



A STUDY OF THE ADMINISTRATIVE COSTS ACCRUING TO ASSOCIATION HEALTH PLANS

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Andrew C. Rucks, Ph.D.





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EXECUTIVE SUMMARY

This study examined five cases of Association Health Plan (AHP) operations with the focus on the administrative costs of the plans. The study found that the plans experienced average administrative costs of 7.8 percent of premium revenue, with a range of 4.6 to 10.7 percent. This level of administrative costs is significant in that it is lower than administrative costs reported for other small insurance plans, for-profit Medicaid plans, and not-for-profit Medicaid plans. The AHPs in the study exhibited long-term stability in administrative costs as these costs declined an average of 1.3 percent year-to-year, which compares very favorably with Blue Cross Plans that exhibit increases in administrative costs of 6.1 percent annually. The AHPs participating in the study achieved these desirable and successful results by: 1) inherently having lower marketing expenses than traditional health plans; 2) outsourcing administrative activities for which vendors are motivated to offer pricing commensurate with the purchasing power of the AHPs; 3) in-sourcing those administrative functions that offer inherent advantages to the “birds of a feather” nature of AHPs; and 4) effective use of earned surpluses to mitigate cost volatility. The study suggests that the presence of AHPs in the health-insurance marketplace is potentially a significant contributor to the containment of health-insurance costs in the national economy through competition with traditional health plans.



OBJECTIVE

The purpose of the study was to determine where and how administrative cost savings occur in Association Health Plans (AHPs). The study was sponsored by the NFIB Research Foundation.

OVERVIEW OF THE STUDY METHODOLOGY

The study examined five cases of operating AHPs to analyze the following seven lines of inquiry. (A detailed explanation of the methodology used in this study is presented in Appendix 1.)

INQUIRY 1: The AHPs' administrative costs. These data will be presented in the form of an Administrative Cost Model and expressed as a percent of premium revenue. The Administrative Cost Model is described in detail in Appendix 2. The model presents a consistent and simple method of understanding the derivation of administrative costs.

INQUIRY 2: For the AHP, what administrative functions are performed in-house and what administrative functions are out-sourced?

INQUIRY 3: A brief history of the AHP. This line of inquiry is intended to gain an understanding of how and when it was started, how it has changed over time in size (number of participants), coverage, and cost.

INQUIRY 4: Demographic data about the AHP, such as: the number of employers participating, the range in the number of participants per employer, and average number of participants per employer.

INQUIRY 5: Referring to the data associated with Inquiry 1 (administrative costs as a percent of premium receipts), what actions have been taken and policies implemented to manage administrative costs?

INQUIRY 6: The executive's perspective on the administrative cost advantage of AHPs relative to non-AHP plans.

INQUIRY 7: The executive's perspective on the competitive dynamics of the health insurance market without the proposed AHP legislation.



FINDINGS AND DISCUSSION

This section presents the findings from all cases included in the study. The order of presentation is in the order of the Inquiries listed in the previous section. The specific findings for each case are presented in Appendix 3.

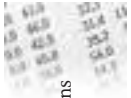
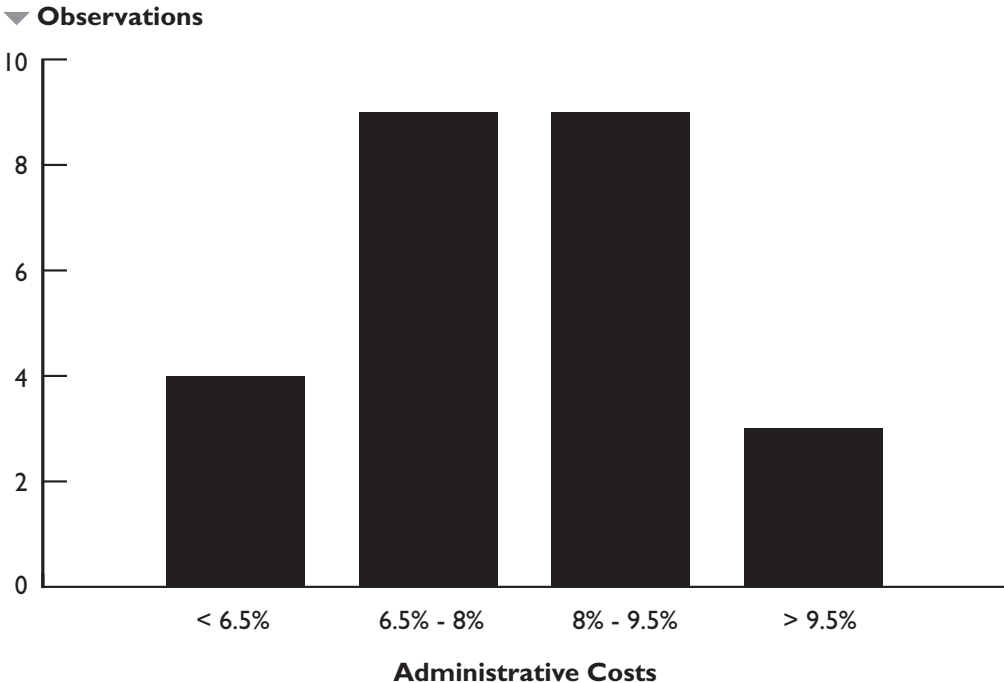
INQUIRY 1—ADMINISTRATIVE COSTS

The five cases included in this study collectively provided 25 observations of administrative costs as a percent of premium. The average for the study observations is 7.8 percent with a median of 8.0 percent. As the descriptive statistics presented in Table 1 indicate, the range of observations is 6.1 percent with the minimum observed value of 4.6 percent of premium and maximum of 10.7 percent. As the histogram in Figure 1 suggests, and the information in Table 1 confirms, the observations are slightly skewed toward the lower end of the range.

