



Dashboard Results

For the trailing three months ended October 31st, 2011, the thirteen health plans in our *Health Plan Dashboard* reported health revenue growth of 5.5%. Public-sponsored products grew most rapidly. Medicare Advantage increased by 12.2%, while ASO/ASC grew by 6.5%. This was followed by Indemnity revenue growth of 5.3% and Managed Care at 1.1%. Medicaid product revenue declined by 0.6%.

Overall, membership increased by 3.4% in health lines. Membership declined by 2.2% for Indemnity and 1.1% in the Managed Care business. Similar to revenue, the public-sponsored products had the largest membership growth. Membership grew for ASO/ASC at 7.7% and Medicare Advantage at 5.6%. This was followed by Medicaid membership growth of 2.6%. Managed Care & Indemnity insured membership fell by 1.1% and 2.2%, respectively. Blue Plans had a large decline of year-over-year Managed Care membership at 26.3%.

Indemnity and Managed Care had price increases of 4.5% and 3.7%, respectively, while ASO / ASC grew by 3.3%. The price for the Medicare Advantage product increased by 3.1%, while the Medicaid product declined by 3.1%.

Health benefits ratios for health lines decreased by 0.3 percentage point to 86.8%. The Managed Care product had the largest increase at 2.5 percentage points. The number of scripts per person held constant at 9.5 on an annualized basis. E/R visits per thousand members increased by 7.2 to an annual rate of 250.8 per thousand, while hospital days increased by 1.6 days to 345.0 days per thousand.

The administrative expense to premium ratio decreased 0.1 percentage points to 9.3%, while the administrative costs per member per month increased 2.1% to \$27.53. Claims volumes grew

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Managing Appropriate Use of Sherlock Benchmarks

A few months ago, we learned that one of our licensees had distributed the Sherlock Benchmarks beyond the "internal use" restrictions in our governing agreement. In response to our calling this to its attention, after some rigmarole, the licensee then took a number of actions, including restricting its use to the applications anticipated in the license agreement.

Sherlock benchmarks are protected by agreements with each user and through registered copyrights. These restrictions are necessary to preserve the incentives of users to supply high quality data and/or to financially support the benchmarks that result from them. Since our business model depends upon our protection of the valuable resource embodied in the Sherlock information, we en-

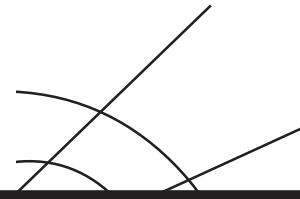
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Estimating Cost Performance Using On-Line Tools

Sometimes organizations need to know how health plans are managing their costs, but face gaps in their information. Suppose the following situations:

1. A health plan that does not participate in the Sherlock benchmarking study wants a quick analysis of its relative performance. It has only access to membership segmented by product and internal financial statements that are not segmented by product or by operating function.
2. A health plan is facing tough competition in the market and wants a sense of how effectively a competitor is managing its administrative costs.

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Estimating Cost Performance: *Continued from Page 1*

Only a public filing with the state insurance department is available

3. An investor is seeking to learn whether a publicly traded health plan is operating at low costs. The investor has access only to SEC filings, which provide income statements and membership but administrative costs are not segmented by function or by product.

4. A management consultant or business process outsourcing firm is attempting to determine whether it can add value to a health plan that has not yet engaged it. Only public information is available.

For all of these situations, the Calculator (<http://www.sherlockco.com/seer/calculator.shtml>) provides a valuable starting point.

In the examples above, note that the ability to get an answer to the question of cost efficiency is constrained by lack of available information. In each of these cases, costs are not segmented by product or by function. On the other hand, reliable income statements on most health plans are available in the form of statutory or SEC statements. Moreover, membership is also available through statutory and SEC statements.

To address this limitation, you may take advantage of the fact that, while the subject company does not provide the segmentation you require, the Sherlock Company benchmarks *do segment costs by product*. Our “trick” is to estimate the administrative costs that benchmarks would expect from the plan, and then this estimate is compared with the actual results.

Sources of Data

There are few health plans for which useful health plan information is not publicly available. For a plan trying to determine its own cost structure, it can access financial and operating information to

the degree that it finds convenient. For firms that are state-regulated or who are SEC registrants, this information is normally available on the internet. In any case, the only information you require is the total administrative expenses for products included in the Sherlock benchmarks and the number of members in each product.

USE OF NAIC DATA

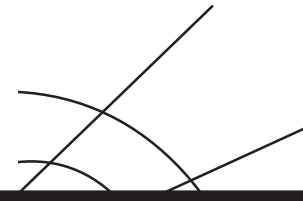
Health plans that submit their financial statements to their states usually employ a format approved by the National Association of Insurance Commissioners. These financial statements are all available for a modest cost at the www.naic.org web site, though some states, such as Arkansas, California, Rhode Island, Michigan and Washington, maintain free access to through their state insurance departments. The relevant NAIC website is <https://eapps.naic.org/cis/>. A “search” tool is found on the right side of this page. Once you have found the company, you will need to pay for the statement - the cost is \$10.00 for an annual report.

Statutory Statements are designed to provide insight to creditors, chiefly providers and members, as well as the regulations that look after them. Accordingly, cost information is designed to offset total costs by those associated with ASO products since such products bear no health care cost variance. While this represents an important limitation, it can still provide insight to the overall operations, especially when insurance products are dominant in the portfolio.

If only one product is offered, and that product is not an ASO, then only the Statement of Revenue and Expenses, found on page 4 in the Annual Statement is necessary. The sum of lines 20 (Claims adjustment expenses) and 21 (General administrative expenses) total administrative expenses. Line 1 is member months. This will need to be divided by the annual months, 12, for Calculator purposes.

