Advisory Group on Administrative Expenses

Report to the Minnesota Legislature 2012

Minnesota Department of Health

Date: February 15, 2012

MINNESOTA MDH DEPARTMENT of HEALTH

Commissioner's Office
625 Robert St. N.
P.O. Box 64975
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Advisory Group on Administrative Expenses

Date: February 15, 2012

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As requested by Minnesota Statutes 3.197: This report cost approximately $17,611 to prepare, including staff time, printing and mailing expenses.

MINNESOTA
MDH
DEPARTMENT OF HEALTH

Protecting, maintaining and improving the health of all Minnesotans

February 15, 2012

The Honorable David Hann
Chair
Health and Human Services
Minnesota Senate
Room 328 State Capitol
75 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155-1606

The Honorable Jim Abeler
Chair
Health and Human Services Finance
Minnesota House of Representatives
479 State Office Building
100 Rev. Dr. Martin Luther King Jr.
St. Paul, MN 55155

The Honorable Steve Gottwalt
Chair
Health and Human Services Reform
Minnesota House of Representatives
485 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

To the Honorable Chairs:

In 2010 the Legislature adopted Minnesota Statutes, section 62D.31 establishing the Advisory Group on Administrative Expenses. The purpose of this Advisory Group was to make recommendations on the development of consistent guidelines and reporting requirements, including development of a reporting template, for health maintenance organizations and county-based purchasing plans that participate in publicly funded programs. Membership of the Advisory Group included representatives of the Departments of Health, Human Services and Commerce, health maintenance organizations and county based purchasers. The Department of Health contracted with Deloitte Consulting LLP to provide expertise in the development of guidelines and a reporting template.

This Report contains two recommendations of the Advisory Group. HMOs and CBPs use the NAIC reporting formats in submitting their quarterly and annual financial statements to the Department of Health. The first recommendation is that the 25 categories of administrative expenses found in the National Association of Insurance Commissioners (NAIC) health blank be grouped into seven reporting categories. This will help provide consistency between plans in the way the various administrative expenses are identified and reported. It will also provide a framework for consistently allocating expenses across each company's various lines of business, both publicly funded and commercial.

The second recommendation is that a new Excel spreadsheet be adopted as part of the annual financial reports filed by health maintenance organizations and county based purchasers. The purpose of this new form is to expand the categories of administrative expenses and investment income reported on the Statement of Revenue, Expenses and Net Income (Supplemental Report #1) submitted as part of the annual financial statement. The Work Group believes using the new template will enable each company to allocate administrative expenses to specific lines of business or products to the greatest extent possible. It also will enable allocation of investment income based on cumulative net income over time by business line or product.

If you have questions or would like to discuss this in more detail, please contact Irene Goldman, Manager, Managed Care Systems, at 651-201-5166 or at Irene.Goldman@state.mn.us.

Sincerely,

Edward P. Ehlinger, M.D., M.S.P.H.
Commissioner
P.O. Box 64975
St. Paul, Minnesota 55164-0975

Executive summary

This report is submitted by the Department of Health on behalf of the Advisory Group on Administrative Expenses and an outside consultant Deloitte Consulting LLP. The Legislature directed the Advisory Group on Administrative Expenses to recommend consistent guidelines and reporting requirements, including a reporting template, for health maintenance organizations (HMOs) and county-based purchasers (CBPs) that participate in publicly funded programs. The purpose of the guidelines and reporting template is to have consistent allocation of administrative expenses and investment income by Minnesota health plans that participate in the state managed health care program. This will enable tracking and comparison of administrative expenses over time and between health plans by product line and will help ensure that the publicly funded programs are not subsidizing commercially funded products.

