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Administrative expenses:

2010 commercial health insurance



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INTRODUCTION

Health insurance issuers report administrative expenses by category in the Supplemental Health Care Exhibit, a new exhibit for insurer annual statements in 2010. This report examines the following administrative expense categories for the large group, small group, and individual insured markets:

- Expenses for improving health care quality
- Claims adjustment expenses
- Agents and brokers fees and commissions
- Direct sales salaries and benefits expenses
- Other general and administrative expenses

The health insurance issuers included in the analyses presented in this report are all health insurance issuers in the United States that submitted Supplemental Health Care Exhibits with their 2010 annual statements and that had positive earned premium (including high-risk pools), incurred claims, and member months for 2010.

EXECUTIVE SUMMARY

Figure 1 presents a summary of average 2010 expenses by insured market on a per-member-per-month (PMPM) basis. Overall, the small group insured market had the highest administrative expenses at \$43.83 PMPM while the large group insured market has the lowest administrative expenses at \$30.84 PMPM, a difference of about 30%. Agents and brokers fees and commissions account for the majority of the difference in administrative expenses by market.¹ Other general and administrative expenses were the second-largest contributor to the difference in administrative expenses by market.

FIGURE 1: SUMMARY OF AVERAGE 2010 EXPENSES BY INSURED MARKET

EXPENSE CATEGORY	INSURED MARKET		
	LARGE GROUP	SMALL GROUP	INDIVIDUAL
Expenses for improving health care quality	\$2.36	\$2.35	\$1.40
Claims adjustment expenses	7.88	8.76	8.26
Agents and brokers fees and commissions	6.13	15.34	12.05
Direct sales salaries and benefits expenses	1.69	2.13	2.16
Other general and administrative expenses ²	12.78	15.25	16.44
Total administrative expenses	\$30.84	\$43.83	\$40.31

Although administrative expenses on a PMPM basis were higher for the small group market than the individual market, administrative expenses as a percent of premium were lower in the small group market than in the individual market, which is due to the higher premiums in the small group market. Administrative expenses averaged 19% of premium in the individual market, 13% of premium in the small group market, and 9% of premium in the large group market.

For most expense categories, the individual insured market showed greater variance in PMPM expenses between health insurance issuers than the large group and small group insured markets.

Each expense category is examined in the subsequent sections of this report to further understand the differences in administrative expenses among the markets as well as the distribution and variability of administrative expenses within each market.

¹ Many large groups compensate their agents, brokers, and other advisors directly. Direct compensation does not appear on health insurance issuer financial statements. The comparisons presented are of values on health insurance issuer financial statements, rather than total costs.

² Other general and administrative expenses includes the relatively small other taxes reported on Line 10.3 of Part 1 of the Supplemental Health Care Exhibit.

