

GAO

Testimony

Before the Subcommittee on Compensation
and Employee Benefits
Committee on Post Office and Civil Service,
House of Representatives

For Release on Delivery
Expected at
1:00 p.m. EST
Wednesday
March 11, 1992

**FEDERAL HEALTH
BENEFITS PROGRAM**

**Stronger Controls Needed to
Reduce Administrative Costs**

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STRONGER CONTROLS NEEDED
TO REDUCE ADMINISTRATIVE COSTS

Summary of Statement by
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At the request of the Chairmen, House Post Office and Civil Service Committee and Subcommittee on Compensation and Employee Benefits, GAO reviewed the administrative costs of the fee-for-service (FFS) portion of the Federal Employees Health Benefits Program (FEHBP).

GAO found that the FFS plans cost \$8.56 to administer for each \$100 of benefits paid in 1988. That cost ratio was 51 percent more than the average cost ratio for the large insured programs and 89 percent more than the average cost ratio for the self-insured programs GAO reviewed. Although administrative and benefit differences may have contributed to FEHBP's higher cost, the magnitude of the cost differences and a wide unexplained variation in the costs of the largest FFS plans led GAO to conclude that FEHBP's costs can be reduced.

GAO believes that FEHBP's high cost was also attributable to its structure, which was legislatively designed to include certain plans regardless of the cost effectiveness of their operations. Thus, the Office of Personnel Management (OPM) could not use competitive procedures to select only those carriers that would provide the most cost-effective administrative services, and the carriers did not have to maintain their operational expenses at levels competitive with other claims processors. Although noncompetitive, self-renewing plan contracts may have weakened OPM's ability to negotiate lower administrative cost levels, OPM could have used more effective controls and monetary incentives to encourage carriers to contain their administrative costs. OPM agreed with GAO's findings and expressed a commitment to improve the administration of FEHBP.

The Department of Defense's Civilian Health and Medical Program of the Uniformed Services (CHAMPUS) was successful in reducing the administrative costs of its health insurance claims processors by converting to competitive, fixed-price contracts. Lessons learned from CHAMPUS' experience in awarding and administering competitive contracts could help to avoid contractor performance problems if FEHBP is reformed.

The potential annual savings could range from an estimated minimum of at least \$35 million in the short term, if OPM controls over the operational expenses of the FFS plans are improved, to as much as \$200 million, if legislation is enacted that would provide a more uniform benefits structure and change the way contractors are selected and paid. Monetary incentives and improved controls could require additional funding that would partially offset the estimated savings.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to summarize the findings in our recent report entitled Federal Health Benefits Program: Stronger Controls Needed to Reduce Administrative Costs (GAO/GGD-92-37). Your joint request with the Chairman of the Committee on Post Office and Civil Service asked us to review the Federal Employees Health Benefits Program's (FEHBP) administrative costs as part of your comprehensive evaluation of the program and the need for legislative reforms.

The debate on reform has appropriately focused on issues related to the design, choice, and cost of FEHBP's health benefits. However, at a cost of over one-half of a billion dollars, the administration of those benefits is also an important consideration. Specifically, you asked us to determine

- how FEHBP's administrative costs compare with the costs of other large health benefits programs, including the Department of Defense's Civilian Health and Medical Program of the Uniformed Services (CHAMPUS);
- whether opportunities exist to reduce FEHBP's costs; and
- what lessons could be learned from the change in CHAMPUS' procurement of administrative services that could be applied to the reform of FEHBP.

BACKGROUND

The Office of Personnel Management (OPM) administers FEHBP by contracting with organizations that sponsor health insurance plans, which are known within the program as carriers. At the time of our review, 1988 was the latest year for which complete data on FEHBP's administrative costs were available. That year, over 3 million federal employees and retirees, 78 percent of FEHBP's participants, were enrolled in the 25 fee-for-service (FFS) plans. The FFS plans permit enrollees to choose their doctors and other health care providers and provide benefits by paying claims for partial or full reimbursement of medical costs. Plans commonly known as health maintenance organizations, which provide prepaid health care through specific groups of providers, were not included in our review because most of those plans charge FEHBP the same premium rate charged other group health insurance programs and, thus, do not account for their administrative costs to the government.