TABLE I
DESCRIPTIVE STATISTICS FOR STUDY OBSERVATIONS OF ADMINISTRATIVE COSTS
 (Administrative costs are expressed as percent of Premium Receipts)

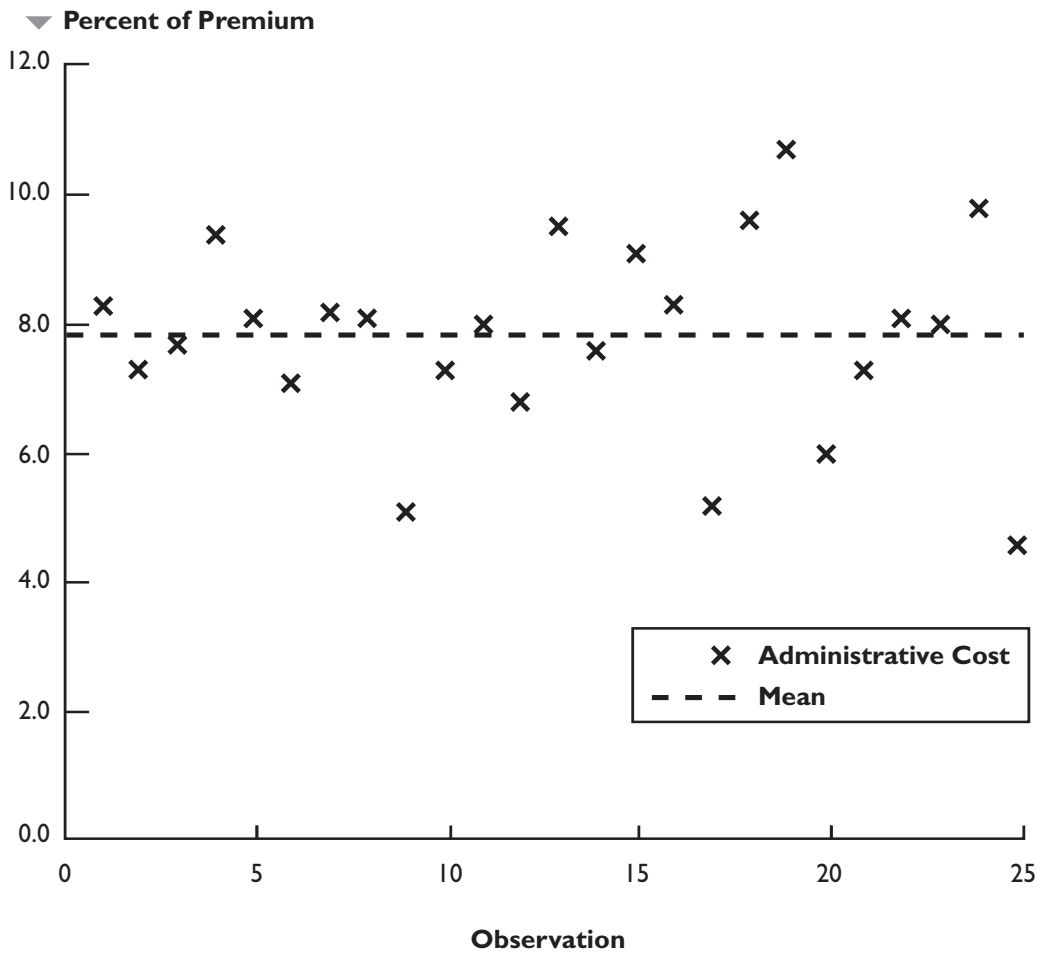
Statistic	Value
Mean	7.8
Median	8.0
Standard Deviation	1.5
Skewness	-0.4
Range	6.1
Minimum	4.6
Maximum	10.7

FIGURE I
HISTOGRAM OF ADMINISTRATIVE COSTS AS A PERCENT OF PREMIUM RECEIPTS



The administrative costs are shown in two scatter diagrams in Figures 2 and 3. In each figure, the individual observations and the mean for the set of observations are plotted. The differences between the scatter diagrams is that Figure 2 presents all 25 observations and Figure 3 shows the observations without the two “outliers”—the lowest observed value (4.6 percent of premium revenue) and the highest observed value (10.7 percent of premium revenue). The order in which the observations are presented in the scatter diagrams is random. The randomization of the sequencing was performed to assist in maintaining the confidentiality of the sources. As a result of the randomization, information may be derived about the clustering of observations, but not about serial or time-series relationships.

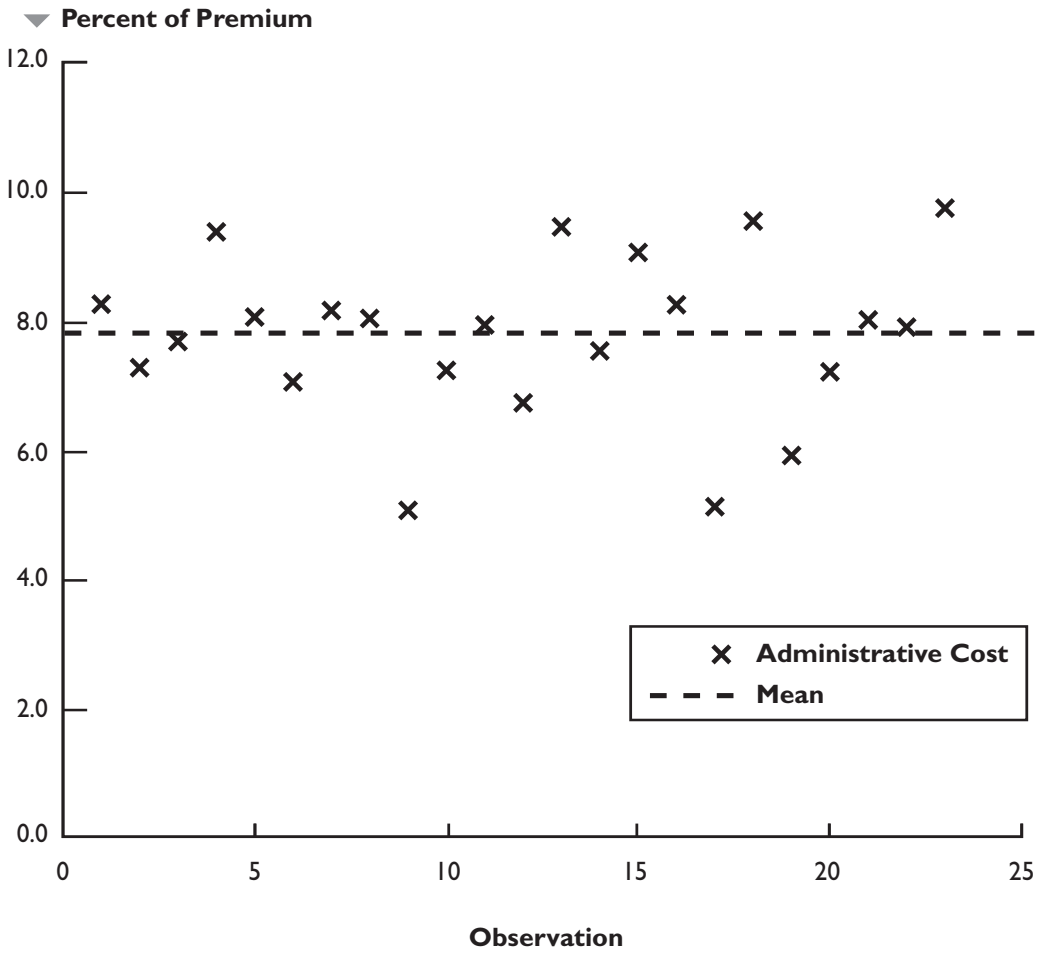
FIGURE 2
SCATTER DIAGRAM OF ADMINISTRATIVE COSTS, ALL OBSERVATIONS



Administrative costs measured as a percent of premium revenue show close clustering about the average of 7.8 percent as illustrated in Figures 2 and 3. This clustering is to be expected given the relatively small range shown in Table 1. The tightness of the clustering around the mean suggests that the executive managers of the AHPs represented in the study have achieved remarkably similar administrative cost outcomes.