This report recommends that the 25 categories of administrative expenses found in the National Association of Insurance Commissioners (NAIC) health blank be grouped into seven reporting categories as follows:

Employee benefit expenses: salaries, wages and benefits

Sales expenses: commissions, marketing and advertising; cost of sales-related materials, postage, telephone and printing materials

General business and office type expenses: rent; non-sales related postage, express delivery and telephone; non-sales related printing and office supplies; taxes (excluding state premium taxes and assessments), licenses and fees; traveling expenses; insurance, except on real estate; collection and bank service charges; group service and administration fees; real estate expenses; real estate taxes; equipment; occupancy, depreciation and amortization; cost of depreciation of EDP equipment and software

State premium taxes and assessments

Consulting and professional fees: legal fees and expenses; certifications and accreditation fees; auditing, actuarial and other consulting fees; board, bureaus and association fees

Outsourced services: EDP; claims and other services

Other expenses: investment expenses not included elsewhere; aggregate write-ins for expenses; reimbursements by uninsured plans; reimbursements from fiscal intermediaries.

The work group recommends that these seven categories of administrative expenses be used by all HMOs and CBPs when filing their annual and quarterly financial statements with the Department of Health. Use of these defined categories will help ensure consistency in reporting administrative expenses among all the HMOs and CBPs.

The work group recommends that HMOS and CBPs be required to file a new form specific to reporting administrative expenses. This new form is in the format of an Excel spreadsheet and is referred to as Supplemental Report #1A. It enables the HMOs and CBPs to report seven categories of administrative expenses by product line. It will allow more accurate review of how administrative expenses are allocated by each HMO and CBP across their various lines of business. This new reporting template is in the same format as Supplemental Report #1 and is not expected to be unduly burdensome to the HMOs and CBPs.

Background

In February 2008, the Minnesota Office of the Legislative Auditor released a report on Financial Management of Health Care Programs. One of the findings was that "state agencies have conducted limited review of health plans' administrative spending for public programs, which totaled $200 million in 2006." One of the recommendations was that "DHS should increase its scrutiny of administrative spending by health plans serving Minnesota's public programs. The Legislature should require the departments of Health and Commerce to develop procedures for more detailed reviews of the "reasonableness" of health plan expenditures." The Auditor recommended that the Department of Health develop guidelines to ensure that health plans have consistent procedures for allocating administrative expenses and investment income across their lines of business (commercial and public) and across individual public programs (e.g. medical assistance, MinnesotaCare). In the 2008 session the Legislature directed the Commissioner of Health to develop and report guidelines to ensure that health plans, including CBPs, have consistent procedures for allocating administrative expenses and investment income across their commercial and public lines of business and across individual public programs. This report was due by January 15, 2009.

The Department of Health contracted with Deloitte Consulting LLP ("Deloitte Consulting") to research these issues and provide a written report of its findings and recommendations. A copy of this report is attached. Deloitte Consulting found a wide variation in the methods used by six health plans and three CBPs to allocate administrative expenses. All of the methods were determined to be reasonable. While some plans used similar methods, no two plans used the same exact method. Methods included direct allocation by product, member months, revenue, claim counts, square footage, and estimates of staff time and call center statistics.

The lack of consistency in reporting administrative expenses and investment income made it extremely difficult to compare the health plans to each other. It also made it difficult to determine if the reported administrative expenses were reasonable. To the extent health plans participate in the commercial market as well as the state public programs, it was not possible to determine if administrative expenses and investment income was being properly and fairly allocated among all of an HMO's lines of business.

Deloitte Consulting recommended direct allocation of administrative expenses to specific lines of business as the most accurate method. Expenses that cannot be directly allocated should then be allocated based on another method. Reducing the methods allowed would provide more consistency between plans. For reporting investment income, Deloitte Consulting advised allocation based on cumulative net/operating income over time by business/product line as the preferred option.

In the 2010 first special session, the Minnesota Legislature by statute required HMOs to allocate administrative expenses to specific lines of business or products when such information is available. Investment income must be reported based on cumulative net income over time by business lines or product. These new requirements are effective January 1, 2013. The Legislature also established the Advisory Group on Administrative Expenses to make recommendations on the development of consistent guidelines and reporting requirements including the development of a reporting template for consistent reporting of administrative expenses and investment income.

Project scope

There are two specific deliverables required of this report. One is to report recommendations, including any proposed legislation necessary to implement the recommendations, to the commissioner of health as well as key legislators. The second is to develop reporting templates to be used by HMOs and CBPs to report administrative expenses and investment income in a uniform and comparable way.

