



Benefits Administration: Should You Outsource or Manage In-House?

As companies consider options,
Health Care Reform may impact decisions

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INTRODUCTION

Outsourcing of benefits administration first emerged in the mid-1980s. Originally, outsourcers focused primarily on handling only “back-room” operations for employers related to such things as enrollment processing and carrier interfaces.

By 1990, outsource providers had also begun to support direct employee and manager access.

Today, virtually any and every aspect of benefits administration, from enrollment to call center support to vendor interfaces to mobile and/or online self-service, can be and is successfully outsourced.

Since the emergence of outsourcing as a potential alternative for benefits administration, employers have grappled with the question of which makes more sense:

- Managing benefits administration internally (for the purpose of this discussion “insourcing”)
- Outsourcing benefits administration
- Implementing a co-sourced solution combining elements of outsourcing and insourcing

The major reasons for insourcing benefits administration have historically tended to revolve around three considerations:

- An employer’s desire to maintain total control of the administrative process
- An employer’s need to provide a custom experience to its employees
- The fact that the employers had invested in an Enterprise Resource Planning (ERP) solution (often customized at high cost) that could also support benefits administration (at least to a limited degree)



Insourcing places all of the responsibility for managing all human capital transactions and processes related to a company's HR and benefits administration entirely in the hands of the company's internal human resources department.

On the other side of the coin is outsourcing, which provides the opportunity to:

- Improve service at a lower cost
- Help with tracking important compliance information
- Gain access to knowledge and expertise
- Bring advanced technology to both employees and managers more quickly than most employers could otherwise do so (and at an affordable cost)

Moreover, by outsourcing a complex but essentially repetitive administrative function, employers can free up resources to focus on higher value strategic or core business issues and opportunities.

Outsourcing places the responsibility for the continuous improvement of a company's HR and benefits administration in the hands of one or more external providers whose core competency is human capital management.

In light of both significant technological and legal changes that have impacted and will continue to impact benefits administration, including the Patient Protection and Affordable Care Act (PPACA or Health Care Reform), the ADP Research Institute, a specialized group within ADP, conducted the ADP HR/Benefits Pulse Survey on Benefits Administration in December 2011 to gain insight into what employers in midsized (50-999 employees) and large (1000+ employees) companies are:

- Thinking about – the various trade-offs inherent in insourcing and outsourcing benefits administration
- Actually doing – that is, which functions are they outsourcing and which are insourced
- Planning on doing – that is, in light of the changing technological and legal landscape, are employers planning on insourcing or outsourcing more functionality

FINDINGS

Which Areas of Benefits Administration Are Insourced and Which Are Outsourced?

Most employers of all sizes continue to handle at least some elements of benefits administration internally, although large employers are more likely to outsource benefits administration than are midsized employers.

The exceptions to this finding are services that are highly technical and have significant compliance requirements. These highly outsourced functions are:

- COBRA Administration
- Flexible Spending Account (FSA) Administration
- 401(k) Administration



Among companies handling these tasks (not all companies offer FSAs, a 401(k) plan, etc.), 60% - 75% of midsize companies outsource all or some of the work related to these tasks, while among large companies the rate of full or partial outsourcing ranges from 70% to over 80%.

It will be interesting to see if full outsourcing becomes more common to the extent that compliance becomes increasingly more complex. In fact, employers indicated in this survey that Health Care Reform is leading them to consider outsourcing more administrative functions.

Health Care Reform is increasing administrative complexity, especially in the area of compliance, for health and welfare plans as employers address new requirements such as:

- Nondiscrimination testing for both insured and self-insured health plans*
- Automatic enrollment*
- Tracking part-time and full-time employee status for purposes of shared responsibility reporting and reconciliation (Our survey found that fully 18% of all employees in midsize companies and 20% in large companies are today considered to be part-time.)
- Expanded reporting requirements
- New and expanded employee communications