FIGURE 3
SCATTER DIAGRAM OF ADMINISTRATIVE COSTS, EXCLUSIVE OF OUTLIERS



The data offer insight into the year-to-year relative change in administrative costs as a percent of premium revenue. The data also offer 19 observations of year-to-year changes in administrative costs. For the 19 observations, the average change from year-to-year was a decline of 1.3 percent. As shown in Figure 4, the majority (14) of the observed year-to-year changes are either no change or decreases, while five were positive changes. Interpreting the year-to-year changes in administrative costs as a percent of premium suggests two conclusions: 1) the managers of the AHPs in the study maintained stable or declining administrative costs, and 2) the managers of AHPs in the study were able to constrain administrative costs to smaller year-to-year increases than premiums. Both of these conclusions reflect favorably on the management of the AHPs in the study.

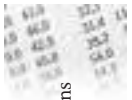
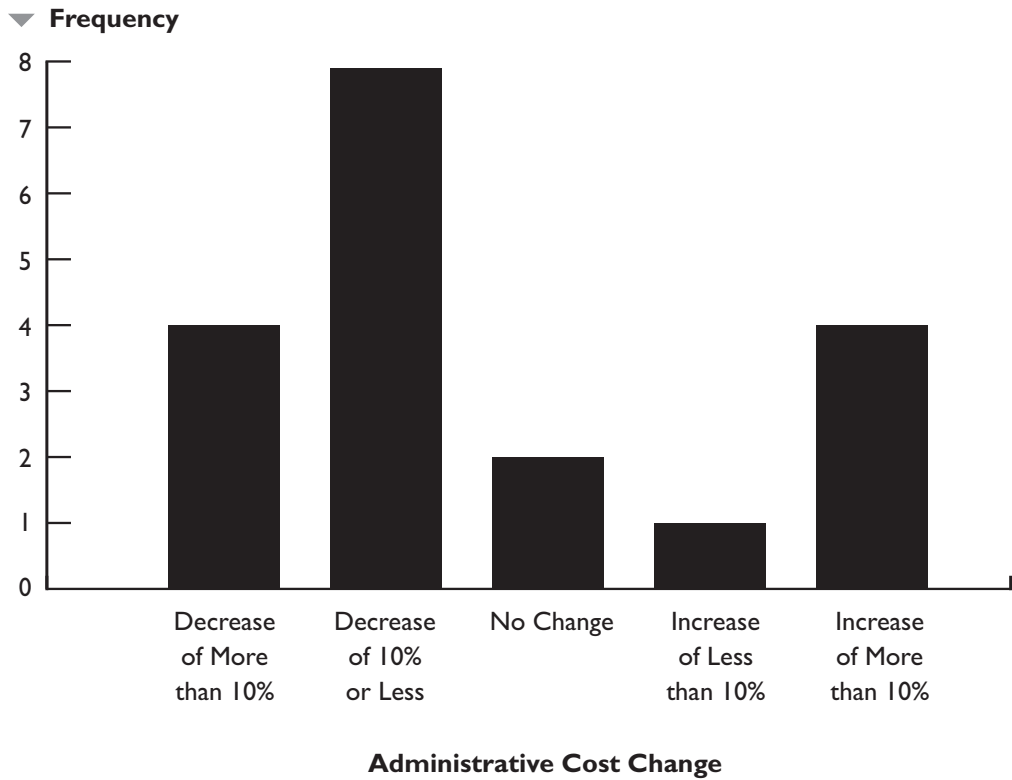


FIGURE 4
YEAR-TO-YEAR CHANGE IN ADMINISTRATIVE COSTS
AS A PERCENT OF PREMIUM REVENUE



Benchmarks for administrative costs of health plans are not abundant. However, publicly available information provides a few benchmarks for evaluating the observations in this study. Table 2 presents the benchmarks and their sources. When the performance of the AHPs in the study is compared to the benchmarks, the AHPs in the study were exemplar—administrative costs for the study participants were lower, on average by 14 percent (7.8 percent for the study participants, 9.1 percent for the lowest benchmark); and the average annual change in administrative costs was lower than that for the Blue Cross plans.

TABLE 2
ADMINISTRATIVE COST BENCHMARKS

Source	Description of Study	Type of Benchmark	Value
Small Business Administration (2003)	Filings of 15 insurance companies	Administrative costs as a percent of premium	27.4%
McCue, Hurley & Chukmaitov (2004)	For-profit Medicaid-focused plans	Administrative costs as a percent of premium	11.1%
McCue, Hurley & Chukmaitov (2004)	Not-for-profit Medicaid-focused plans	Administrative costs as a percent of premium	9.1%
Capitation Management Report (2004)	Blue Cross Plans	Average increase in Administrative costs	6.1%

How have the AHPs in the study been able to achieve comparatively better performance concerning administrative costs? Two factors emerge as the primary drivers of the study group’s performance 1) economies of scale and 2) adroit in-sourcing and outsourcing (this element of the AHP advantage will be discussed in the next section of this report). The achievement of economies of scale is perhaps best described by one of the executives participating in the study who portrays economies of scale as “achieving the appearance of a single employer.” The pooling of interests allowed the AHP to present a large population to the market. This market presence would have been a motivation to vendors to engage in marginal-cost pricing rather than average-cost or full-cost pricing and lower the costs to the AHP.* In addition, the AHPs experience lower marketing costs than some other health plan providers by appealing to “birds of a feather.” The AHPs are offered to individuals who have chosen to be part of a common interest group. Thus, the threshold issue of “brand” acceptance has been breached by the fact of association membership: Marketing efforts can focus therefore on availability, affordability, network, and performance rather than having to appeal to a broad, more diverse market for brand acceptance.

INQUIRY 2—ADMINISTRATIVE FUNCTION SOURCING

The choice of whether to perform administrative functions within an AHP or to outsource the functions affects administrative costs. The AHPs participating in the study demonstrated a clear pattern of the locus of administrative function activity as shown in Table 3. Table 3 lists 13 administrative functions and indicates how many of the study participants perform the function in-house, how many outsource the function, and how many divide the function between in-house and outsource performance.