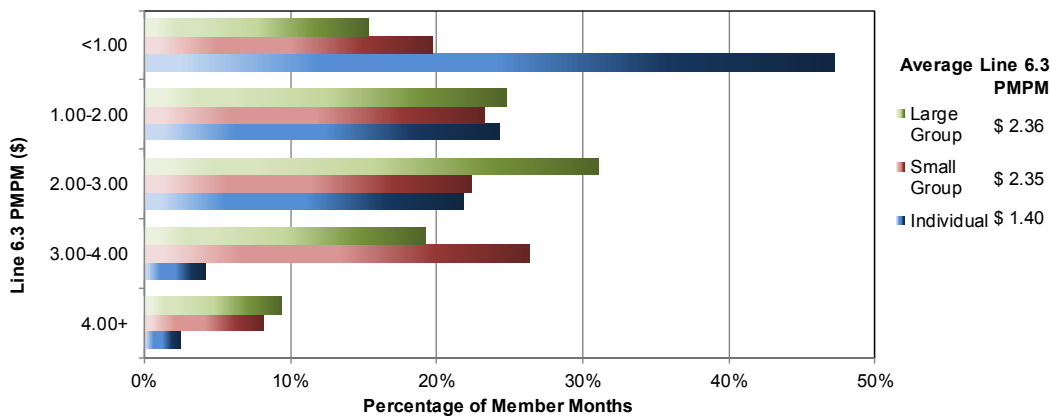
2010 EXPENSES FOR IMPROVING HEALTH CARE QUALITY

Expenses for improving health care quality were reported on Line 6.3 of Part 1 of the Supplemental Health Care Exhibit to 2010 annual statements. Examples of activities to improve health care quality include those designed to prevent hospital readmissions, improve patient safety, reduce medical errors, lower infection and mortality rates, and promote health activities. (The prescribed definition of expenses for activities to improve health care quality can be found in the instructions to the Supplemental Health Care Exhibit.) These expenses were identified separately from other general and administrative expenses in the Supplemental Health Care Exhibit because health insurance issuers are permitted to adjust for them in the medical loss ratio calculation prescribed for purposes of determining rebates under the federal minimum medical loss ratio requirements promulgated by the Patient Protection and Affordable Care Act (PPACA) of 2010. In another Milliman research paper,³ the adjustment was estimated to increase the 2010 medical loss ratio of health insurance issuers by an average of 0.7%.

Figure 2 presents the distribution of member months by 2010 expenses to improve health care quality for the large group, small group, and individual insured markets. Figure 2 indicates that approximately 91% of member months in the large group insured market and 92% of member months in the small group insured market had 2010 expenses to improve health care quality of less than \$4 PMPM. Average expenses to improve health care quality were very similar for the large group and small group insured markets, and there was a broad distribution of 2010 expenses to improve health care quality below the \$4 PMPM level.

The individual insured market showed average expenses to improve health care quality of \$1.40 PMPM, nearly 40% below that for the large group and small group insured markets. In the individual insured market, 98% of member months had 2010 expenses to improve health care quality of less than \$4 PMPM. The lower expenses to improve health care quality in the individual insured market may be reflective of a different product mix or the lower morbidity in this market in most states, which is due to medical underwriting.

FIGURE 2: DISTRIBUTION OF MEMBER MONTHS BY EXPENSES FOR IMPROVING HEALTH CARE QUALITY (LINE 6.3)



Note: State-specific information is available upon request.

³ Herbold, J. "2010 Commercial health insurance: Medical loss ratios and illustrative rebates." Milliman research report.

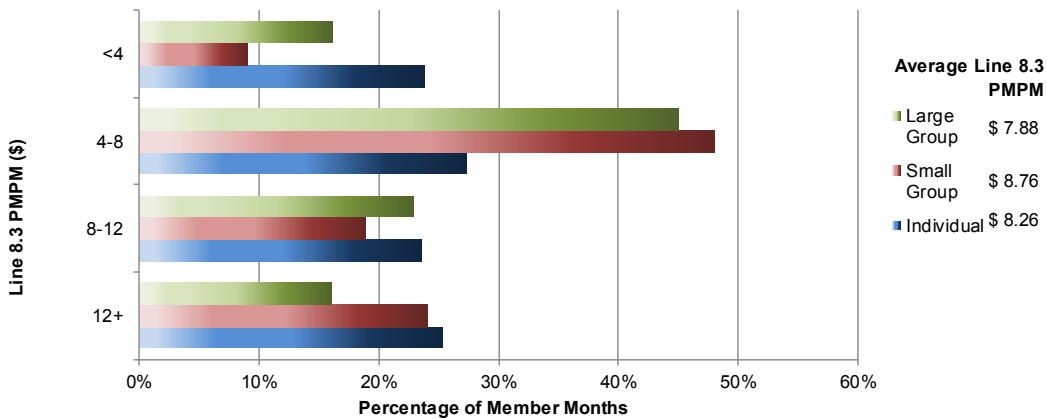
2010 CLAIMS ADJUSTMENT EXPENSES

Claims adjustment expenses were reported on Line 8.3 of Part 1 of the Supplemental Health Care Exhibit to 2010 annual statements. Claims adjustment expenses are expenses associated with the adjudication of claims. Figure 3 presents the distribution of member months by 2010 claims adjustment expenses for the large group, small group, and individual insured markets.

