPA segment. Health benefits, self-insurance and third party administration are all multifaceted business models. In this challenging environment it is left to supposition on what the future holds for the health benefits administrative services business.

Health Coverage Portal™

The Health Coverage Portal™ (/products/health-coverage-portal.aspx) is the complete solution for health insurance market data. This robust online database provides access to detailed performance measures for more than 1,000 U.S. insurance carriers selling major medical coverage. Financials include company assets, liabilities, net worth, revenue, expenses, income, loss ratios, margins and more. Membership breakdowns are presented for private risk, self-insured, group, individual, Medicare Supplement, Medicare Advantage, Managed Medicaid and more. Historical data enables year-over-year and quarter-to-quarter performance comparisons. Subscribers also have access to profiles of industry leaders and market analysis reports.

The MFA data partner for this product is the National Association of Insurance Commissioners (NAIC); other sources include the California Department of Managed Health Care (DMHC), the Centers for Medicare & Medicaid Services (CMS) and the U.S. Census Bureau.

About Mark Farrah Associates (MFA)

Mark Farrah Associates (MFA) is a leading data aggregator and publisher providing health plan market data and analysis tools for the healthcare industry. We are a licensed distributor of NAIC data. MFA's Health Coverage Portal™ includes both risk-based and administrative services only (ASO) membership and financial data by plan, parent, state, region and nationally. Committed to simplifying analysis of health insurance business, our products include Medicare Business Online™, the new Medicare Benefits Analyzer, Health Coverage Portal™, Health Insurer Insights™ and Health Plans USA™.

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