TABLE 3
SOURCING OF ADMINISTRATIVE FUNCTIONS AMONG STUDY PARTICIPANTS

Administrative Function	In-House	Outsourced	Combination In-House and Outsourced
Bookkeeping	2	2	1
Accounting Services	0	5	0
Audit	0	5	0
Actuarial Services	0	5	0
Case Management	0	5	0
Claims Adjudication	0	5	0

Table 3 continued on next page

* The concept of marginal-cost pricing may be illuminated by analogy. It is generally accepted that the added cost to an airline of filling the last few seats on a nearly full flight is very small in terms of variable costs--small amount of extra fuel, bags of peanuts, etc. and zero for fixed costs--no additional major costs such as adding a wing or lavatory. Thus, if so desired, the airline could charge less for the last few seats than for the first many and continue to make a contribution to profit so long as it covered the small amount of variable costs associated with selling the last few seats. Airlines are not inclined to offer lower prices on the last few seats because the buyer, the individual, has less market power than the airline. However, if an organization with a large number of fliers approaches the airline and offers to fill the last few seats on a number of flights, the organization may possess sufficient market power to persuade the airline to offer pricing “at the margin” or marginal-cost pricing. It is this type of clout that AHPs possess in the health-insurance marketplace that contributes to their achieving lower administrative costs.



TABLE 3 CONTINUED
SOURCING OF ADMINISTRATIVE FUNCTIONS AMONG STUDY PARTICIPANTS

Administrative Function	In-House	Outsourced	Combination In-House and Outsourced
Consulting Services	0	4	1
Customer Service	1	2	2
Enrollment	3	2	0
Investment Management	0	4	1
Regulatory Compliance	1	3	1
Renewals	3	2	0
Sales and Marketing	5	0	0

Of the 13 administrative functions, the AHPs in the study have selected exclusive ownership of only one function—sales and marketing. Exclusive outsourcing is applied to accounting services, auditing, actuarial services, case management, and claims adjudication. The majority of study participants exclusively outsource investment management and one study participant supplemented the outsourced investment management with in-house expertise. The distribution of the remaining administrative functions—bookkeeping, customer service, enrollment, regulatory compliance, and renewals—were shared responsibilities.

The label that best describes the pattern shown in Table 3 is “adroit in-sourcing and outsourcing.” The AHPs focus their attention on factors with which they were most familiar and allow vendors to engage in activities for which they were uniquely qualified. The exclusive in-sourcing of sales and marketing, clearly reflects the proximity of the AHP to the market—the AHP through the association is “closer” to the market—association members—than anyone else. The expert knowledge gives the AHP an advantage in identifying and fulfilling needs. The AHPs largely outsource plan operations to vendors. This allowed the health insurance professionals to effectively employ their organizational expertise in claim adjudication, provider network management, enrollment, and underwriting.

The skillful in-sourcing and outsourcing of administrative functions significantly contributes to achieving the low administrative costs exhibited by the AHPs in the study. The AHPs are able to maintain leaner organizations than they would if they performed all or the majority of the administrative functions in-house, especially the labor and skill intensive functions of claims adjudication and actuarial services. Vendors are motivated to offer marginal cost pricing for administrative services because, up to the point that added volume requires additional fixed costs (for capacity expansion), the added volume received from AHPs improves vendor efficiency.

INQUIRY 3—HISTORY OF THE AHPs

The AHPs participating in the study represent a varied history. The oldest was formed in 1937 and the youngest in the 1990s. The historical commonality among the participants is the intentional effort to provide mechanisms for meeting association-member employers’ needs to offer affordable employee health benefits. In all cases, the leadership of the AHPs sought to exploit the purchasing power of the collective to offer pricing advantages that the members could not achieve individually.



INQUIRY 4—DEMOGRAPHICS

Table 4 summarizes the key demographic indicators for the participants in the study. For each demographic parameter the range and average for the study participants is presented and the cumulative values for study participants as a whole.

TABLE 4
DEMOGRAPHIC PROFILE OF THE STUDY PARTICIPANTS

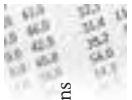
Parameter	Range	Average	Collective
Number of employers enrolled	75 – 1,500	~800	~3,500
Largest number of employees with medical coverage	100 – 2,000	~600	NM
Smallest number of employees with medical coverage	1 – 55	~20	NM
Average number of employees with medical coverage	3 - 80	35	NM
Covered lives—medical	5,000 – 45,000	~17,000	~85,000

INQUIRY 5—ACTIONS AND POLICIES OF THE AHPs FOR MANAGING ADMINISTRATIVE COSTS

The list presented in Table 5 is the set of action and policy decisions that the AHPs participating in the study used to assist in the management of administrative costs. The list suggests that the common focus of these activities is attention to detail in every aspect of cost management.

TABLE 5
ADMINISTRATIVE COST MANAGEMENT ACTIONS OF STUDY PARTICIPANTS

- Aggressive attention to all details of administration to manage costs.
- Centralized billing.
- Centralized regulatory filing.
- Consolidation of billings from multiple vendors.
- Contract negotiations from a strong negotiating position with provider.
- Contract negotiations with vendors.
- Control of promotional activities.
- Electronic maintenance and distribution of eligibility lists to vendors.
- Executive skill in monitoring expenses and negotiating expense ratios.
- Group purchasing power provides economies of scale resulting in lower administrative cost and long-term guaranteed contracts with best-in-class vendors.
- Monthly consolidated financial reporting.
- Providing consulting services as needed to effectively design plans and to deal with compliance, and financial projections.
- Soliciting competitive quotes regularly for all service providers.



INQUIRY 6—EXECUTIVE PERSPECTIVE ON AHP ADMINISTRATIVE COST ADVANTAGE

Table 6 paraphrases the opinions of the executives participating in the study relative to the administrative cost advantage of AHPs and the manner in which this advantage is achieved. The statements define the key advantages as: expert knowledge of the executives concerning appropriate administrative cost ratios (ability to create and measure internal benchmarks), effective use of surpluses to stabilize the operating environment, and economies of scale for negotiating with vendors. Of particular note is the final comment in which the executive emphatically states the fact of his AHP's advantage.

TABLE 6
KEY ELEMENTS OF AHP EXECUTIVES' PERSPECTIVE ON THE ADVANTAGES OF AHPs

Creation of a "single-employer profile" through centralized operational services, e.g., enrollment, renewals, and claim advocacy, and a single point for strategic negotiations. This profile reduces redundancy, streamlines responses, improves efficiency, and reduces administrative costs.

[Our] plan offers unique cash flow advantages that allow us to weather potential bad claims experience and take advantage of surpluses generated from good claims experiences. Over time we avoid the adverse renewal underwriting of Fully Insured plans and elude the spikes in claim experiences of Self-Funded plans.

Representing a relatively homogenous group of individual companies with broad geographic reach, the association has the ability to present a clear understanding of the risk characteristics of the population and offer a centralized sales, promotion, and enrollment operation.