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Estimating Cost Performance: *Continued from Page 2*

If more than one product is offered, then it is important to understand the product mix. Company press releases may be helpful. Failing that, a more useful schedule is the Analysis of Operation by Lines of Business, found on page 7. (Exhibit 1 – Enrollment by Product Type for Health Business Only, on page 17 is often insufficiently granular.) To estimate membership by product, divide row 1 Net premium income, by your judgment of what a normal premium rate would be for each product. (We would be pleased to supply median values for these to you upon request.) The sum of these should be similar to the line 1 value in the Statement of Revenue and Expenses, though only dumb luck will make it exact. Again, each of these member month values must be divided by 12 for calculator purposes.

To estimate the associated administrative expenses, the Analysis of Operation by Lines of Business is once again helpful. Note that lines 19 and 20 on this schedule are the same as lines 20 and 21 on the Statement of Revenue and Expenses. From this amount, subtract row 19 and 20 values for Other Non-Health and Vision to arrive at the administrative expenses measured in the Sherlock Benchmarks.

At the end of these calculations, you have member months by product and total administrative expenses. While a segmentation of high level administrative expenses by product is also available in the Analysis of Operation by Lines of Business, our approach minimizes the need to rely on the product cost segmentation supplied by the firms themselves designed for external audiences. Like with GAAP and statutory financial statements, financial statements like this are developed with specific users in mind.

These are limitations to statutory data. Again, the member months by product and total administrative expenses do not include the costs of ASO products. Another limitation for subsidiaries of

larger organizations is that individual filing entities may have intersegment charges from sister organizations that are debatable with respect to actual costs.

USE OF SEC DATA

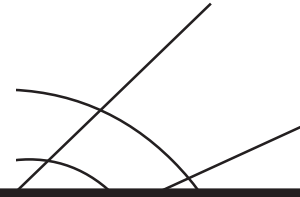
Data from Securities and Exchange Commission filings have advantages and disadvantages to NAIC data. Subject to important qualifications, this information is easier to use.

Again, the two pieces of information required by the user are total administrative expenses and membership by product. In the SEC form 10-K, Item 8. Financial Statements and Supplementary Data includes the Consolidated Statements of Income from which the administrative expense number is drawn. As normally categorized, total administrative expenses are the sum of Selling, General and Administrative and Depreciation and Amortization. That these companies are not (generally) subsidiaries means that their reported administration is not distorted through intersegment charges.

Membership is nearly always disclosed so no estimations are necessary unlike with statutory statements.

Membership is normally found in either or both of Item 1. Business and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. Membership is usually sufficiently detailed to correspond with the product categories of the Sherlock calculator. Membership is often provided as an end-of-period snapshot. This weakens the precision of the membership numbers, though we take comfort in the fact that seasonality mitigates this somewhat. Since the big enrollment periods are January, April, July and October, each of the quarterly end-of-period membership is a plausible estimate for average membership for the period. For annual periods, we prefer to employ the average of the quarterly membership information found in the companies' 10-Qs.





Estimating Cost Performance: *Continued from Page 3*

Application of the Calculator

To use the Calculator, the first step is to enter the average members for each product that the subject plan has. Then, by selecting the universe of peer plans you wish to compare the subject plan to (either in total or by individual product), an expected PMPM administrative expense value will be calculated. Enter the plan's total annualized administrative expenses and these will be compared to the expected PMPM value. An elaboration on how to use the Calculator are found on the web site.

The data used to calculate the benchmark value is drawn from the various *Plan Management Navigators* for Blue Cross and Blue Shield Plans, Independent/Provider-Sponsored Plans, Medicare and Medicaid Plans, and TPAs. Administrative expenses include those of Pharmacy and Mental Health management as well as miscellaneous business taxes such as premium taxes. This data is, in turn, selected from various *SEER* benchmarking studies.

Limitations to the Use of the Calculator

The Calculator is only intended as a first approximation so that there are certain limitations. Some of them are as follows:

- Use of the Statutory Statements loses the content of the ASO lines.
- Use of the SEC data may exclude medical management as some of the public firms report such costs as health care.
- Regardless of what the data source for the subject health plan, remember that you do not have a complete picture. For instance, low costs may indicate efficiency in core functional areas or they may indicate that the plan has elected not to invest in Sales and Marketing to achieve long-term growth.

- The segmentation by cluster found in the *Navigators* won't get you any further in determining the source of any variances since resource mixes vary greatly by product.

We hope this calculator will prove to be a helpful starting point in the analysis of your health plan administrative expenses. It will not tell you why your plan performs as it does, it will not tell you what factors contributed to its performance, and it compares your results only to central tendencies. Still, this Calculator is a way to begin and, in the current environment, getting a jump on administrative expense management is prudent. We are always available to answer any questions you might have about the Calculator. ♠

Dashboard Results: *Continued from Page 1*

0.27 to 15.7 per member per year while inquiries per member fell 0.03 to 1.4 per member per year. Staffing ratios decreased 0.09 FTEs to 19.7.

Health plans in our *Dashboard* universe are comprised of Blue Cross Blue Shield and Independent/Provider-Sponsored Plans. Please contact us if you have an interest in participating or receiving the *Dashboards* at 215-628-2289 or sherlock@sherlockco.com. ♠

Managing Benchmark Use: *Continued from Page 1*

deavor to be vigilant in learning about and responding to any violations.

Your organization could also become a victim of this if one of your competitors improperly uses the benchmarks to provide them with an unfair competitive advantage. We hope that, if your organization is the victim of such inappropriate use, that you will not hesitate to contact us so we can help to ameliorate this situation. ♠