In 1988, the government and enrollees together paid \$7.4 billion to the FFS plans, which used \$6.7 billion for health benefit claims and \$564 million for administrative costs. The FFS plans' administrative costs consisted of \$458 million for operational expenses, \$57 million for premium taxes paid to states and other governments, \$2 million for health insurance reserves required by

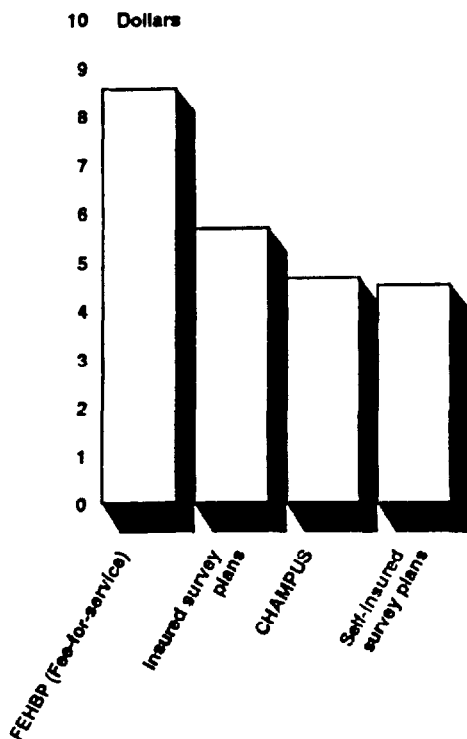
some states, and \$48 million for carrier profits.¹

FEHBP COSTS MORE TO ADMINISTER THAN OTHER LARGE HEALTH BENEFITS PROGRAMS

FEHBP, the largest employer-sponsored health insurance program in the United States, is unique because it offers enrollees a broad choice of plans with different benefit and premium levels. Although other large health benefits programs may also differ from FEHBP with respect to benefit and enrollee coverage, our comparison of administrative costs is useful for determining what FEHBP could cost to administer if the FFS portion of the program were reformed to more closely resemble other large insured or self-insured health benefits programs.

Including OPM's administrative costs of \$10 million, the FFS plans cost \$8.56 to administer for each \$100 of benefits paid. This cost ratio was 89 percent more than the average cost ratio of \$4.52 reported by the large self-insured programs in our review, 84 percent more than the cost ratio of \$4.66 for CHAMPUS, and 51 percent more than the average cost ratio of \$5.68 reported by the insured programs. Figure 1 depicts the magnitude of the differences in costs between FEHBP and the other programs.

Figure 1: Administrative Costs for Each \$100 of Benefits Paid (1988)