The primary advantage is for the executive to have a good perspective on what an appropriate expense ratio should be and then to engage in effective negotiations that maintain that appropriate ratio.

Our administrative costs are significantly lower than those charged by insurance companies who are selling group health insurance to the employer community.

INQUIRY 7—EXECUTIVE PERSPECTIVE ON THE COMPETITIVE DYNAMICS OF THE HEALTH INSURANCE MARKET

Table 7 offers the summary comments of the executives represented in the study concerning the health insurance market. The key points presented in Table 7 are:

- The presence of AHPs increases competition and thereby lowers health insurance costs for all employers.
- AHPs offer significant cost savings to small businesses.
- Strong Boards of Directors and independent auditors permit AHPs to overcome negative marketing by for-profit insurers.
- AHPs can use earned surpluses as a major tool for controlling health insurance costs.

TABLE 7

AHP EXECUTIVES' PERSPECTIVE ON THE HEALTH INSURANCE MARKET

For-profit health insurers often present AHPs in a negative light, emphasizing bad behavior of defunct fly-by-night associations. Well-managed associations with Board of Director leadership and independent auditors recognize the advantages of collective action. For our members, we offer more robust plans at lower premiums than for-profit insurers.

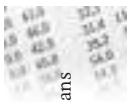
For an AHP, the primary stakeholders are the members compared with stockholders of for-profit insurers. In an AHP, financial surpluses may be either retained by the association to mitigate the effects of higher-than expected claim activity or for future premium reductions. The use of surpluses for member benefit is something that non-AHP medical insurers do not offer frequently and almost never offer to smaller employers.

The market for medical insurance should improve with AHP legislation by increasing the options available to employers. The increased opportunities will permit the lowering of overall costs to employers.

The renewal of AHP opportunities will increase the options that our members have regarding providing health benefits to employees. These increased opportunities will help to mitigate the health insurance oligopoly that tends to drive premium costs in the market. Association Health Plans offer real advantages to smaller employers who will have access to broader and less expensive benefit options than are currently available.

The expansion of the market of health insurance options available to “birds of a feather” will tend to reduce the overall cost of such insurance.

Without AHP legislation, existing self-funded AHPs will continue to be strangled by individual state insurance department regulation and state taxation efforts that will eventually result in the obliteration of such plans. Without the continued existence of these AHPs and the formation of new AHPs, competition will be stifled in the group health insurance marketplace and the costs to employers for group coverage will continue to escalate to the point that many will no longer be able to provide coverage to their employees and the ranks of the uninsured will continue to increase.



CONCLUSIONS

1. The administrative costs of AHPs are lower, on average, than those achieved by other small health plans, for-profit Medicaid plans, and not-for-profit Medicaid plans.
2. The lower administrative costs of AHPs have been achieved by three factors: 1) marketing expenses for AHPs are lower because of the focused-association-member market. In other words, potential customers have made the threshold decision of brand acceptance through association membership; 2) skillful outsourcing of administrative functions to take advantage of variable-pricing motivations of vendors; and 3) plan participants, that is to say, association members, are the primary stakeholders of the AHPs, thus operating surpluses accrue to their benefit for mitigating unexpected claim demand and other cost factors.
3. The administrative costs of AHPs, as a percent of premium revenue, have tended to decline on a year-to-year basis. This is illustrative of effective cost management, inasmuch as, administrative costs are declining on an absolute basis or not increasing at the same rate as premiums. The data suggest the effective management of administrative costs is sustainable over the long term.
4. The presence of AHPs in the health-insurance marketplace increases competition and may contribute to the containment of the cost of employee-health benefits

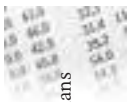


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APPENDIX I—DETAILS OF THE STUDY METHODOLOGY

RESEARCH DESIGN

The approach or research design undertaken in the study is case analysis. Case analysis is the process of conducting in-depth interviews with executives and the review of internal documents to obtain detailed knowledge of strategies and operating outcomes. Case analysis leads to inductive reasoning—developing postulations applicable to a larger population from detailed analysis of a small sample. A prerequisite for case analysis is the willing participation of organizations, that is to say, “cases.” The selection of cases is a purposeful activity, best undertaken by a person with expert knowledge of the population of organizations from which cases are solicited. Case selection involves seeking organizations willing to give the case researcher unfettered access to appropriate information in the form of personal interviews and confirming documentation.

A generally accepted alternative to case analysis is survey research. In survey research the researcher devises a data collection instrument and administers it to a sample of the population. Data collected in this manner suffer from at least three deficiencies: 1) the sample (respondents) is self-selected, 2) the veracity of the data is indeterminable, and 3) the confirming documentation is difficult, and frequently impossible, to obtain. Survey research leads to deductive reasoning—the development of theories of the attributes of a population by extrapolating the characteristics of the sample to the population. Survey research is not as robust as case analysis for achieving the objective of this study—gaining an understanding of the facts of administrative costs of AHPs and the methods of administrative cost control and reduction. Case analysis is particularly adept at delving into the operational characteristics and policies associated with management decisions. For this reason, it is fully appropriate that case analysis was chosen for this study.

PARTICIPANTS IN THE STUDY

Five membership organizations were the subjects of this study. While not all have requested anonymity, at least one has made this request, and in deference to preserving the propriety of privileged information, the names of the participating organizations will not be revealed in this report. However, the names are well known to the sponsor of the study. Each of the organizations either has an active AHP or had an AHP in the recent past.

RESEARCH PROCESS

The NFIB Research Foundation identified those organizations that consented to participate in the study and provided the researcher with contact information. An introductory letter to each participant was delivered via electronic mail (a copy of the letter is shown in Figure 5). With the exception of one subject, the researcher conducted an interview of the executive responsi-



ble for AHP activities in each participant. The one exception, due to irresolvable scheduling conflicts preventing a face-to-face meeting, was handled through several telephone conversations and a set of written information requests. The documentation obtained was consistent with that obtained from the personal interviews.

FIGURE 5
INTRODUCTORY LETTER SENT TO STUDY PARTICIPANTS

Dear

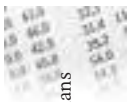
As you may know from communication with Duane Musser, I have been retained by the National Federation of Independent Business (NFIB), to study the administrative cost savings accruing to Association Health Plans (AHPs). To this end, I would like to schedule a meeting with you in the next few weeks for the purpose of gaining an understanding of the administrative costs of your AHP.

My preference would be a Monday or Tuesday meeting. The following dates are available: [dates supplied] If either of these dates is inconvenient, please propose alternative dates. I believe we can accomplish my objectives in one business day or less, with the time equally divided between face-to-face interviews and document review.

Please accept my thank you for your time in advance of my visit. I look forward to meeting you and working with you on this project.