One issue that falls outside the scope of this report is the allocation of costs under the terms of a management agreement between an HMO and an affiliated organization. For example, an HMO may obtain administrative services under a contract with an affiliated insurance company. The insurance company provides administrative services for the HMO itself and perhaps additional affiliates. The insurance company charges the HMO and affiliates for these services which allocates for such items as legal, actuarial, executive, and other overhead. Ideally there would be a way to confirm that the allocation of these expenses between all the affiliates is fair and consistent. It clearly has an impact on the administrative expenses borne by the HMO. However, the work group determined that this issue does not fall within its jurisdiction of this work group.

Workgroup discussion and analysis

The Legislature identified the membership of the advisory work group to include representatives of state agencies, HMOs and CBPs. The first meeting of the work group was to be held by December 1, 2010.

In October 2010, the Department of Health contacted stakeholders and asked that they each designate one representative and one alternate to participate in the advisory work

group. Once the representatives were named, they were asked to attend the first work group meeting to be held on November 30, 2010. All stakeholders were represented at this meeting.

The work group discussed the mission as identified in the legislation: to facilitate more uniform reporting of administrative expenses and investment income attributed to the public programs so that meaningful comparisons can be made. The workgroup discussed the findings of the 2009 Deloitte Consulting report and the various methods currently used. A copy of the executive summary of this report is included. The workgroup further discussed the potential impact that the federal health reform law might have. Minnesota HMOs file their quarterly and annual financial statements with the NAIC. Minnesota CBPs follow the NAIC format when filing their quarterly and annual financial statements. It was explained to the work group that the NAIC was in the process of revising its reporting forms to accommodate some requirements of the federal Affordable Care Act (ACA). The revised forms were expected to be adopted by midyear 2011. The revised forms would include definitions of administrative expenses that might be useful for the purposes of the advisory work group. Rather than developing definitions of what is an administrative expense, it seemed prudent to see if the NAIC definition could be adopted. The work group was mindful that using a different definition of administrative expense could be confusing and make it harder to draw comparisons between plans.

The second meeting of the work group took place on November 18, 2011. All stakeholders were represented at the meeting. The members discussed the NAIC revised forms and definitions. The members focused on allocation of indirect expenses with the understanding that direct expenses are already allocated appropriately. The members concluded that it was crucial to look at the definitions of direct vs. indirect expenses provided by the NAIC to see if they make sense for purposes of this report.

The work group then discussed use of a reporting format specific to Minnesota. Currently the Department of Health requires HMOs and CBPs to file HMO Annual Supplemental Report #1 - a statement of revenue, expense and net income. They also must file the Health Plan Financial and Statistical Report (HPFSR). The work group discussed if the detailed information in the HPFSR might be consolidated and reported in Supplemental Report #1. Supplemental Report #1 is specific to Minnesota and the format of the report can be easily revised by the Department of Health. By comparison, the NAIC forms are used nationally and a state cannot make any changes to these forms.

The work group members were asked to submit written comments and suggestions to the Department of Health addressing the topics discussed at the November 18th meeting. A number of comments and suggestions were received by early December. At subsequent meetings, agency staff discussed the comments and suggestions and drafted a new reporting template for use by HMOs and CBPs for reporting administrative expenses to more clearly allocate across product lines. It is noted that use of this form does not in any way change the information reported to the NAIC by HMOs. A draft report was created and circulated to all members of the work group with a request for comments. All comments were considered in preparation of this final report to the Legislature.

Recommendations

The Legislature has determined that administrative expenses and investment income shall be reported by HMOs and CBPs by direct allocation to specific lines of business or products. In order to do this consistently, there must be agreement on what kinds of expenses should be classified as "administrative" expenses. The NAIC administrative expenses page, underwriting and investment exhibit Part 3, of the NAIC health blank, contains 25 categories of administrative expenses. All Minnesota HMOs and CBPs are familiar with this expense page.