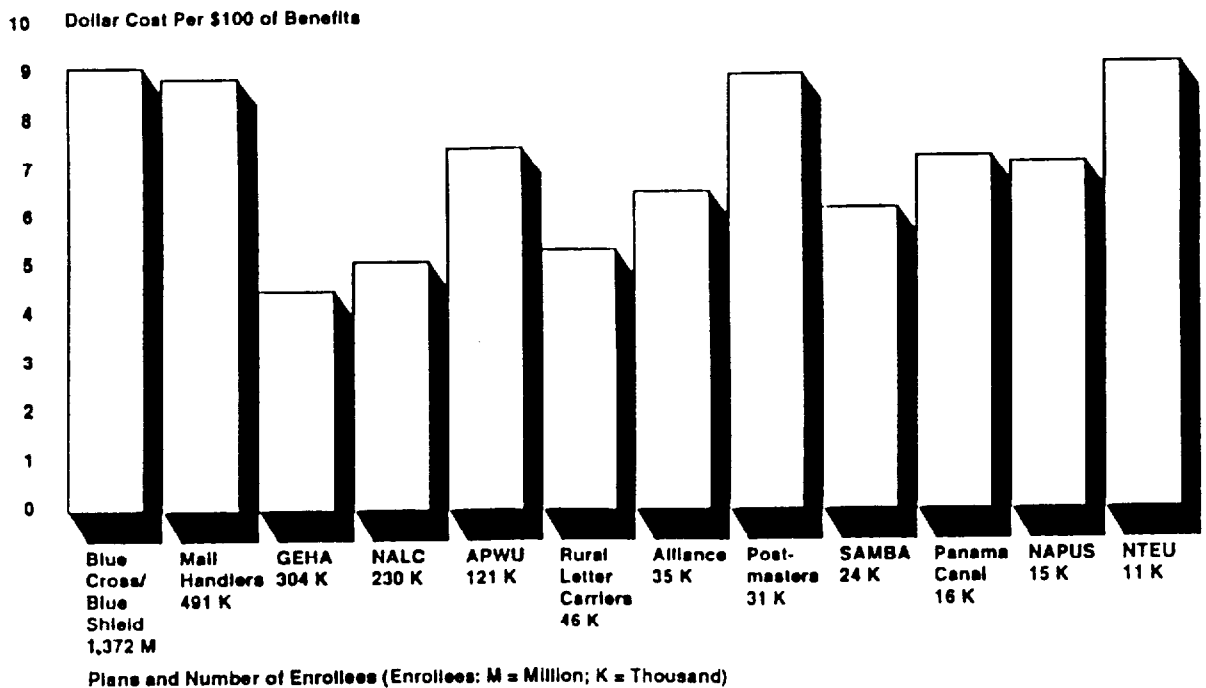


¹The component amounts do not add to \$564 million because of rounding. Also, the Omnibus Budget Reconciliation Act of 1990 exempted FEHBP from premium taxes.

Because the self-insured programs and CHAMPUS contract only for administrative services, they do not pay the premium taxes, state reserves, charges for insurance risk, or expenses associated with benefit and premium rate negotiations that are incurred by insured programs and the FEHBP plans, most of which were underwritten by insurance companies. Also, each FEHBP plan incurs expenses for annual open seasons, enrollment changes, actuarial services, overhead, and other costs that would be incurred less frequently or centrally in programs with a more uniform benefits structure, such as CHAMPUS and the other large programs in our review.

Although some of the differences in cost between FEHBP and the other large programs were attributable to FEHBP's unique characteristics, we also found a large variation in cost among the FFS plans. Excluding premium taxes and state reserves, which were not incurred by all of the plans, the cost ratios for the 17 FFS plans with over 10,000 enrollees ranged from \$4.44 to \$9.10 for each \$100 of benefits paid and averaged \$7.52. Appendix I shows the ratios for the 17 plans and figure 2 shows the relative costs for those plans still participating in FEHBP.

Figure 2: 1988 FEHBP Plan Cost Variation Listed by Enrollment



We were not able to determine why the plans' cost ratios varied by so much. A primary administrative function of the plans is to process claims, but the cost variation was not explained by factors that we believed could have caused differences in the plans' claims processing costs, such as (1) economies of scale, (2) percentage of enrollees eligible for Medicare coverage, (3) number of claims processors per enrollee, (4) claims processor salaries and turnover rates, or (5) the size of the customer service staff compared to the size of the claims processing staff.

Sufficient data were not available for us to determine if the variation was caused by other factors that could have affected claims work loads, such as benefit deductibles and copayments or enrollee characteristics, or by differences in the amounts spent to contain health care expenses. Although those factors could cause some variation in administrative costs, we do not believe they would fully account for the wide variation.