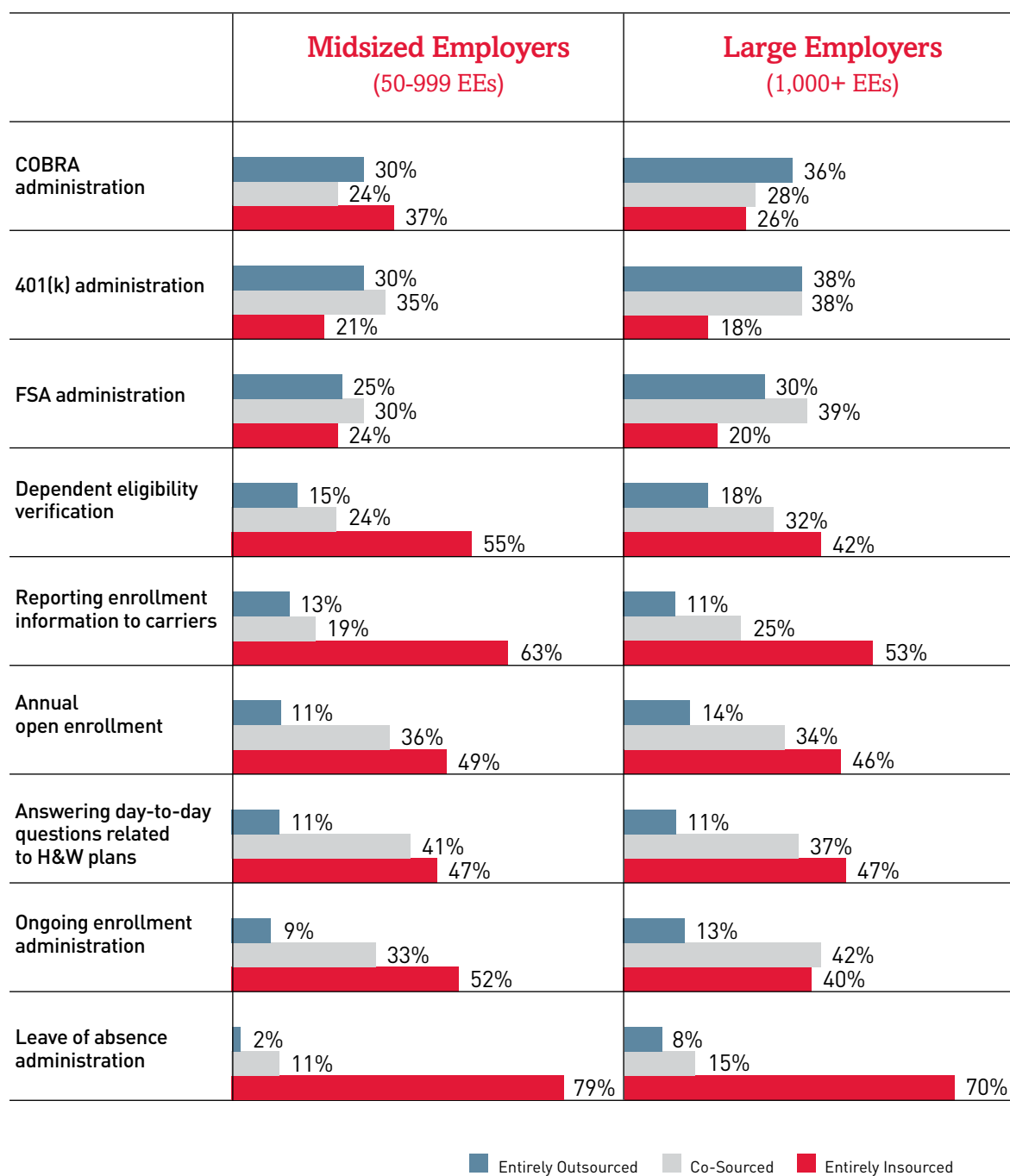
In fact, over half of employers (52% of midsize and 54% of large) believe that benefits administration will be more complex, as a result of Health Care Reform. An even higher percentage of employers (57% of midsize and 64% of large) believe that Health Care Reform will cause the time spent on benefits administration to increase.

Over half of employers believe that benefits administration will be more complex, as a result of Health Care Reform.

But it is not just in the area of Health Care Reform that compliance is becoming more demanding. The Sarbanes-Oxley Act (SOX), Health Insurance Portability and Accountability Act (HIPAA), Consolidated Omnibus Budget Reconciliation Act (COBRA), Family and Medical Leave Act (FMLA), Americans with Disabilities Act (ADA), and Age Discrimination in Employment Act (ADEA) – to name only a few areas — have increased administrative complexity related to benefits plans for most employers. And, as new regulations are issued or prior ones amended, this trend is likely to continue.

*The effective date of these mandates is uncertain.

Most Common Benefits Tasks and How They Are Handled



Source: ADP HR/Benefits Pulse Survey on Benefits Administration

Number of Outsourcing Providers Used

There is a significant difference in the approaches favored by midsized and large employers when they outsource benefits administration.

Midsized employers favor using fewer providers – with 68% reporting that they use only one or two providers and 32% using three or more when they outsource benefits administration.

On the other hand, 44% of large employers report using three or more outsourcing providers.



Increasingly Complex Compliance Requirements Make Integration Critical

Employers' use of multiple benefits vendors is likely to become increasingly problematic as new compliance requirements drive the need for integration across benefits functions.

For example, PPACA generally requires employers with fifty or more full-time equivalent employees to offer affordable health coverage to full-time employees or pay a penalty. To effectively manage this shared responsibility requirement, employers will have to integrate, in ways that they have never had to do previously, time and labor management systems, payroll, and benefits administration. While this can be done across multiple platforms and various providers, a single, integrated solution for all three applications would be most efficient.

This integrated solution should:

1. Empower local managers to make the most cost-effective decisions in real-time.
 - Provide the tools for the manager to differentiate among employees who have already triggered a "full-time" designation, those who are far away from such a designation based on scheduled hours, and those who are very close to crossing from part-time to full-time.
2. Ensure that employees who should be eligible for employer-provided healthcare coverage are actually made eligible in a timely and compliant fashion.
 - Determine if such coverage is "affordable" under PPACA.
3. Estimate benefits and/or penalty liabilities in order to accrue.
4. Provide necessary data to track and reconcile with the government for those employees who ultimately choose to utilize a public health insurance exchange rather than an employer's plan.
 - Track and report on all part-time employees who become "full-time" and the period of time during which this coverage applies.
 - Track and report on all newly designated "full-time" employees who are eligible, whose contributions for employee-only coverage exceed the affordability standard, and the period of time they would be eligible.

