SMALL BUSINESS
RESEARCH SUMMARY

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Study of the Administrative Costs and Actuarial Values of Small Health Plans

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Purpose

Efforts to extend full health care coverage in the United States have focused on small businesses. Small businesses, on average, have more tenuous finances and less market clout than large businesses. Small businesses also often have employees that obtain health care coverage through another family member. For these reasons, small businesses offer health care coverage to a lower percentage of their work force and are a different type of customer than large firms.

This study looks at the non-care costs to insurers of small firm health policies and compares the value of the health care products that small and large firms buy. This information will better enable policymakers to understand small businesses as a consumer of health care coverage.

Overall Findings

The prices that small and large firms paid for health insurance and the value of the products purchased are more similar than expected. However, insurers of small health plans have higher administrative expenses than those who insure larger companies. Sales, underwriting, and operating expenses are all higher for small health plans. Considering these expenses, it is unclear why small firms' insurance prices appear to be similar to what large firms pay. At least part of the explanation may be that small firms received slightly less generous health insurance benefits, according to calculations of actuarial value.

Highlights

• Administrative expenses for insurers of small health plans make up 25 to 27 percent of premiums and 33 to 37 percent of claims. This compares with about 5 to 11 percent of claims for large companies' self-insured plans.

• For small business insurers, administrative costs break out as follows: The cost of commissions makes up 4 to 11 percent of premiums, taxes and fees make up 2 to 3 percent, general expenses make up 10 to 11 percent, and profits make up 4 to 5 percent.

• Legislation has been proposed to exempt association health plans (AHPs) from rate regulation and state benefit mandates. The researchers' analysis indicates that AHPs have the potential to lower insurance premiums for small firms by freeing employers from direct and indirect state taxation, some mandated benefits, and the cost of compliance with multiple state regulations.

• Commission rates vary widely. The researchers studied two states: West Virginia, where commissions average 4 percent of premiums, and Colorado, where they average 11 percent.

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• The actuarial value of a health plan is a measure of the plan's generosity; that is, it measures how much of the health expenditures of a standard employed population would be paid by the health plan. The higher the actuarial value, the greater the benefits per dollar. Actuarial value ranged from 78 percent of expected costs for firms with one to nine employees to 83 percent of expected costs for firms with 1,000 or more employees.

• While there is only a small difference in actuarial value between the plans purchased by small and large businesses, firm size is a major factor in the difference.

• Small and large firm premiums are similar overall, but some data sources show conflicting price trends across firm sizes for individual and family coverage.

• All data sources show increases in health care premiums in recent years for both small and large firms. Data from Kaiser/HRET Surveys found that increases have been higher for small firms.

• Reports from state insurance departments and insurance executives offered the researchers some insight into the recent substantial consolidation in the small group health insurance market. A variety of factors, including state laws enacted in the 1990s, have made it very difficult for most insurers without large, concentrated market shares to operate profitably; many insurers have left the market. The resulting concentration and reduced competition mean small employers have fewer choices and higher costs.

Scope and Methodology

In introducing the subject matter, the researchers discuss basic results from various health information sources. To conduct the research, they relied upon publicly available information in the 1997 Robert Wood Johnson Survey (RWJS) and they sought out accounting information from small group insurers in Colorado and West Virginia. These two states were chosen because of the availability of data. The administrative expenses for 19 insurers were broken down and discussed. A model was created using RWJS data to determine the actuarial value of policies. The report focuses on the time period 1997 to 2002, depending upon the availability of data.

Ordering Information

The full text of this report and summaries of other studies performed under contract to the U.S. Small Business Administration's Office of Advocacy are available on the Internet at ***www.sba.gov/advo/research***.

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