Warm regards,
Andy Rucks

To achieve the objectives of the study, administrative costs were defined in the form of a model and from this model, seven lines of inquiry were pursued. A model for defining administrative costs was needed because, although similar, the transactional accounting practices of each participant varied sufficiently to make comparisons of administrative costs less meaningful than with a common definition. The Lines of Inquiry guided the collection of data and the presentation of findings.



APPENDIX 2—ADMINISTRATIVE COST MODEL

For consistency and simplicity, administrative costs were defined by the following Administrative Cost Model:

$$\text{Administrative Costs} = \text{Premium Receipts} - \text{Claim Payments} - \text{Surplus}$$

The definition of administrative costs is a rearrangement and expansion of the elements of the standard accounting organization of an income statement. Generally accepted accounting practices construct a Statement of Activity in the following manner:

Revenue
Less Expenses
Excess (Deficit) of Revenues over Expenses

For purposes of this study the revenues of interest are those associated with premium payments by participants in AHPs. In other words, the revenues of interest are those from operating the AHP. The Administrative Cost Model uses the term **Premium Receipts** to represent AHP operating revenue. Other types of revenue, such as gains or losses from investment activity, are excluded from the defining model of this study. They are considered “non-operating” revenue and would be treated “below the line.” Expenses of interest are of two types: 1) those for “benefit” payments, either claim payments or insurance premium payments to third parties for insurance products that pay additional benefits, but are not paid to beneficiaries directly by the AHP; and 2) those “other” or overhead expenses associated with the management and operation of the AHP. This study combines claim payments and AHP-paid insurance premiums in the **Claim Payments** component of the Administrative Cost Model. The term **Surplus** in the Administrative Cost Model is the “Excess (Deficit) of Revenues over Expenses” defined in the Statement of Activity equation. In order to express **administrative costs** as expansively as possible, the Administrative Cost Model defines them as a derivative by subtracting **Claim Payments** and **Surplus** from **Premium Receipts**.

APPENDIX 3—CASE-BY-CASE FINDINGS

CASE I

INQUIRY 1—ADMINISTRATIVE COSTS

For Case I, only one annual fiscal period was available for disclosure. The data for the Administrative Cost Model are shown in Table 8.

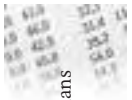
TABLE 8
ADMINISTRATIVE COST MODEL FOR CASE I
(expressed as percent of Premium Receipts)

Fiscal Period	Administrative Costs	Premium Receipts	Claim Payments	Surplus
I	8.3	100.0	73.0	18.7

INQUIRY 2—FUNCTION LOCUS

TABLE 9
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE I

Administrative Function	In-House	Outsourced
Bookkeeping	✓	
Accounting Services		✓
Audit		✓
Actuarial Services		✓
Case Management		✓
Claims Adjudication		✓
Consulting Services		✓
Customer Service	✓	✓
Enrollment	✓	
Investment Management		✓
Regulatory Compliance		✓
Renewals	✓	
Sales and Marketing	✓	



INQUIRY 3—BRIEF HISTORY OF THE AHP

The Association has provided Employee Benefit Group Plans since 1937. Today, more than 6,000 employees are insured in our programs. These plans provide coverage for:

- Group Term Life Insurance, Accidental Death and Dismemberment and various other Life Insurance products.
- Group Short-Term and Long-Term Disability.
- Group Medical including Preferred Provider Plans (PPOs) and Health Maintenance Plans (HMOs).
- Dental, Prescription Drug and Vision Plans.
- Group Dental, Prescription Drug, Vision and Executive Reimbursement Plans.
- Specific and Aggregate Stop Loss Plans.

Association members with more than 100 employees are currently eligible for our Separately Handled Program. This program allows an individual member to customize its plan design and remain experience rated while taking advantage of the Association’s mass purchasing power and administrative ease. In 2000, the fully-pooled program for members with fewer than 100 employees was combined with the program for employers with 100 to 200 employees to form a program for employers with fewer than 200 employees. Should market conditions including the regulatory environment favorably change thereby permitting our re-entry into this market, we will advise the membership.

INQUIRY 4—DEMOGRAPHICS

TABLE 10
KEY DEMOGRAPHIC PROFILE FOR CASE I

Parameter	Value
Number of employers enrolled	75
Largest number of employees with medical coverage	2,033
Smallest number of employees with medical coverage	55
Average number of employees with medical coverage	80
Covered lives—medical	15,000

INQUIRY 5—ACTIONS TO EFFECTIVELY MANAGE ADMINISTRATIVE COSTS

- Consolidation of billings from multiple vendors.
- Electronic maintenance and distribution of eligibility lists to vendors.
- Monthly consolidated financial reporting.
- Contract negotiations with vendors.
- Centralized regulatory filing.
- Providing consulting services as needed to effectively design plans and to deal with compliance, and financial projections.
- Group purchasing power provides economies of scale resulting in lower administrative cost and long-term guaranteed contracts with best-in-class vendors.

INQUIRY 6—EXECUTIVE PERSPECTIVE ON AHP ADMINISTRATIVE COST ADVANTAGE

The primary advantage of AHPs, especially for groups of smaller businesses, is the creation of a “single-employer profile.” This is achieved by offering centralized operational services such as enrollment, renewals, and claim advocacy and a single point for strategic negotiations. All of these efforts reduce redundancy within the association, streamline responses, improve efficiency, and reduce administrative costs.

Most importantly, our plan offers unique cash flow advantages that are realized through our medical, pharmacy and dental plans which allow for you to weather potential bad claims experience and take advantage of surpluses generated during good claims experience period while paying an annual fixed premium rate. Over time you will avoid adverse renewal underwriting from Fully Insured plans, and elude the spikes in claim fluctuation experienced under Self-Funded plans.

INQUIRY 7—EXECUTIVE PERSPECTIVE ON THE COMPETITIVE DYNAMICS OF THE HEALTH INSURANCE MARKET

For-profit health insurers often present associations in a negative light, emphasizing some less than ethical behaviors of fly-by-night associations. However, members of well-structured and well-managed associations that offer strong Board of Director leadership, and independent auditors, recognize the advantages of collective action. We believe that for our members, we can offer more robust plans at lower premiums than for-profit insurers. An additional advantage is that any financial surpluses that accrue to the association may be either retained by the association to mitigate the effects of higher-than-expected claim activity or be returned as premium rebates. The use of surpluses for member benefit is something that non-AHP medical insurers do not offer frequently and almost never offer to smaller employers.