Ideally, these processes will occur seamlessly and consistently without the need for local managers or human resources professionals to take any special action.



Why Do Employers Handle Benefits Administration Internally?

Midsized and large companies have different reasons for choosing to handle benefits administration internally. In fact, of the top ten reasons given for insourcing benefits administration, midsized and large companies only agree on two. Both groups share a common view – although far less than 50% in each group – that internal benefits administration:

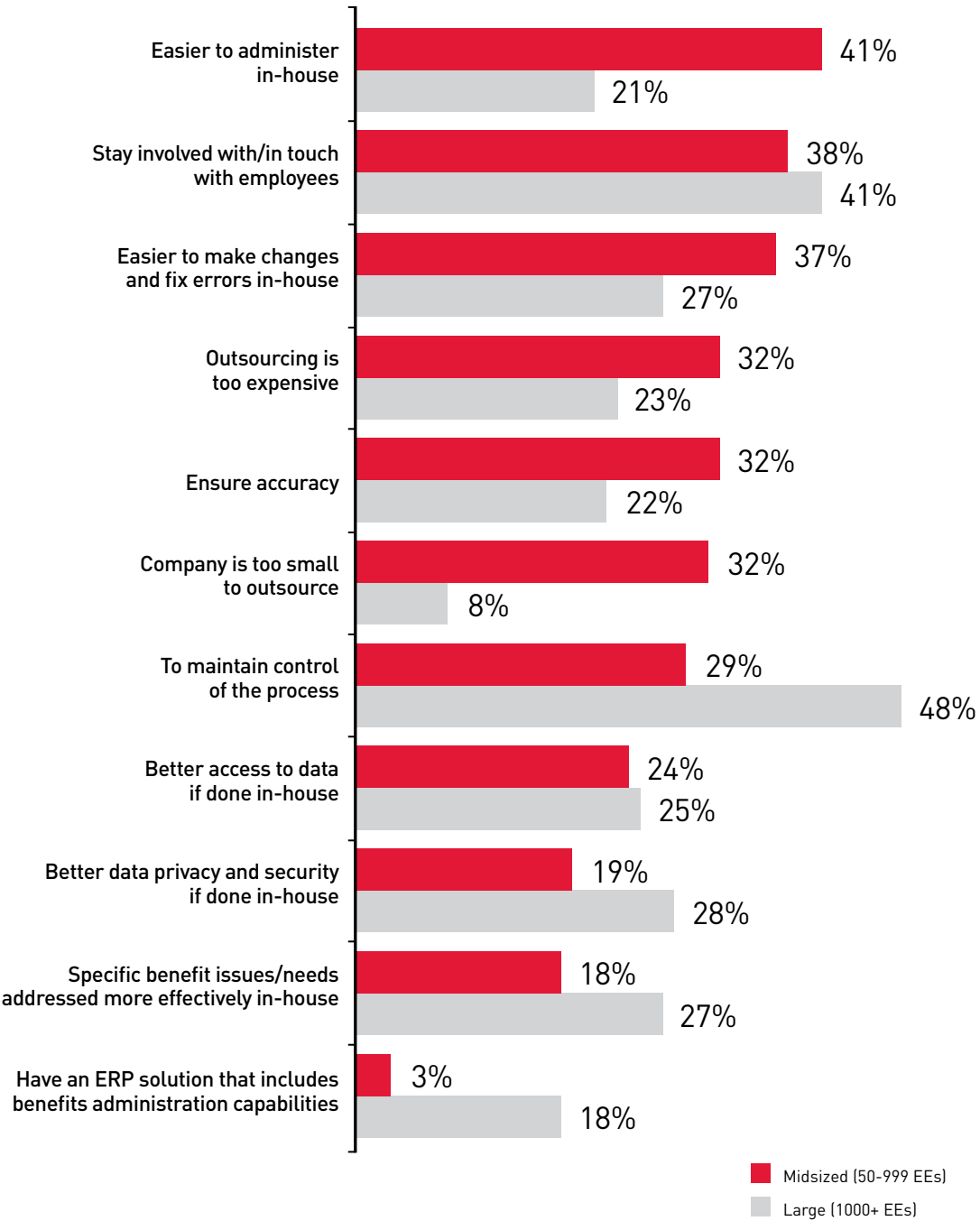
- Improves their ability to stay involved with their employees
- Provides better access to data

Just over 40% of HR/benefits decision makers in midsized companies (compared to 21% in large companies) report that they are most likely to administer benefits in-house because they believe it is easier to do so.

Some of the concerns raised by midsized companies could be attributed to past experiences or vendors who could not scale their services downward. The marketplace continues to evolve and many vendors may now be better able to address these concerns.

HR/benefits decision makers in large companies have a different priority, with 48% (compared to 29% of midsized) reporting that they are most likely to administer benefits in-house because they want to maintain control over the process.

Key Reasons for Administering Benefits Entirely In-House



Source: ADP HR/Benefits Pulse Survey on Benefits Administration

Why Do Employers Outsource Benefits Administration?