Figure 3 indicates that 45% of member months in the large group insured market and 48% of member months in the small group insured market had 2010 claims adjustment expenses between \$4 and \$8 PMPM, while the individual insured market had only 27% of member months in this PMPM range. Though the individual insured market showed a wider variance in 2010 claims adjustment expenses on a PMPM basis, the market average of \$8.26 PMPM was between the large group insured market average of \$7.88 PMPM and the small group insured market average of \$8.76 PMPM.

The market averages for 2010 claims adjustment expenses varied less between the markets than the market averages for other administrative expense categories. This is indicative of the greater consistency of the claims adjudication function among markets in comparison with the other administrative functions.

FIGURE 3: DISTRIBUTION OF MEMBER MONTHS BY CLAIMS ADJUSTMENT EXPENSES (LINE 8.3)



Note: State-specific information is available upon request.

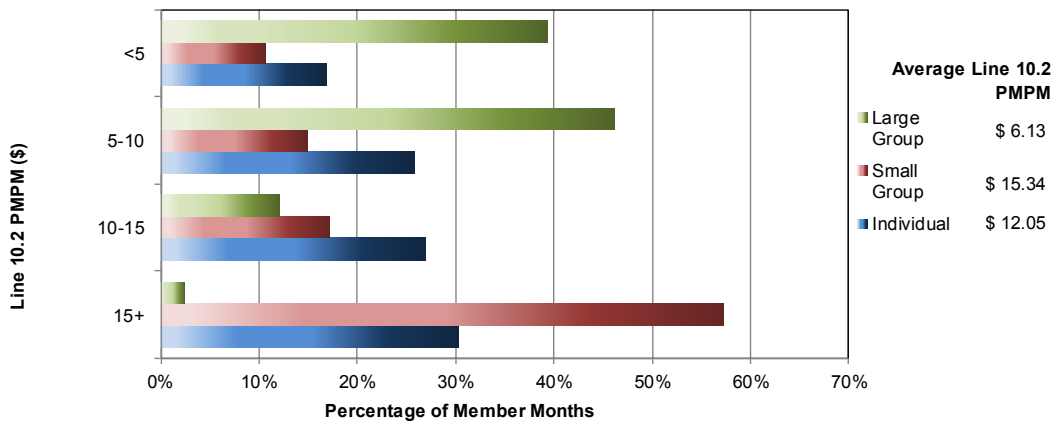
2010 AGENTS AND BROKERS FEES AND COMMISSIONS

Agents and brokers fees and commissions were reported on Line 10.2 of Part 1 of the Supplemental Health Care Exhibit to 2010 annual statements. Agents and brokers fees and commissions are external distribution expenses. Figure 4 presents the distribution of member months by 2010 agent and broker fees and commissions for the large group, small group, and individual insured markets.

Figure 4 indicates that 39% of member months in the large group insured market had 2010 agents and brokers fees and commissions less than \$5 PMPM and another 46% of member months had 2010 agents and brokers fees and commissions between \$5 and \$10 PMPM, for a total of 85% of member months in the large group insured market with 2010 agents and brokers fees and commissions less than \$10 PMPM. This is a notable contrast to the small group insured market where 57% of member months had 2010 agents and brokers fees and commissions greater than \$15 PMPM.

Though the individual insured market showed a wider variance in 2010 agents and brokers fees and commissions PMPM than the other markets, the market average of \$12.05 PMPM was between the large group insured market average of \$6.13 PMPM and the small group insured market average of \$15.34 PMPM. These significant differences between the market averages for agents and brokers fees and commissions account for the majority of the difference in total administrative expenses by market. In considering the differences across markets, it should be noted that the agents and brokers fees and commissions reported on health insurance issuer financial statements do not include the direct compensation paid by many large groups to their agents and brokers or other advisors. Many large groups also have employees that handle many of the functions handled by agents and brokers in the small group insured market. These additional expenses paid by large groups would need to be considered in a comparison of the total administrative expenses among the individual, small group, and large group insured markets.

FIGURE 4: DISTRIBUTION OF MEMBER MONTHS BY AGENT FEES AND COMMISSIONS (LINE 10.2)



Note: State-specific information is available upon request.