CASE II

INQUIRY 1—ADMINISTRATIVE COST MODEL

TABLE II
ADMINISTRATIVE COST MODEL FOR CASE II
(expressed as percent of Premium Receipts)

Fiscal Period	Administrative Costs	Premium Receipts	Claim Payments	Surplus
1	9.8	100.0	107.4	-17.2
2	7.3	100.0	115.3	-22.6
3	6.0	100.0	97.1	-3.1
4	6.8	100.0	102.6	-9.4
5	5.2	100.0	91.2	3.6
6	4.6	100.0	89.3	6.1
7	5.1	100.0	97.7	-2.8



INQUIRY 2—FUNCTION LOCUS

TABLE 12
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE II

Administrative Function	In-House	Outsourced
Bookkeeping	✓	✓
Accounting Services		✓
Audit		✓
Actuarial Services		✓
Case Management		✓
Claims Adjudication		✓
Consulting Services	✓	✓
Customer Service	✓	✓
Enrollment		✓
Investment Management	✓	✓
Regulatory Compliance	✓	✓
Renewals		✓
Sales and Marketing	✓	

INQUIRY 3—BRIEF HISTORY OF THE AHP

Case II has had a long experience with an AHP, having begun such a program in 1957. The stability of the plan and the close association with its membership have created significant loyalty to the association's plan. A very favorable characteristic of Case II is its consistently diminishing administrative costs as a percent of premium receipts over the fiscal periods presented in Table 11. Another characteristic is that its long history has allowed it to achieve a significant reserve (an asset on the balance sheet), which produces investment income of sufficient magnitude to mitigate operating deficiencies.



INQUIRY 4—DEMOGRAPHICS

TABLE 13
KEY DEMOGRAPHIC PROFILE FOR CASE II

Parameter	Value
Number of employers enrolled	1,500
Largest number of employees with medical coverage	100
Smallest number of employees with medical coverage	1
Average number of employees with medical coverage	3
Covered lives—medical (average)	10,000

INQUIRY 5—ACTIONS TO EFFECTIVELY MANAGE ADMINISTRATIVE COSTS

- Marketing to a focused group of potential clients.
- Aggressive attention to all details of administration to manage costs.
- Frequent review of vendor financial performance.

INQUIRY 6—EXECUTIVE PERSPECTIVE ON AHP ADMINISTRATIVE COST ADVANTAGE

The executive responsible for managing the AHP for Case II has engaged in an aggressive campaign to control administrative expenses. Long-standing relationships with administrative service vendors has given the association an advantage of being a known quantity with regard to service consumption, thus holding year-to-year variations in pricing of services to a minimum.

INQUIRY 7—EXECUTIVE PERSPECTIVE ON THE COMPETITIVE DYNAMICS OF THE HEALTH INSURANCE MARKET

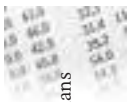
The market for medical insurance should improve with AHP legislation, by increasing the options available to employers. The increased opportunities will permit the lowering of overall costs to employers.

CASE III

INQUIRY 1—ADMINISTRATIVE COST MODEL

TABLE 14
ADMINISTRATIVE COST MODEL FOR CASE III
(expressed as percent of Premium Receipts)

Fiscal Period	Administrative Costs	Premium Receipts	Claim Payments	Surplus
1	8.1	100.0	94.2	-2.3
2	8.1	100.0	98.9	-7.0
3	8.0	100.0	90.1	1.9
4	8.0	100.0	90.1	1.9



INQUIRY 2—FUNCTION LOCUS

TABLE 15
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE III

Administrative Function	In-House	Outsourced
Bookkeeping	✓	
Accounting Services		✓
Audit		✓
Actuarial Services		✓
Case Management		✓
Claims Adjudication		✓
Consulting Services		✓
Customer Service		✓
Enrollment	✓	
Investment Management		✓
Regulatory Compliance		✓
Renewals	✓	
Sales and Marketing	✓	

INQUIRY 3—BRIEF HISTORY OF THE AHP

Case III had experience as an AHP for a period during the 1990s. In the late 90s, medical coverage was removed from the package of insurance offerings of the association due to “the complexity and inconsistency of state laws.” During the period that it was offered, medical coverage was very popular with annual growth averaging 8.7 percent, measured by covered lives, and 16.7 percent as measured by premiums. The gap between growth in covered lives and premiums reflects the general rise in health insurance premiums experienced in the economy during the period in which the AHP operated. As the information in Table 14 illustrates, the association operated at very low administrative costs.



INQUIRY 4—DEMOGRAPHICS

TABLE 16
KEY DEMOGRAPHIC PROFILE FOR CASE III

Parameter	Value
Number of employers enrolled	NA
Largest number of employees with medical coverage	NA
Smallest number of employees with medical coverage	NA
Average number of employees with medical coverage	NA
Covered lives—medical (average)	4,800

INQUIRY 5—ACTIONS TO EFFECTIVELY MANAGE ADMINISTRATIVE COSTS

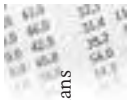
- Marketing to a focused group of potential clients.
- Control of promotional activities.
- Centralized billing.
- Contract negotiations.
- Centralized regulatory filing.

INQUIRY 6—EXECUTIVE PERSPECTIVE ON AHP ADMINISTRATIVE COST ADVANTAGE

Being the representative of a relatively homogenous group of individual companies and broad geographic reach, the association has the ability to present a clear understanding of the risk characteristics of the population and offer a centralized sales, promotion, and enrollment operation.

INQUIRY 7—EXECUTIVE PERSPECTIVE ON THE COMPETITIVE DYNAMICS OF THE HEALTH INSURANCE MARKET

The renewal of AHP opportunities will increase the options that our members have regarding providing health benefits to employees. These increased opportunities will help to mitigate the health insurance oligopoly that tends to drive premium costs in the market. Additionally, AHPs are real advantages to smaller employers who will have access to broader and less expensive benefit options than are currently available.



CASE IV

INQUIRY 1—ADMINISTRATIVE COST MODEL

TABLE 17
ADMINISTRATIVE COST MODEL FOR CASE IV
(expressed as percent of Premium Receipts)

Fiscal Period	Administrative Costs	Premium Receipts	Claim Payments	Surplus
1	9.6	100.0	NA	NA
2	9.4	100.0	NA	NA
3	9.1	100.0	NA	NA
4	8.2	100.0	NA	NA
5	10.7	100.0	NA	NA

Case IV asked that its specific ratios of claim payments and surplus to premium receipts not be disclosed inasmuch as the focus of the research is administrative costs. The researcher asserts that the administrative costs disclosed in Table 17 by Case IV are computed in a manner consistent with the Administrative Cost Model.