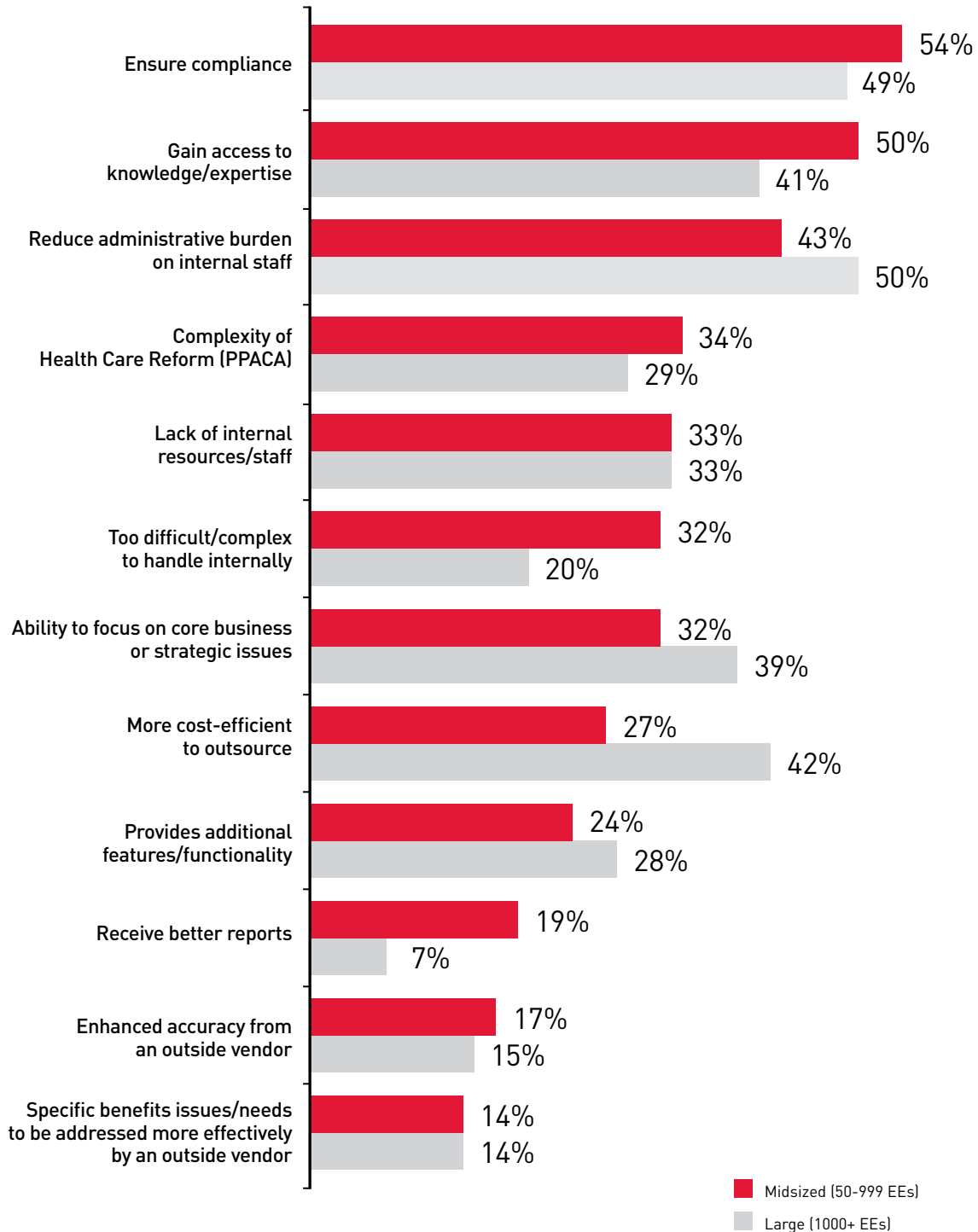
Ensuring compliance is the most important driver of benefits outsourcing. It is clear that increasing compliance complexity – taking into account both new and amended law – is making outsourcing a more attractive proposition for employers.

Employers want to make certain that they comply fully with legal requirements in order to avoid lawsuits, fines, and penalties. In order to do this they need access to subject matter knowledge and expertise that has become ever more expensive to maintain internally – and the effort to do so internally has placed a growing and, for many employers, an unsustainable administrative burden on internal staff. This can be clearly seen in the top reasons that employers choose to outsource benefits administration in the chart on the following page – with 40% to over 50% of HR/benefits decision makers in both groups indicating that these are the most important reasons for outsourcing.