The work group recommends that the 25 categories of administrative expenses found in the NAIC health blank be rolled up into seven reporting categories as follows:

Employee benefit expenses: salaries, wages and benefits

Sales expenses: commissions, marketing and advertising; cost of sales-related materials, postage, telephone and printing materials

General business and office type expenses: rent; non-sales related postage, express delivery and telephone; non-sales related printing and office supplies; taxes (excluding state premium taxes and assessments), licenses and fees; traveling expenses; insurance, except on real estate; collection and bank service charges; group service and administration fees; real estate expenses; real estate taxes; equipment; occupancy, depreciation and amortization; cost of depreciation of EDP equipment and software

State premium taxes and assessments

Consulting and professional fees: legal fees and expenses; certifications and accreditation fees; auditing, actuarial and other consulting fees; board, bureaus and association fees

Outsourced services: EDP; claims and other services

Other expenses: investment expenses not included elsewhere; aggregate write-ins for expenses; reimbursements by uninsured plans; reimbursements from fiscal intermediaries.

The work group recommends that these seven categories of administrative expenses be used by all HMOs and CBPs when filing their annual financial report with the Department of Health. Use of these defined categories will help ensure consistency in reporting administrative expenses among all the HMOs and CBPs.

The work group was tasked with development of a reporting template that will help ensure consistency in the allocation of administrative expenses by product line. One option identified was to revise Supplemental Report #1 statement of revenue, expenses

and net income (Report #1) filed by HMOs and CBPs annually. Administrative expenses are reported using Report #1. However the work group concluded that Report #1 does not provide enough specificity to ensure consistent reporting of administrative expenses.

Rather than revising Report #1, the work group recommends that HMOs and CBPs be required to file a new form specific to reporting administrative expenses. This new form is in the format of an Excel spreadsheet and is referred to as Supplemental Report #1A. It enables the HMOs and CBPs to report seven categories of administrative expenses by product line. It will allow more accurate review of how administrative expenses are allocated by each HMO and CBP across their various lines of business. This new reporting template is in the same format as Report #1 and is not expected to be unduly burdensome to the HMOs and CBPs. The information provided by Report #1A will be very valuable in determining that administrative expenses are fairly and properly allocated between an HMO's various lines of public and commercial business.

A copy of the proposed new Supplemental Report #1A is attached.

HMO Name

DRAFT

Minnesota Supplement Report #1A

14-Feb-12

REALLOCATION OF EXPENSES AND INVESTMENT INCOME

For the Year Ending December 31, 2012

Public Information, Minnesota Statutes § 62D.08

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
Line	Direct Non-Claim Expenses	Total	Non MN	Total MN	Commercial	M+C	Medicare	MSHO	SNBC MA	SNBC	PMAP	MNCare	Dental	Other	Admin
1	Employee benefit expenses	0		0											
2	Sales expenses	0		0											
3	General business/office expense	0		0											
4	State premium taxes and assessments	0		0											
5	Consulting and professional fees	0		0											
6	Outsourced services	0		0											
7	Other expenses	0		0											
8	Total Direct Expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
Line	Reallocated Indirect Non-Claim Expenses	Total	Non MN	Total MN	Commercial	M+C	Medicare	MSHO	SNBC MA	SNBC	PMAP	MNCare	Dental	Other	Admin
9	Employee benefit expenses	0		0											
10	Sales expenses	0		0											
11	General business/office expense	0		0											
12	State premium taxes and assessments	0		0											
13	Consulting and professional fees	0		0											
14	Outsourced services	0		0											
15	Other expenses	0		0											
16	Total Indirect Expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0

		1	2	3	4	5	6	7	8	9	10	11	12	13	14
Line	Direct plus Indirect Non-Claim Expenses	NAIC Total	Non MN	Total MN	Commercial	M+C	Medicare	MSHO	SNBC MA	SNBC	PMAP	MNCare	Dental	Other	Admin
17	Employee benefit expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0
18	Sales expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0
19	General business/office expense	0	0	0	0	0	0	0	0	0	0	0	0	0	0
20	State premium taxes and assessments	0	0	0	0	0	0	0	0	0	0	0	0	0	0
21	Consulting and professional fees	0	0	0	0	0	0	0	0	0	0	0	0	0	0
22	Outsourced services	0	0	0	0	0	0	0	0	0	0	0	0	0	0
23	Other expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0
24	Total Non-Claim Expenses = Sum of Lines 17 to 23	0	0	0	0	0	0	0	0	0	0	0	0	0	0
25	Claims Adjustment Expenses	0		0											
26	Revenues (Supp Report #1, Line 8)	0		0											
27	Incurred Claims (Supp Report #1, Line 18 + Line 22)	0		0											
28	Net Investment Gain/(Loss) (Allocated)	0		0											
29	Aggregate Write Ins for Other Income or (Expenses)	0		0											
30	Federal and Foreign Income Taxes Incurred	0		0											
31	Net Income = Lines 26+28+29-24-25-27-30	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Sec. 2. **[62D.31] ADVISORY GROUP ON ADMINISTRATIVE EXPENSES.**

