Healthcare BUSINESS STRATEGY™

Health Insurance Enrollment in Self-Insured Companies Up Significantly

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Nationwide more than 97 million people are covered by administrative services only (ASO) agreements with health insurance companies as of June 2012, compared to 84 million who are covered by commercial fully-insured (risk) arrangements. ASO enrollment increased nearly 5% from June 2011 to June 2012. Enrollment in commercial fully-insured products declined 0.4% during the same time frame. Health care reform, the economy and ASO options becoming more readily available for small to mid-size employers are driving much of the membership growth for administrative services products. However, defined contribution health plans may impact the overall outlook for TPAs and ASO business in general.

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 companies. Trends impacting the growth in this business line are also discussed.

TPAs Promising Outlook

An employer has several options for financing their employees' health benefit plans – fully-insured, self-insured 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 companies offer both fully-insured products and TPA services to successfully compete in the employer group market. In fact, health insurance companies 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. The eighth major market involves companies offering 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.

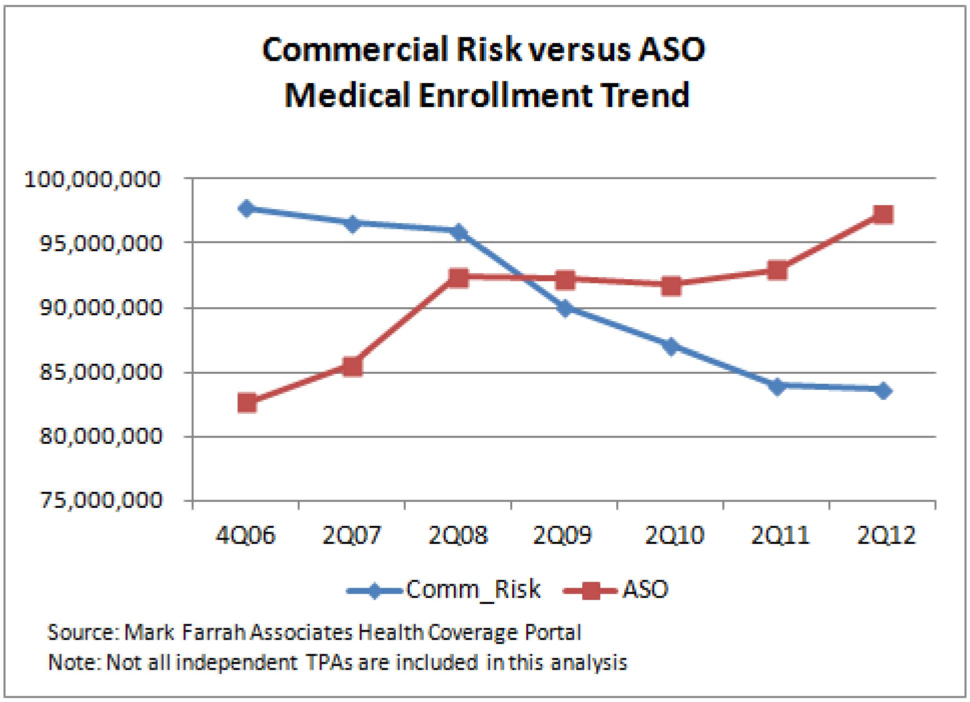
A substitute option employers are now considering is to abstain from providing health insurance for their employees and switch to a defined contribution health plan. In this case, the employer provides a fixed dollar amount to workers through payroll and the employee is expected to purchase coverage on their own. Retail giant, Sears Holding Corporation recently announced that it switched to a defined contribution plan for 2013.

Defined contribution health plans stand to impact employer-sponsored benefits in the same manner that 401 (K) pension plans did. Should employers opt to move to defined contribution options, a third party administrator would still have a role to play in advising and managing this option.

Rise of ASO

Nearly 97.3 million people nationwide are covered by ASO agreements with health insurance companies as of June 2012, compared to 83.7 million who are covered by fully-insured (risk) arrangements. ASO enrollment increased 4.7% since June 2011. Risk enrollment declined 0.4% for the same time frame.