Large employers have two other key goals when they outsource benefits administration:

- Focus internal staff on core business or strategic issues (39%)
- Reduce the cost of administration (42%)

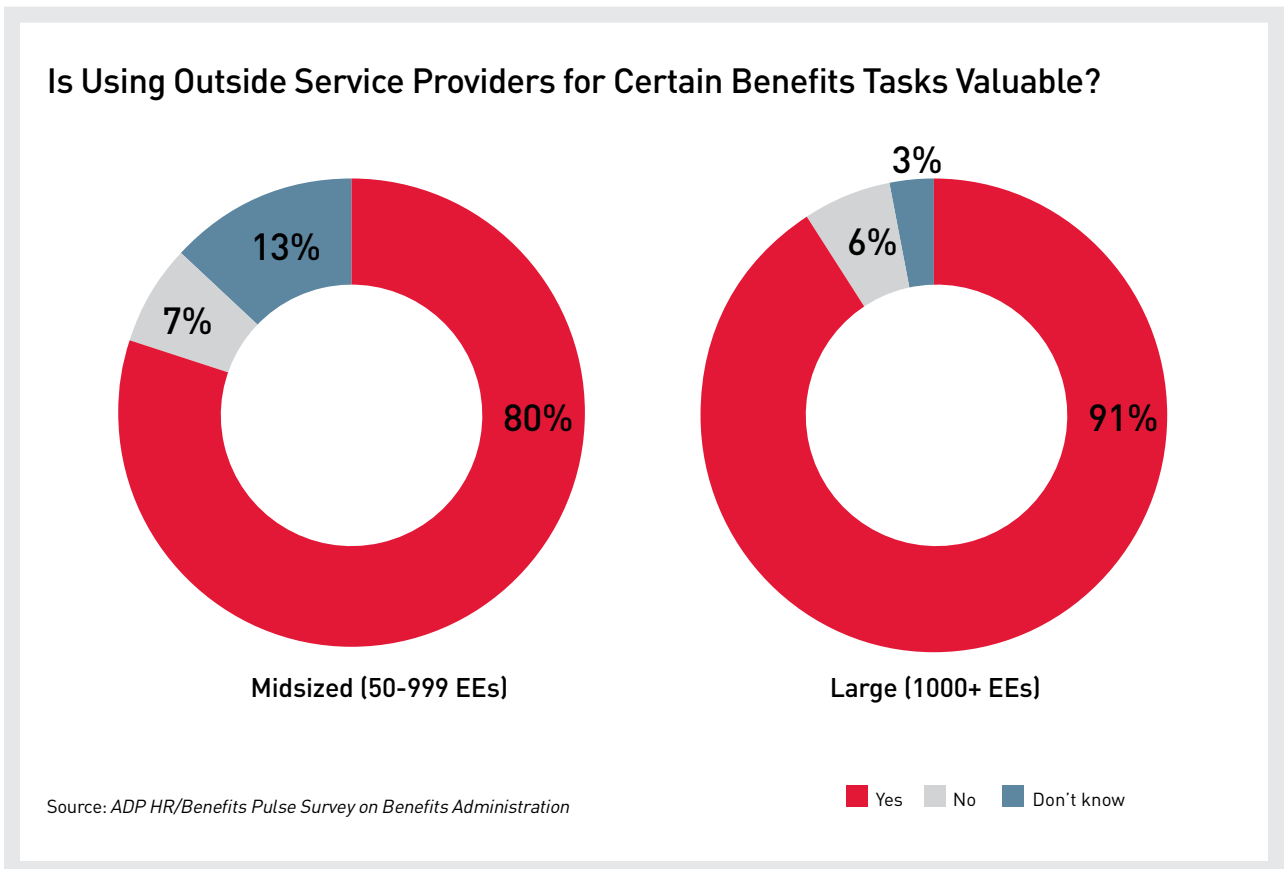
Key Reasons for Outsourcing Benefits Administration



Source: ADP HR/Benefits Pulse Survey on Benefits Administration

Does Outsourcing Benefits Administration Offer Value to Employers?