Subdivision 1. **Establishment.** The Advisory Group on Administrative Expenses is established to make recommendations on the development of consistent guidelines and reporting requirements, including development of a reporting template, for health maintenance organizations and county-based purchasing plans that participate in publicly funded programs.

Subd. 2. **Membership.** The membership of the advisory group shall be comprised of the following, who serve at the pleasure of their appointing authority:

(1) the commissioner of health or the commissioner's designee;

(2) the commissioner of human services or the commissioner's designee;

(3) the commissioner of commerce or the commissioner's designee; and

(4) representatives of health maintenance organizations and county-based purchasers appointed by the commissioner of health.

Subd. 3. **Administration.** The commissioner of health shall convene the first meeting of the advisory group by December 1, 2010, and shall provide administrative support and staff. The commissioner of health may contract with a consultant to provide professional assistance and expertise to the advisory group.

Subd. 4. **Recommendations.** The Advisory Group on Administrative Expenses must report its recommendations, including any proposed legislation necessary to implement the recommendations, to the commissioner of health and to the chairs and ranking minority members of the legislative committees and divisions with jurisdiction over health policy and finance by February 15, 2012.

Subd. 5. **Expiration.** This section expires after submission of the report required under subdivision 4 or June 30, 2012, whichever is sooner.

Section 1. Minnesota Statutes 2008, section 62D.08, is amended by adding a subdivision to read:

Subd. 7. **Consistent administrative expenses and investment income reporting.** (a) Every health maintenance organization must directly allocate administrative expenses to specific lines of business or products when such information is available. Remaining expenses that cannot be directly allocated must be allocated based on other methods, as recommended by the Advisory Group on Administrative Expenses. Health maintenance organizations must submit this information, including administrative expenses for dental

services, using the reporting template provided by the commissioner of health.

(b) Every health maintenance organization must allocate investment income based on cumulative net income over time by business line or product and must submit this information, including investment income for dental services, using the reporting template provided by the commissioner of health.

EFFECTIVE DATE. This section is effective January 1, 2013.

Advisory Work Group on Administrative Expenses

Irene Goldman, Manager
Managed Care Systems Section
Minnesota Department of Health

Brian Hicks
CFO
South Country Health Alliance

Mark Hudson
Director of Purchasing and Service Delivery
Minnesota Department of Human Services

John Klein
CFO
PrimeWest Health System

Darcy Miner, Director
Compliance Monitoring Division
Minnesota Department of Health

Beth Monsrud
Senior Vice President and CFO
UCare Minnesota

Patrick Pechacek
Deloitte Consulting LLP

Julia Philips
Life and Health Actuary
Minnesota Department of Commerce

Mary Quist
Director, Corporate Finance
Medica Health Plans

Chris Schmidt
Deloitte Consulting LLP

Administrative Expenses and Investment Income for Health Plans and County-Based Purchasers: Guidelines and Recommendations

Report to the Minnesota Legislature 2009

Minnesota Department of Health

March 2009

MINNESOTA MDH DEPARTMENT OF HEALTH

Commissioner's Office
625 Robert St. N.
P.O. Box 64975
St. Paul, MN 55164-0975
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Administrative Expenses and Investment Income for Health Plans and County-Based Purchasers: Guidelines and Recommendations

Report to the Minnesota Legislature 2009

March 2009

For more information, contact:
Compliance Monitoring Division
Minnesota Department of Health
85 East 7th Place
P.O. Box 64882
St. Paul, MN 55164-0882

Phone: (651) 201-4301
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As requested by Minnesota Statute 3.197: This report cost approximately $90,056 to prepare, including staff time, printing and mailing expenses.