FEHBP'S STRUCTURE AND ADMINISTRATION CONTRIBUTED TO ITS HIGH ADMINISTRATIVE COSTS

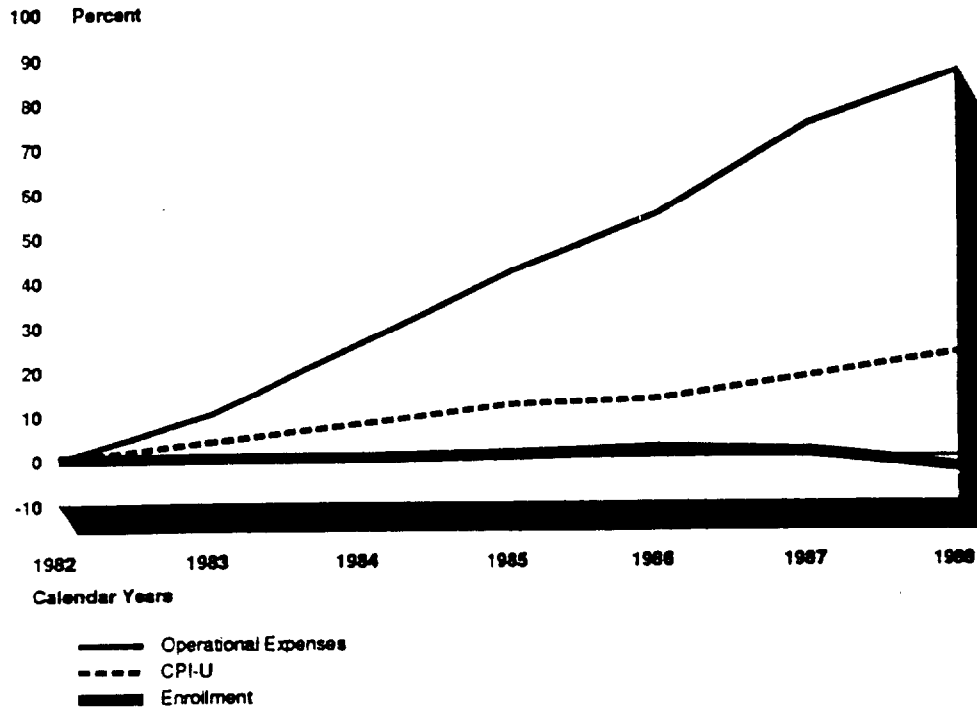
The large unexplained differences in cost between FEHBP and the other large health benefit programs and among the FFS plans led us to conclude that FEHBP's administrative costs are too high. We believe that the legislative structure contributed to FEHBP's high cost because it was designed to include the service benefit and employee organization plans. Thus, the carriers were not selected on the basis of their administrative efficiency and have not had to keep their operational expenses at levels charged by competing firms. This structure has also made OPM's administration of the program more difficult. Because the plan contracts are noncompetitive and self-renewing, OPM's leverage in negotiating lower expense levels for individual carriers is weak. Nevertheless, we believe OPM could have done more to control the carriers' operational expenses.

The contracts that OPM negotiated with the carriers did not provide sufficient incentives to improve efficiency and reduce costs. The contracts are characterized by the procurement regulations as fixed-price with retroactive price redeterminations. However, for administrative costs, the carriers are reimbursed for their actual, allowable operational expenses up to negotiated ceilings.

As shown in figure 3, from 1982 to 1988, the carriers' operational expenses increased from \$246 million to \$458 million, or 86 percent. The increase was not attributable to enrollment growth in the FFS plans, which declined during that period by 3 percent, and was only partially attributable to inflation, which was 23 percent, as measured by the Consumer Price Index for All Urban Consumers (CPI-U). The negotiated ceilings did not contain

that rapid increase because they were initially higher than the carriers' actual, allowable expenses and were adjusted on the basis of the plans' premiums, which largely reflected the cost of covered medical services and supplies.

Figure 3: Changes in Expenses, Inflation, and Enrollment (1982-1988)



Because OPM considered plan administration to be the responsibility of the carriers, it did little to monitor operational efficiency and did not require the carriers to report sufficient information on work loads or costs to determine the reasons for the large percentage increase or wide variation in the carriers' expenses. Thus, OPM did not emphasize administrative efficiency by making its oversight presence felt. Also, the carriers lacked adequate incentives to initiate expense reductions on their own because the reductions would not have reduced premiums enough to make their plans more competitive in attracting enrollees, and the carriers would not have profited by sharing in the savings.

WHAT CAN BE LEARNED FROM CHAMPUS?

CHAMPUS provides health care coverage for dependents of active-duty members of the military and other beneficiaries. It is funded through annual appropriations and only contracts for services related to the processing of claims. Although CHAMPUS'

1988 administrative cost of \$4.66 per \$100 of benefit payments was comparable to the self-insured programs in our review, its costs were higher before 1976, when its administrative services were procured through a large number of cost-reimbursable contracts and contractors with high costs and low productivity were not replaced.