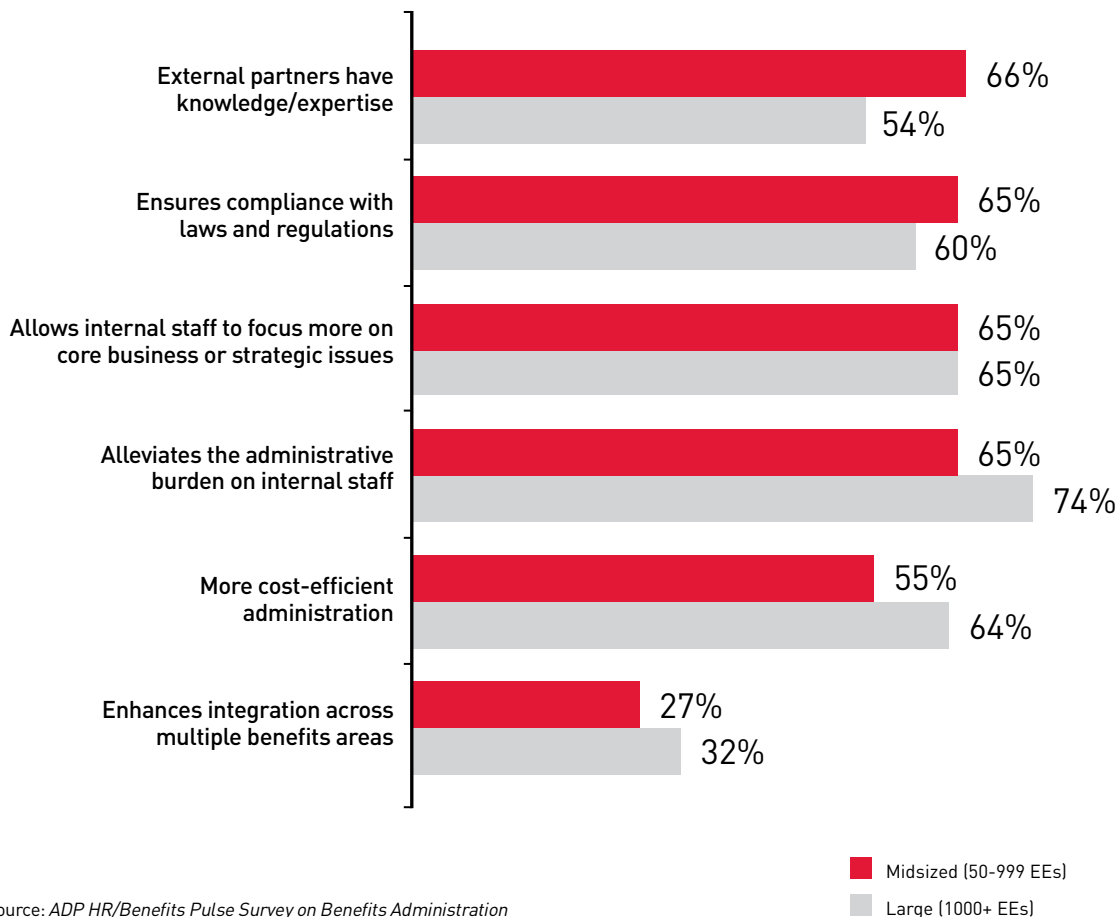
The vast majority of HR/benefits decision makers in both midsized and large companies think that outsourcing at least some elements of benefits administration provides real value for their companies.



Midsized and large employers generally agree on the advantages of outsourcing. However, there were two significant areas in which their opinions differ in regards to the value they realize from services provided by an outsourcing partner:

- Midsized companies place a greater emphasis on the outsourcer's knowledge and expertise than did large employers
- Large employers place a greater emphasis on the fact that outsourcing reduces the administrative burden on internal staff

Key Advantages of Outsourcing Certain Benefits Administration Functions



Another important finding is the fact that only a quarter to a third of HR/benefits decision makers think that outsourcing enhances integration across multiple functions. This likely reflects past practice where minimal integration, often batch updates on a periodic cycle (commonly payroll cycle), was sufficient to meet those requirements. We anticipate that companies will place a higher degree of importance on integration as compliance demands require close to real-time data transfers from multiple systems. For example, PPACA's shared responsibility requirements will require much tighter integration across time and labor, payroll and benefits systems in order for employers to actively manage rather than be reactive to the law.

The Future of Outsourcing Benefits Administration

The vast majority of HR/benefits decision makers in midsized and large companies report that their outsourcing provider or providers have met or exceeded expectations (88% of midsized and 92% of large).

This high level of satisfaction is not, however, stopping employers from evaluating the market. Three out of ten HR/benefits decision makers in midsized companies (31%) and nearly half in large companies (47%) report that they are at least somewhat likely to switch outsourcing vendors within the next 24 months.

In addition, decision makers – especially those in large companies – are planning to outsource more tasks in the next 24 months. Nearly three out of ten in midsized companies (28%) and four out of ten in large companies (42%) report that they are planning to do this.

Part of this move to expand outsourcing is driven by PPACA. Forty-five percent of HR/benefits decision makers in midsized companies and 54% percent in large companies report that regulatory changes have made them more likely to outsource all or some of their benefits administration, as Health Care Reform increases both the complexity of and the time required to administer benefits.

Approximately half of all HR/benefits decision makers report that regulatory changes have made them more likely to outsource all or some of their benefits administration.

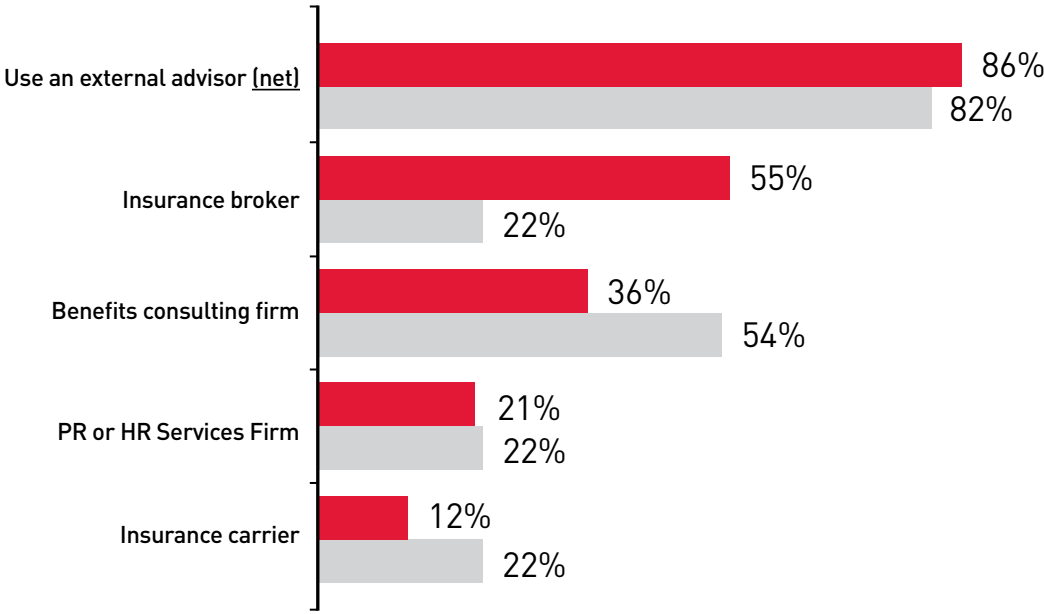
Professional Assistance in Selecting Outsourcing Vendors