MINNESOTA MDH DEPARTMENT OF HEALTH

Protecting, maintaining and improving the health of all Minnesotans

March 3, 2009

The Honorable Linda Berglin
Chair, Health and Human Services Budget Division
Minnesota Senate
Room 309, State Capitol
75 Rev. Dr. Martin Luther King Jr. Blvd.
Saint Paul, MN 55155-1606

The Honorable Thomas Huntley
Chair, Health Care and Human Services Finance Division
Minnesota House of Representatives
585 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
Saint Paul, MN 55155

The Honorable John Marty
Chair, Health, Housing, and Family Security Committee
Minnesota Senate
Room 328, State Capitol
75 Rev. Dr. Martin Luther King Jr. Blvd.
Saint Paul, MN 55155-1606

The Honorable Paul Thissen
Chair, Health and Human Services Committee
Minnesota House of Representatives
351 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
Saint Paul, MN 55155

To the Honorable Chairs:

Senate File 3322, section 12 directed the Commissioner of Health to report to the Legislature on guidelines and recommendations intended to assure consistency in reporting of administrative expenses and investment income for health plans and county based purchasing entities. In addition, the report was to provide recommendations for examining the reasonableness of administrative expenditures for publicly funded health programs.

The Department contracted with Deloitte Consulting LLT to research these issues and provide a written report of its findings and recommendations. Information was provided by nine entities: three large health plans; three small health plans; and three county based purchasers. The Executive Summary and the full Report are enclosed for your review. The key findings and recommendations from this study are:

- **Administrative Expenses:** There is a wide variation in the methodology used by the six health plans and three county based purchasers to allocate administrative expenses. Methods include direct allocation by product, member months, revenue, claim counts, square footage, and estimates of staff time and call center statistics. All of these methods are reasonable ways to allocate certain administrative costs. While some plans used similar methods of allocation, no two plans used the exact same methodology. Four health plans and one county based purchaser use direct allocation to a product line as well as other methods of allocation. Although more sophisticated methods might result in more accurate allocation, enhanced methods would likely result in increased administrative costs to the plans.

  Based on Deloitte's review of several possible allocation methods, the report concludes that direct allocation to specific lines of business is the most accurate, assuming this information is available. Expenses that cannot be directly allocated should then be allocated based on

another method such as claim counts. Reducing the methods allowed to report administrative expenses will provide more consistency between the plans. Should the Legislature determine that having consistency across plans is desirable, perhaps a phase-in would allow those plans not currently using a product line method of allocation to move to that over time, and incur less cost.

- **Investment income:** There are a variety of methods used by five health plans and the three county based purchasers to allocate investment income. Methods used are generally simpler than those used to allocate administrative expenses. Five plans allocate based on revenue, three by operating or net income, and one plan uses member months. Deloitte performed an analysis of annual reports to the Department of Health where investment income was allocated to lines of business and products using four simple allocation methods: member months; revenue; claims dollars, and underwriting gains/losses. Deloitte then compared this to the allocation of investment income used by the plans. The results vary significantly by allocation method for all plans, and most lines of business have extremely large variation. Based on this analysis, the report recommends allocation of investment income based on cumulative net/operating income over time by business/product line.

- **Recommendations and costs of developing standards:** The third issue addressed in this Report is to provide recommendations and estimated costs of developing detailed standards and procedures for examining the reasonableness of administrative expenses by individual publicly funded program. Should the Legislature adopt the guidelines recommended in the Report, we would develop detailed standards and procedures as well as a reporting template for use by all plans that participate in the publicly funded programs. To conduct this work, we would establish an advisory committee to provide assistance, with representation from the health plans, county based purchasers, Departments of Human Services and Commerce. We would anticipate the need to contract with an outside consultant to conduct the work for this project. We anticipate that this project would cost approximately $100,000 to complete.

If you have questions or would like to discuss this in more detail, please contact Irene Goldman, Director of Managed Care, at 651-201-5166.

Sincerely,

Sanne Magnan

Sanne Magnan, M.D., Ph.D.
Commissioner
P. O. Box 64975
St. Paul, Minnesota 55164-0975

Enclosure

Deloitte.