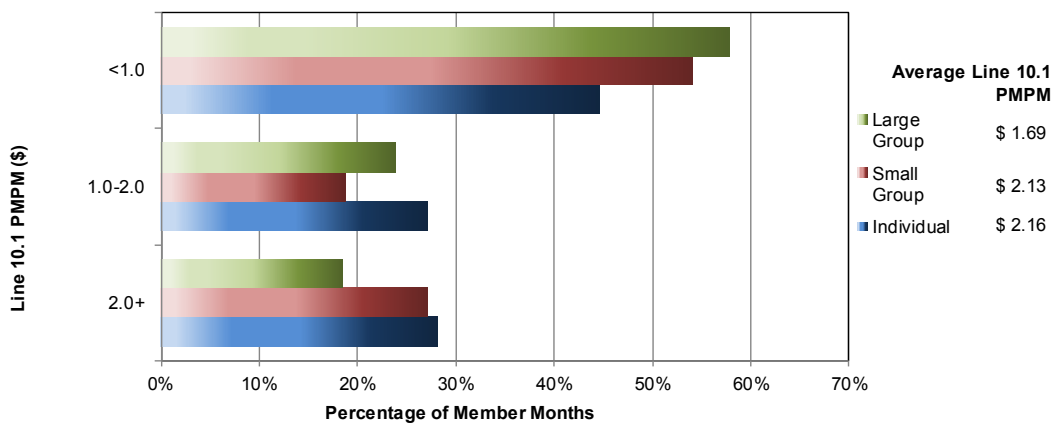
2010 DIRECT SALES SALARIES AND BENEFITS EXPENSES

Direct sales salaries and benefits expenses were reported on Line 10.1 of Part 1 of the Supplemental Health Care Exhibit to 2010 annual statements. Direct sales salaries and benefits expenses are internal distribution expenses. Figure 5 presents the distribution of member months by 2010 direct sales salaries and benefits expenses for the large group, small group, and individual insured markets.

Figure 5 indicates that 58% of member months in the large group insured market, 54% of member months in the small group insured market, and 45% of member months in the individual insured market had direct sales salaries and benefits expenses less than \$1 PMPM. The distributions were generally similar across the markets.

The large group insured market average of \$1.69 PMPM for direct sales salaries and benefits expenses was about 20% less than the small group and individual insured market averages. On a PMPM basis this is a small contribution to the difference in total administrative expenses between the markets.

FIGURE 5: DISTRIBUTION OF MEMBER MONTHS BY DIRECT SALES SALARIES AND BENEFITS (LINE 10.1)

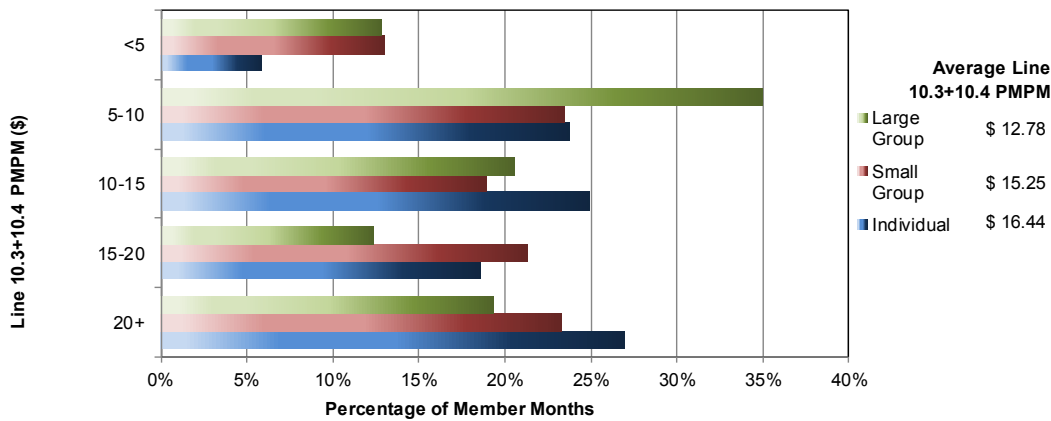


2010 OTHER GENERAL AND ADMINISTRATIVE EXPENSES

Other general and administrative expenses are administrative expenses not reported in another administrative expense category. Other general and administrative expenses were reported on Line 10.4 of Part 1 of the Supplemental Health Care Exhibit to 2010 annual statements. Note that this analysis includes the relatively small other taxes on Line 10.3 of Part 1 of the Supplemental Health Care Exhibit with the other general and administrative expenses. Figure 6 presents the distribution of member months by 2010 other general and administrative expenses for the large group, small group, and individual insured markets.