Selecting an outsourcing partner for benefits administration is a significant undertaking in terms of specifying the scope of work to be provided, service levels to be maintained, and the fact that this is a long-term relationship for most employers.

Therefore, it is not surprising that the majority of both mid-sized (86%) and large (82%) companies rely on external advisors when choosing an outsourcing vendor to provide benefits services.

However, mid-sized employers are far more likely to rely on the advice of their broker, while large employers are more likely to rely on a fee-for-service benefits consulting firm.

External Advisors Relied Upon When Selecting an Outsourcing Vendor



Source: ADP HR/Benefits Pulse Survey on Benefits Administration

■ Mid-sized (50-999 EEs)
■ Large (1000+ EEs)

Not surprisingly, there is a significant value placed on the advice received from external advisors, with 80% of mid-sized employers saying that their broker was extremely or very important in the selection of an outsourced benefits administrator and 73% of large employers saying the same about their consultants.

Criteria Used to Select an Outsourcing Provider

While ensuring compliance is one of the most significant considerations driving employers to move from an in-house to an outsourced benefits solution, it is not the most significant factor considered when the employer and/or its external advisor evaluate potential providers.

The most significant factor is the cost of services – ranked as the most important criterion by ~70% of all HR/benefits decision makers in both midsized and large companies. Interestingly, they are not yet evaluating such things as the outsourced administrator’s ability – or lack thereof – to impact:

- Total benefits spend (not merely the administrative component)
- Tax savings (for employer and employee)

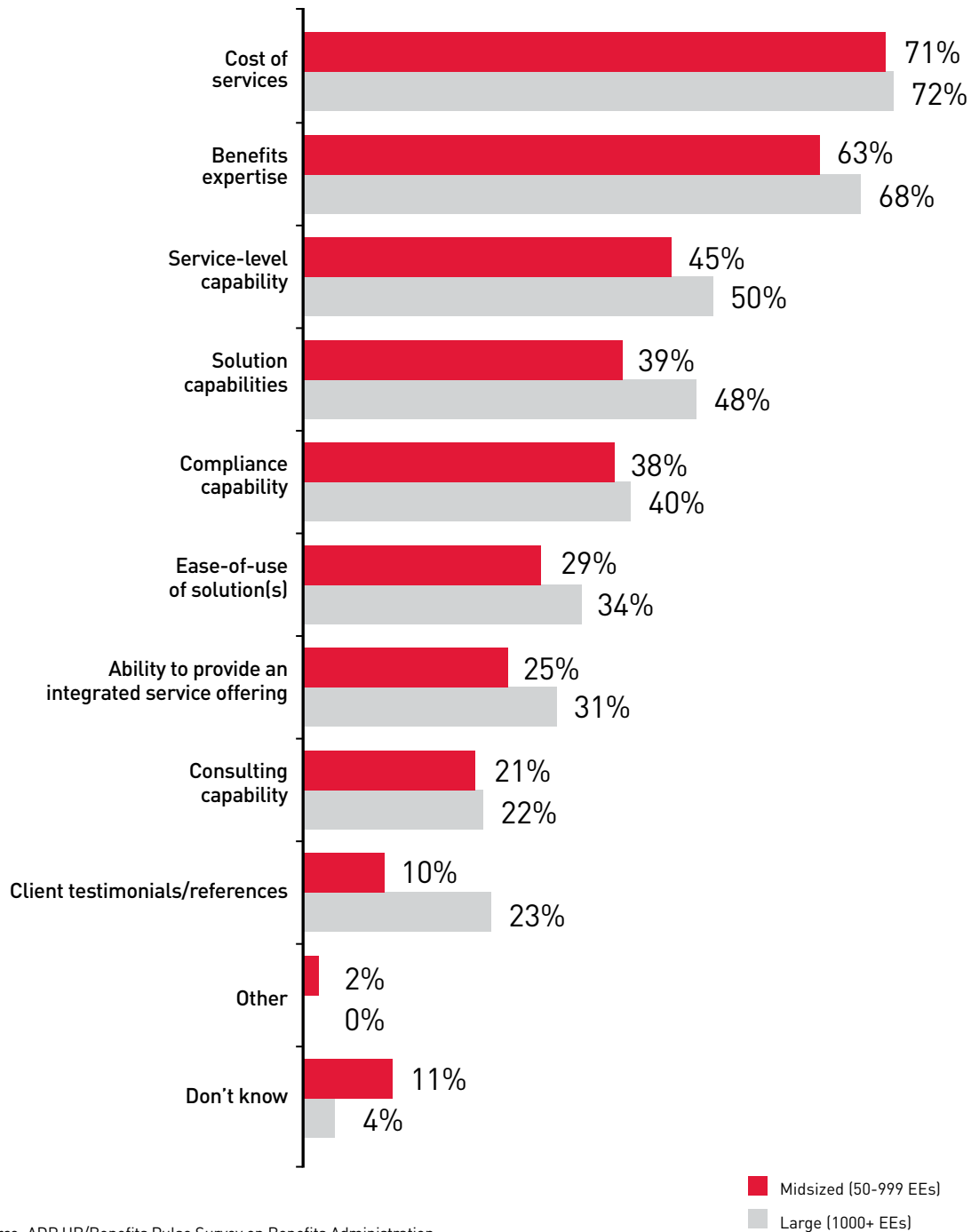
Subject matter expertise is the 2nd most important factor – with roughly two-thirds of employers reporting it as a significant consideration. While this criterion certainly overlaps with compliance, it also covers any number of other issues including administrative best practices, data analytics, and strategic plan design, to name only a few.