CHAMPUS' costs were substantially reduced when it began to phase in competitive, fixed-price contracts and reduce the number of contractors. Also, its costs have continued to decrease as its contracts have been rebid. However, CHAMPUS' first fixed-price contractor was unable to fulfill the contract terms, and the claims processing services provided by subsequent fixed-price contractors were not of an acceptable quality. Our reviews of CHAMPUS' conversion to, and administration of, those contracts identified the following important lessons applicable to OPM's administration of FEHBP if the program is reformed:

- Monitoring of plan operations and expanded reporting of expense information are needed to ensure that the fixed-price contractors selected will be able to perform the required services at the agreed-upon price.
- Performance standards, measures, and monitoring are needed to ensure that service quality is not sacrificed for a lower price.
- The selection of fixed-price contractors and the development and testing of claims processing systems could be lengthy, since CHAMPUS takes up to 18 months to award and implement new contracts.
- The level, type, and focus of OPM's resources for administering the program may need to be changed.

STRUCTURAL AND ADMINISTRATIVE CHANGES WOULD REDUCE FEHBP'S ADMINISTRATIVE COSTS

We estimated that as much as \$200 million annually could be saved if FEHBP's administrative costs were reduced to the level of CHAMPUS and the nonfederal programs in our review. However, to achieve savings of that magnitude, we believe that legislation would be necessary to provide a more uniform benefits structure and allow for the procurement of administrative services under competitive, fixed-price contracts that would be periodically rebid.

The Subcommittee is currently considering H.R. 1774, which would have the government share the health insurance risk with competitively selected, licensed insurers. To ensure that FEHBP's administrative services would be procured at the lowest possible price under that type of funding arrangement, the

Committee should consider the merits of requiring separate negotiations with competitively selected insurance and/or claims processing contractors. We have agreed to assist your office with the design of contracting requirements under that bill.

Regardless of whether reform legislation is enacted, OPM needs to establish controls that would ensure that quality administrative services are obtained at a reasonable price. Although OPM's ability to negotiate administrative cost reductions under the current program structure may be weak, we believe that a 7- to 10-percent reduction in FEHBP's average cost ratio is an achievable goal. A reduction within that range would result in annual savings of from \$35 million to \$52 million.

Because arbitrary reductions in the expense ceilings established for individual plans could affect the quality of services provided, the savings should be achieved through objective analyses of what the efficient administration of the plans ought to cost. Thus, to achieve those savings, we recommended that OPM (1) obtain better work load and expense information to use in determining appropriate ceiling levels for individual plans, (2) establish monetary incentives to encourage improvements in the efficiency of plan operations, and (3) implement performance standards and measures to ensure that administrative cost reductions do not affect the quality of services provided. Monetary incentives and the monitoring of plan performance and expenses could require additional funding that would partially offset the estimated savings.

We are pleased to report that OPM agreed with our findings and has expressed a firm commitment to improve the administration of FEHBP. It is also acting to correct the weaknesses identified in our earlier report to you on FEHBP's internal controls.²

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Mr. Chairman, that concludes my prepared statement. We would be pleased to answer any questions.

²Fraud and Abuse: Stronger Controls Needed in Federal Employees Health Benefits Program (GAO/GGD-91-95, July 16, 1991).

1988 FEHBP Plan Cost Variation

| <u>Plans with more than 10,000 enrollees</u> | <u>Enrollees (In thousands)</u> | <u>Costs per \$100 of benefits^a</u> |
|--|-------------------------------------|--|
| NAGE ^b | 18 | 9.10 |
| Blue Cross/Blue Shield | 1,372 | 8.91 |
| NTEU | 11 | 8.90 |
| NFFE ^b | 18 | 8.82 |
| Postmasters | 31 | 8.71 |
| Mail Handlers | 491 | 8.69 |
| Postal Supervisors ^b | 46 | 7.67 |
| APWU | 121 | 7.30 |
| AFGE ^b | 28 | 7.29 |
| Panama Canal | 16 | 7.09 |
| NAPUS | 15 | 6.96 |
| Alliance | 35 | 6.40 |
| SAMBA | 24 | 6.05 |
| Aetna ^b | 237 | 6.01 |
| Rural Carriers | 46 | 5.22 |
| NALC | 230 | 5.01 |
| GEHA | <u>304</u> | 4.44 |
| Total | <u>3,043</u> | \$ <u>7.52^c</u> |

^aCosts include operational expenses and profits. Premium taxes and state statutory reserves are not included.

^bPlan no longer in FEHBP.

^cThis figure is the weighted average.

Source: GAO calculations based on data from OPM.

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