Figure 6 indicates a wide distribution of other general and administrative expenses on a PMPM basis for all three markets. Average other general and administrative expenses were lowest for the large group insured market at \$12.78 PMPM and highest for the individual insured market at \$16.44 PMPM, a difference of about 20%. The lower other general and administrative expenses for the large group insured market reflects some economies of scale from larger groups. On a PMPM basis, other general and administrative expenses were the second-largest contributor, after agents and brokers fees and commissions, to the difference in total administrative expenses among the markets.

FIGURE 6: DISTRIBUTION OF MEMBER MONTHS BY OTHER GENERAL AND ADMINISTRATIVE EXPENSES (LINE 10.3+10.4)



Note: State-specific information is available upon request.

CONCLUDING REMARKS

The Supplemental Health Care Exhibit and its instructions were not available until late in 2010, requiring many health insurance issuers to estimate the allocation of their administrative expenses among the categories required in the Supplemental Health Care Exhibit. Analysis of the information in the Supplemental Health Care Exhibit to annual statements for 2011 and later will provide valuable insight as health insurance issuers refine their accounting of administrative expenses and make changes in their operations in reaction to market conditions and health care reform legislation.

LIMITATIONS

This analysis has relied on data and other information from the Supplemental Health Care Exhibit of 2010 annual statements of health insurance issuers. This information was obtained using Insurance Analyst PRO from Highline Data in June 2011. The data and other information has not been audited or verified but a limited review was performed for reasonableness and consistency. If the underlying data or information is inaccurate or incomplete, the results of this analysis may likewise be inaccurate or incomplete. Values from Supplemental Health Care Exhibits submitted by health insurance issuers after the data and other information was obtained from the Highline Data in June 2011 are not included in this report.

The views expressed in this report are made by the author of this report and do not represent the opinions of Milliman, Inc. Other Milliman consultants may hold different views.

ACKNOWLEDGEMENT

Jason Howard, ASA, MAAA, created the database of data and other information used to support the analyses in this report. Andrew Naugle, MBA, peer reviewed this report. The author appreciates their assistance.

QUALIFICATIONS

Guidelines issued by the American Academy of Actuaries require actuaries to include their professional qualifications in all actuarial communications. The author is a member of the American Academy of Actuaries, and meets the qualification standards for performing the analyses in this report.

APPENDIX: METHODOLOGY

Values from the Supplemental Health Care Exhibit of 2010 annual statements of health insurance issuers were obtained using Insurance Analyst PRO from Highline Data in June 2011. Values were collected from health; life, accident and health; and property and casualty 2010 annual statements. Values were stored in a database to support the summaries and analyses presented in this report.

The health insurance issuers included in the analyses presented in this report are all health insurance issuers in the United States that submitted Supplemental Health Care Exhibits with their 2010 annual statements and that had positive earned premium including high-risk pools from Line 1.4, incurred claims from Line 5.0, and member months from Other Indicators Line 4 of Part 1 of the Supplemental Health Care Exhibit for 2010. Figure 7 below presents a summary of 2010 member months and earned premiums including high-risk pools from the Supplemental Health Care Exhibit of 2010 annual statements of health insurance issuers used in the analyses in this report.

FIGURE 7: SUMMARY OF 2010 MEMBER MONTHS AND EARNED PREMIUMS

INSURED MARKET	2010 MEMBER MONTHS (IN MILLIONS)	2010 EARNED PREMIUM INCLUDING HIGH RISK POOLS (IN MILLIONS)
Large Group	478.0	159,311.6
Small Group	216.7	72,259.5
Individual	121.7	25,672.5
Total	816.3	257,243.5

Note: Values have been rounded. State-specific information is available upon request.