Roughly 40% of midsized and large employers specifically mention compliance as a key criterion in selecting a benefits administration outsourcer.

It appears that buyers of outsourcing services assume that most providers provide a consistent compliance experience, although this is not necessarily the case – especially as new laws and regulations continue to impact day-to-day benefits administration. As a result, it will be important for buyers to thoroughly evaluate the compliance capabilities of the providers being considered in several areas:

- Current compliance with existing laws and regulations
- Ability to quickly and accurately update/change compliance rules to accommodate new laws and regulations
- Flexibility in supporting alternative compliant solutions in instances where the law and/or regulations permit alternate approaches

Criteria Used When Identifying Potential Third Party Partners



Source: ADP HR/Benefits Pulse Survey on Benefits Administration

Conclusion

Deciding when to insource and when to outsource benefits administration requires a comprehensive knowledge of the supplier market and an understanding of the advantages and disadvantages of each approach.

Outsourcing is not the right solution for every employer.

However, for many employers outsourcing some or all of their benefits tasks (and the necessarily related areas of payroll and time and labor management) may become increasingly more attractive over the next 3 to 5 years.

The complexity of Health Care Reform for both the employer and the employee is a key factor in this trend.

Healthcare costs have risen faster than inflation every year since 1965^{1,2}, driving employers to look for new solutions, including:

- Wellness programs
- Consumer-focused healthcare alternatives
- Embedded communications
- Integrated decision support tools
- Defined-contribution strategies

The need to support combinations of these solutions and to generate meaningful data analytics that link these areas with other high-cost benefits (such as Leaves of Absence) when developing strategic solutions further adds to the complexity of benefits administration.

Add in the requirements under Health Care Reform and the implications start to multiply exponentially.

1. Per Capita National Health Expenditures (NHE) - Centers For Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, U.S. Department of Commerce, Bureau of Economic Analysis

2. Percent Change in CPI (All Items and Medical Care) - U.S. Dept of Labor, Bureau of Labor Statistics

About the Survey

The ADP Research Institute conducted the ADP HR/Benefits Pulse Survey on *Benefits Administration: To Outsource or Manage In-House?* in December 2011. This survey is one of the quarterly thought leadership studies conducted among HR and benefits decision makers on topics of current interest.

Decision makers in midsized (50-999 employees) and large (1000+ employees) organizations, across the United States were surveyed to better understand the incidence of and their attitudes towards handling a wide range of benefits administration tasks in-house versus outsourcing.

Research Methodology

The ADP HR/Benefits Pulse Survey on *Benefits Administration: To Outsource or Manage In-House?* in December 2011 includes input from 504 HR/benefits decision makers in U.S. enterprises. These respondents include 254 participants from midsized organizations (those with 50-999 employees) and 250 from large organizations (those with 1,000 or more employees). The resulting data for midsized and large companies achieved statistical reliability at the 95% confidence level.

Respondents had to be key decision makers (evaluators, recommenders, final decision makers) for critical employee benefits policy changes or major benefits system or service purchases within their enterprises.

Forty-six percent of midsized respondents and 36% of large respondents were the actual heads of HR or employee benefits within their organizations.

About the ADP Research Institute

The ADP Research Institute provides insights to leaders in both the private and public sectors around issues in human capital management, employment trends, and workforce strategy.

About ADP

Automatic Data Processing, Inc. (NASDAQ: ADP), with about \$10 billion in revenues and approximately 570,000 clients, is one of the world's largest providers of business outsourcing solutions. Leveraging over 60 years of experience, ADP offers a wide range of human resource, payroll, tax and benefits administration solutions from a single source. ADP's easy-to-use solutions for employers provide superior value to companies of all types and sizes. ADP is also a leading provider of integrated computing solutions to auto, truck, motorcycle, marine, recreational vehicle, and heavy equipment dealers throughout the world. For more information about ADP or to contact a local ADP sales office, reach us at **1-800-CALL-ADP (1-800-225-5237)** or visit the company's website at **adp.com**.

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