Administrative Expense Study

for the

Minnesota Department of Health

Deloitte Consulting LLP

Deloitte

Deloitte Consulting LLP
400 One Financial Plaza
120 South Sixth Street
Minneapolis, MN 55402-1844
USA

Tel: +1 612 397 4000
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www.Deloitte Consulting.com

November 7, 2008

Scott Leitz
Assistant Commissioner
Minnesota Department of Health
Freeman Building
625 Robert St. N.
P.O. Box 64975
St. Paul, MN 55164-0975

Re: Administrative Expense Study

Dear Scott:

The following report addresses the findings of our analysis regarding development of guidelines for the allocation of administrative expenses and investment income by Minnesota health plans and county based purchasing organizations. We have reviewed the administrative expense allocation methods for numerous health plans. A description of our analysis and the results are contained in the following report.

As requested our report provides recommendations for developing guidelines for consistent procedures for allocating administrative expenses and investment income across commercial and public lines of business and across individual public programs for health plans and county based purchasing plans. Our report also addresses recommendations and cost estimates for developing detailed standards and procedures for examining the reasonableness of health plan and county based purchasing plan administrative expenditures for publicly funded programs.

We would be pleased to provide any additional information and discuss our report. Should you have any questions, please feel free to contact Pat at (612) 397-4033 / ppechacek@deloitte.com.

Sincerely,

Deloitte Consulting LLP

Deloitte Consulting LLP

Patrick Pechacek

By: _____
Patrick Pechacek, Director
Deloitte Consulting LLP

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Table of Contents

Executive Summary

Background

With the passing of Senate File No. 3322 into law, Section 12 directs the State of Minnesota Department of Health (the State) to conduct a study and report to the legislature regarding guidelines and recommendations that would allow for consistent comparison of health plans and county-based purchasing plans administrative expenses and investment income. Additionally, the State is to provide recommendations as to the steps and costs necessary to develop standards and procedures for examining the reasonableness of administrative expenses by program and functional area once those guidelines are adopted. The State has retained Deloitte Consulting LLP (Deloitte Consulting) for assistance with this study.

The goals of the study are to:

1. Develop guidelines for allocating administrative expenses.
2. Develop guidelines for allocating investment income.
3. Provide recommendations and cost estimates to develop standards and procedures to examine the reasonableness of administrative expenses for publicly funded programs.

Worksteps

To conduct this study, we collected and analyzed data and information from several health and county-based purchasing plans. Currently, the State collects a number of reports that capture administrative expenses at multiple levels. These reports include information specified by the National Association of Insurance Commissioners (NAIC) and reporting unique to the State of Minnesota. We reviewed this information and detailed 2007 reports as part of our analysis. We also sent a data request and questionnaire to the health plan organizations to obtain additional information necessary to conduct the study. The study was focused on those plans providing health care services to commercial and public programs, which narrowed the scope to eleven plans.

Findings

Based on the review of the responses to the data request regarding administrative expense allocation methods being employed, it is clear that health plan organizations currently utilize a wide variety of allocation methods. Out of the nine plans which provided information regarding their allocation methods, many of the plans had similar methods or common themes but no two plans used the exact same methodology. All these methods are generally reasonable. The wide variance in allocation methods leads to significant differences when comparing expense allocations by product across the health plan organizations. Additional details are provided in the body of this report.

The chart below provides a high level summary of the administrative expense allocation methods used by nine plans.

2007 Administrative Expense Allocation Methods		
Large Plans Offering Both Commercial and Public Programs		
Plan A	**Plan B**	**Plan C**
• Allocation methods include: – direct allocation to a product line – member months – weighted member months – claim counts – FTE's – square footage – interviews	• Overhead costs allocated based on Headcount and square feet • Operation costs allocated based on fixed percentages determined by manager interviews • Cost center specific functional costs are allocated based on membership counts and claim counts	• Expenses allocated based on: – claims processed – member months – call center statistics – estimates of staff time
Other Plans Offering Primarily Public Programs		
Plan D	**Plan E**	**Plan F**
• All expenses that can be are allocated to: – product line • The remaining expenses are allocated based on: – premium revenue	• Expenses allocated based on: – direct allocation to a product line – claims expense	• Claims and adjustment expenses are allocated by cost drivers that are appropriate for each cost center. • General administrative expenses are allocated to line of business based on a combination of FTEs, revenue, and member months
County Based Plans Offering Public Programs Only		
Plan G	**Plan H**	**Plan I**
• Allocated based on member months	• Direct allocation to a product line using member months	• Allocated based on reported revenue