INQUIRY 2—FUNCTION LOCUS

TABLE 18
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE IV

Administrative Function	In-House	Outsourced
Bookkeeping		✓
Accounting Services		✓
Audit		✓
Actuarial Services		✓
Case Management		✓
Claims Adjudication		✓
Consulting Services		✓
Customer Service		✓
Enrollment		✓
Investment Management		✓

Table 18 continued on next page

TABLE 18 CONTINUED
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE IV

Administrative Function	In-House	Outsourced
Regulatory Compliance		✓
Renewals		✓
Sales and Marketing	✓	

INQUIRY 3—BRIEF HISTORY OF THE AHP

Case IV has operated an AHP since the early 1990s. Although it has changed in form over the years, it is a long-term major-based program of health insurance. The association’s size gives it considerable clout in negotiations and it uses an internally-executive-managed, carrier-based administrated system. The association’s size and breadth makes it attractive to carriers as they seek economies of scale in local provider networks. This helps to keep premiums under control. The association has experienced administrative costs within the range of 8 percent to 11 percent since the early 1990s.

INQUIRY 4—DEMOGRAPHICS

TABLE 19
KEY DEMOGRAPHIC PROFILE FOR CASE IV

Parameter	Value
Number of employers enrolled	1,500
Largest number of employees with medical coverage	~200
Smallest number of employees with medical coverage	~20
Average number of employees with medical coverage	30
Covered lives—medical (average)	45,000

INQUIRY 5—ACTIONS TO EFFECTIVELY MANAGE ADMINISTRATIVE COSTS

- Marketing to a focused group of potential clients.
- Control of promotional activities.
- Strong negotiating position with provider.
- Executive skill in monitoring expenses and negotiating expense ratios.

INQUIRY 6—EXECUTIVE PERSPECTIVE ON AHP ADMINISTRATIVE COST ADVANTAGE

The primary advantage is for the executive to have a good perspective on what an appropriate expense ratio should be and then to engage in effective negotiations that maintain that appropriate ratio.

INQUIRY 7—EXECUTIVE PERSPECTIVE ON THE COMPETITIVE DYNAMICS OF THE HEALTH INSURANCE MARKET

The expansion of the market of health insurance options available to “birds of a feather” will tend to reduce the overall cost of such insurance. While the potential reduction in premiums will likely cause administrative costs to increase as a percent of premium, the administrative costs should remain stable in real terms and will continue to be advantageous compared to non-AHP health insurers.



CASE V

INQUIRY 1—ADMINISTRATIVE COST MODEL

TABLE 20
ADMINISTRATIVE COST MODEL FOR CASE V
(expressed as percent of Premium Receipts)

Fiscal Period	Administrative Costs	Premium Receipts	Claim Payments	Surplus
1	7.7	100.0	94.9	-2.6
2	7.1	100.0	86.7	6.2
3	7.3	100.0	89.9	2.8
4	8.3	100.0	94.4	-3.2
5	8.1	100.0	96.3	-4.4
6	7.6	100.0	89.3	3.1
7	7.3	100.0	80.9	11.8
8	9.5	100.0	83.0	7.5

INQUIRY 2—FUNCTION LOCUS

TABLE 21
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE V

Administrative Function	In-House	Outsourced
Bookkeeping		✓
Accounting Services		✓
Audit		✓
Actuarial Services		✓
Case Management		✓
Claims Adjudication		✓
Consulting Services		✓
Customer Service	✓	
Enrollment	✓	

TABLE 21 CONTINUED
IN-HOUSE AND OUTSOURCED ADMINISTRATIVE FUNCTIONS FOR CASE V

Administrative Function	In-House	Outsourced
Investment Management		✓
Regulatory Compliance	✓	
Renewals	✓	
Sales and Marketing	✓	

INQUIRY 3—BRIEF HISTORY OF THE AHP

Case V's AHP started in 1960 and currently covers 5,100 employees and 4,359 dependents for a total of 9,459 covered lives. The total number of covered employees and dependents at the end of each of the previous fiscal years was 11,446 (2000), 11,184 (2001), 10,487 (2002), 8,393 (2003), and 8,901 (2004). Case V's AHP offers nine medical plans with many deductibles, office visit and coinsurance options totaling over 365 medical plan variations; three prescription drug programs; three dental plans; and 2 vision plans. Cost of coverage varies by plan design and geographic location.

INQUIRY 4—DEMOGRAPHICS

TABLE 22
KEY DEMOGRAPHIC PROFILE FOR CASE V

Parameter	Value
Number of employers enrolled	190
Largest number of employees with medical coverage	224
Smallest number of employees with medical coverage	2
Average number of employees with medical coverage	27
Covered lives—medical (average)	9,459

INQUIRY 5—ACTIONS TO EFFECTIVELY MANAGE ADMINISTRATIVE COSTS

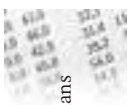
- Soliciting competitive quotes regularly for all service providers.

INQUIRY 6—EXECUTIVE PERSPECTIVE ON AHP ADMINISTRATIVE COST ADVANTAGE

Our AHP's administrative costs are significantly lower than those charged by insurance companies who are selling group health insurance to the employer community.

INQUIRY 7—EXECUTIVE PERSPECTIVE ON THE COMPETITIVE DYNAMICS OF THE HEALTH INSURANCE MARKET

Without AHP legislation, existing self-funded AHPs will continue to be strangled by individual state insurance department regulation and state taxation efforts that will eventually result in the obliteration of such plans. Without the continued existence of these AHPs and the formation of



new AHPs that could be created under the AHP legislation, if enacted, competition will be stifled in the group health insurance marketplace and the costs to employers for group coverage will continue to escalate to the point that many will no longer be able to provide coverage to their employees and the ranks of the uninsured will continue to increase.



The Author

Dr. Rucks, known as Andy, is Associate Professor in the Department of Health Care Organization and Policy at the University of Alabama at Birmingham, School of Public Health. Andy has almost 30 years of academic and business experience. Following the receipt of the Ph.D. degree in Management Science from the University of North Texas, he served four years in the U.S. Army participating in strategic decision analysis and the development of large-scale computer simulations. Following his military service he held business-school faculty positions at Auburn University, the University of Arkansas, the University of Alabama at Birmingham, and Samford University. At Samford, Andy managed the university's computer service department for four years and was Associate Dean of the School of Business for six years. Andy was also the founding director of the Community Banking School at Samford University. He developed a consulting portfolio of local, regional, and international businesses including BellSouth, AmSouth Bank, The Southern Company, Protective Life Corporation, and a number of small- and middle-market manufacturing and service companies. In 1997, Andy left academia at the request of one of his clients and became Chief Operating Officer of Sirco Systems, a medium-sized manufacturer of steel shipping containers with a world-wide market. Following the successful growth and sale of Sirco, Andy held operating executive positions in a middle-market conglomerate and later was a private-practice consultant. In 2004, Andy joined the School of Public Health at UAB as an Associate Professor where he teaches management, strategic planning, and process analysis and conducts research in public health preparedness for disasters. He is the author of two books, nine computer programming aids, and more than 50 articles and cases.

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