ASO and risk-based products switched market share positions from 2006 to 2012. In 2006, 82.6 million people were covered by ASO products, nearly 46% of total commercial enrollment, and risk-based commercial membership was 97.8 million. As of second quarter 2012, commercial risk-based enrollment was 83.7 million, slightly more than 46% of total commercial enrollment. From December 2006 to June 2012 aggregate commercial health insurance enrollment has only increased 0.3%. During the same time frame, aggregate ASO enrollment increased nearly 18% while risk enrollment declined 14%.



Outlook

As economic worries continue and the cloud of uncertainty around health reform lifts, growth in TPA business is expected to increase according to Fredrick D. Hunt Jr., past-president of the Society of Professional Benefit Administrators[2]. It is unlikely that the industry will see a shift back towards risk-based health insurance options in the foreseeable future. Demand for health benefit guidance and administrative services are more likely to increase as additional employers choose to self-insure defined benefit options or opt toward defined contribution plans. This should fuel growth in TPA business.

Self-insuring health insurance benefits exempts employers from expensive state mandated benefits but they must still comply with national regulations. National health reform legislation began impacting plan sponsors on September 23, 2010 with provisions such 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 in 2010 also impacted self-insured plans. National health reform, in essence, eliminated many favorable benefit price differentials associated with self-insuring and these changes could increase the medical costs for self-insured plans over time.

By eliminating benefit price differentials, the value of self-insuring comes down to willingness to bear risk. 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. The cost of this coverage is currently manageable for employers. Should medical loss ratios for reinsurers and stop-loss carriers increase, it could result in tightening of underwriting, possibly restricting access to this type of coverage for some clients. Rising medical loss ratios would increase the cost of self-insuring employees. Based on third quarter 2012 results for some reinsurer and stop-loss carriers, it appears that revenues from sales of stop-loss coverage are up and loss ratios are consistent year-over-year. For the time being, ASO growth is likely to continue given reasonable costs to manage risk. It will take some time before health reform benefit changes impact results of stop loss carriers.

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, while increasing ASO enrollment, stop-loss coverage sales and TPA business, 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.

MFA expects that ASO business will continue to rise through 2013. This may change in 2014, if a large number of employers decide to pursue defined contribution health plan options and/or if reinsurance and stop-loss coverage costs rise, or state and local government regulations change regarding self-insured business. Currently there is relatively little regulatory control of stop-loss carriers, the self-insured market or of third party administrators. Based on results from a National Association of Insurance Commissioners (NAIC) membership survey conducted at the request of the U.S. Department of Health and Human Services and U.S. Department of Labor[3], Mark Farrah Associates believes regulatory oversight of this segment may increase.

Though it's difficult to size this segment, Mark Farrah Associates (MFA) consistently analyzes ASO indicators from a variety of sources to maintain reasonable state membership estimates by carrier. The NAIC now requires carriers to include ASO/ASC enrollment in their annual statutory filings though these reports do not include ASO enrollment administered by health insurer TPA affiliates. NAIC data is only one of several sources used by 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 a shift to defined contribution, as Sears Holding Corporation just announced, appears the most likely future scenario. As more individual's purchase their own insurance the pendulum will shift back to more fully-insured products just not employer-based options.

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[1] "What's the Size, Role & Future of TPAs' Marketplace?" by SPBA President Frederick D. Hunt, Jr. — April 2008
[2] "State of the TPA Industry + Forecast for 2012 by former SPBA President Frederick D. Hunt, Jr. – December 2011
[3] NAIC and The Center for Insurance Policy and Research letter to Kathleen Sebelius, Secretary of US Department of Health and Human Services and Hilda Solis, Secretary of the US Department of Labor dated July 19, 2012.
Source: http://www.dol.gov/ebsa/pdf/StopLoss0108.pdf

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