Based on the review of the responses to the data request regarding investment income allocation methods being employed, again it was clear that the health plans are deploying a variety of allocation methods.. The methods used to allocate investment income are generally simpler than those used to allocate administrative expenses. There was more consistency among methods being used than demonstrated for the administrative expense allocation. However, many of the plans allocate investment income based on revenue which has limited correlation to operating income or earnings.

The chart provides a high level overview of the investment allocation methods used by nine plans.

2007 Investment Income Allocation Methods		
Large Plans Offering Both Commercial and Public Programs		
Plan A	**Plan B**	**Plan C**
• Based on cumulative net income or net loss of that product line since that product has been offered, applied against averaged rate of return on investment portfolio for that year	• Revenue	• Based on adjusting operating income for current year, with investment income on the prior years' surplus classified as "other".
Other Plans Offering Primarily Public Program		
Plan D	**Plan E**	**Plan F**
• Based on a blended percentage of a product line's revenue with the percentage of that product line's three-year average earnings.	• Premium (revenue)	• No response
County Based Plans Offering Public Programs Only		
Plan G	**Plan H**	**Plan I**
• Member months	• Capitation revenue	• Revenue

Recommendations for Guidelines

As noted earlier, the first part of this project was to develop guidelines for a consistent and reasonable method for allocating administrative expenses by line of business or individual public program. Based on our analysis we would recommend that plans employ a hierarchical allocation method. **This hierarchical method would directly allocate expenses to specific lines of business or products when such information is available and then allocate the remaining expenses based on another method such as claims counts.**

The second part of this task was to develop guidelines for allocating investment income by line of business or product. **We would recommend allocation based upon cumulative net/operating income over time by business line/product.**

We would recommend these guidelines be implemented in the Minnesota Supplemental Report #1 which the State requires be submitted for all Health Maintenance Organizations (HMOs), Community Integrated Service Networks (CISNs), County-Based Purchasers (CBPs), and Accountable Provider Networks (APNs).

Recommendations for Developing Detailed Standards and Procedures

The second major task was to develop recommendations as to the steps and costs necessary to develop standards and procedures for examining the reasonableness of expenses by individual public program and functional area. Based on our conversations with the State regarding available resources to develop detailed standards and procedures, the development of a final reporting template, standards and procedures would be driven by Department of Health with input from an advisory committee and from health plans.

Presuming that the guidelines recommended in this report are adopted and plans are able to allocate total administrative expenses and investment income in a similar fashion, the following steps and estimated costs could be used to develop detailed standards and procedures for examining the reasonableness of administrative expenses by individual publicly funded program.

The development of this process would require two steps. First, the State would need to define consistent guidelines to complete a report similar in design to a combined Minnesota Supplemental Report #1 by program and the Health Plan Financial and Statistical Report by functional area. We would recommend using these two reports as the individual program and functional area definitions in the new report. The State would develop the report with input from an advisory committee of representatives from the Departments of Human Services and Commerce. Additional input would be provided by health plan organizations at the State's request. A sample of a report by program and functional area is included in Appendix I.

Second, once the report is defined, the State will need to develop standards and procedures for examining the reasonableness of expenses. Again the State would work with an advisory committee of representatives from the Departments of Human Services and Commerce.

Finally, the study was to provide an estimate of costs if the guidelines are adopted by the legislature and it is necessary to develop detailed standards and procedures for examining the reasonableness of expenses by individual public program and functional area as described. Assuming that the legislation was effective in August and a final report was due to the legislature in January 2010, the project would be completed in about a five to six month period. As the result of our discussions with the State, it our understanding that a reasonable cost estimate for this effort is approximately $200,000. This estimate does not include staffing for future examinations of reasonableness performed by the State, nor does it include any savings or costs incurred by health plans to comply with the resulting guidelines.

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