



2010 TPA BENCHMARKS PUBLISHED

“The most important reminder is that when you’ve seen one TPA, you can draw conclusions about only one TPA. There is no such thing as a “typical” TPA. TPAs give highly personalized service, so whatever the client needs is how the TPA adapts to serve (within the careful delineation of the administrative contract with the client and laws).” Society of Professional Benefits Administrators website.

Measuring TPAs

The quote above is based on the Society’s informed and direct familiarity with TPAs, a key participant in the employee benefits industry. While Sherlock Company’s analyses of the industry are far more recent, we can corroborate the Society’s insight.

Figure 1 illustrates this complexity. When a TPA announces the membership that it serves, the nature of those members may vary greatly. This figure shows that of the TPAs in our study, that collectively serve 1,357,343 members, 62.2% were in Medical products on average, followed by 22.7% on average who were in Pharmacy products. Dental comprised on average 6.2%. Other products included Vision, Short Term Disability, FSA Administration and Student Health Administration.

But the complexity of TPAs compounds since customers of many of the products may elect supplemental services. For instance, on average 91.3% of the Medical members receive Medical

Management / Quality Assurance / Wellness services, while 29.2% of Pharmacy members, on average, receive COBRA and HIPAA Administration services.

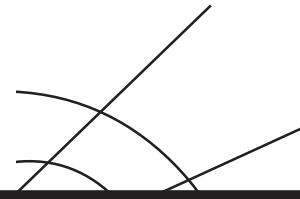
Thus, in theory, TPAs in our survey may offer more than 4,000 combinations of products and services to its potential clients. While this highlights the “highly personalized service” offered by TPAs, it also implies an important measurement challenge since one metric of cost cannot actionably capture all products and combinations of services.

However, as financial analysts, it is our task to draw insights notwithstanding TPA specific differences in products, supplemental services and definitions. The *Sherlock Expense Evaluation Report* eliminates the effects of product mix differences because the participating TPAs segment the costs of their business by product and each supplemental service within those products. Costs for the core services of each product are shown in Figure 5-7, below.

The Society also notes a second measurement challenge, “For your protection & sanity, forget the idea of finding or applying nice neat statistics to TPAs and the benefits and insurance and health arenas!” The Society explains that, “This is not because people lie. It is merely that even the most basic vocabulary (which, of course, defines each question & statistical result) is vastly different

Figure 1. Benchmark Summary
Complexity of TPA Business Mix, 2010
Percent of Members

	Medical	Dental	Vision	Pharmacy	Short Term Disability	Student FSA Admin.	Health Admin.	Other
Percent of Total Members	62.2%	6.2%	2.7%	22.7%	1.5%	2.6%	0.1%	1.9%
Pct. of Members with Sup. Svcs .								
Med. Mgmt. / Qual.Assur./Well.	91.3%	0.0%	0.0%	25.0%	0.0%	0.0%	100.0%	0.0%
Provider Network Mgmt. and Svcs.	85.7%	0.0%	0.0%	15.5%	0.0%	0.0%	100.0%	0.0%
COBRA and HIPAA Admin.	53.5%	36.0%	4.5%	29.2%	0.0%	0.0%	0.0%	0.0%
Mental Health Administration	13.5%	0.0%	0.0%	0.0%	0.0%	0.0%	100.0%	0.0%



within the benefit/insurance/medical community and even from person to person.”

The *Sherlock Expense Evaluation Report* overcomes this difficulty by providing precise definitions for the data used to populate the benchmarks. For instance, each function is named, activities are listed, common cost centers referenced and, to the degree that ambiguities remain, exceptions are specified. Products and supplemental services are similarly specified.

For instance, one of the functions is called 3 (b) Other Sales. Among the 20 or so activities of this function include “Proposals & RFP Dept”, “Administration of Broker Commissions” and “Conducting presentations to potential clients.” Cost centers of this function (drawn from the language of health benefit organizations) include “Direct Sales – Telemarketing” and “Internal Commissions.” Activities listed in this function also contain an exclusion: “Bank fees related to credit card fees, HSAs and other Cafeteria Products. These fees should be included in Finance and Accounting.”

For the most part, these definitions employ operating reporting conventions most commonly used by TPAs. To perform this harmonization, we speak with the participants directly to determine the activities in each functional area. Accordingly, broker commissions are excluded from the survey because TPAs have told us that such commissions, if any, are treated as a pass-through to plan sponsors. Notwithstanding our efforts to mirror TPA practice, every participating TPA reclassifies at least some of their expenses to accord with the *SEER* classifications. Thus, our task in establishing definitions is to minimize the total number of reclassifications necessary for the TPA participants. This enhances the “insight to effort ratio” as well as increases the likelihood of uniformity in reporting. We buttress this effort to ease reporting through a series of checks intended to identify and facilitate correction of aberrant responses.

Overall, these procedures are designed to overcome TPA’s differences in business mix, variations in customer use of supplemental services and differences TPAs’ in internal reporting. We take to be a

favorable indication of our success in achieving comparability that health benefit organizations serving more than 60% of all insured Americans are users of the 2011 editions of the *SEER* benchmarks.

Summary

Core administrative expenses of surveyed TPAs were 98% of fees in 2010. This was \$18.72 Per Employee Per Month (PEPM) or \$8.08 Per Member Per Month (PMPM). Members and Employees are tabulated regardless of the product they receive.

TPAs offer many products and costs vary greatly between them. The central and most expensive Medical product had per employee month costs of \$22.15, and per member month costs of \$10.99. The least expensive product, Vision, was \$0.47 PEPM and \$0.26 PMPM. Expressed as a percent of fees, expenses of Medical were 98.9% of fees while Vision and Dental were 130.3% and 72.0%, respectively.

These results are excerpted from the TPA edition of the 2011 *Sherlock Expense Evaluation Report*, comprised of 2010 data. Because of TPAs unique flexibility, all product costs are segmented into *core* and *non-core* expenses. Summary descriptions of core and non-core services are found in Appendices A and B. Core expenses are the costs of services of TPAs that every employer uses, such as claims processing and enrollment. Non-core services are supplemental, separately-costed services such as medical management, mental health administration and provider network and services. All expenses reported in this article are for core services, exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. As noted above, these costs also exclude broker commissions, as is the reporting convention of TPAs. Revenues similarly exclude broker commissions.

Administrative Costs of TPAs – Per Employee Per Month

For convenience of analysis, we group various functional areas into clusters, and standardize for



the size of the TPA by expressing expenses on a per employee basis. Standardizing by employees served is commonplace in the TPA industry. Values for these clusters and overall are shown in Figure 2. Total core costs per employee served were \$18.72, with the 25th percentile value of \$8.68 and the 75th percentile value of \$20.64.

Sales and Marketing expenses were \$2.42 PEPM in 2010, with 25% of the respondents over \$3.90 and 25% less than \$1.14. The largest function in the Sales and Marketing cluster was Sales. This cluster of functions had the smallest dispersion, with a coefficient of variance (“ σ / Mean”) of 60.2%.

Account and Membership Administration costs had a per employee month median cost of \$8.56. One quarter of the respondents had costs of \$12.53 or higher while one quarter had costs of less than or equal to \$4.67. The highest cost functional area in this cluster of functions was Claim and Encounter Capture and Adjudication, and the sub-function, Processing, in particular. This is notably different from health plans whose Information Systems costs are highest.

Corporate Services had median costs of \$3.94 per employee per month. The highest 25% had costs of \$4.39 or greater while the lowest cost 25% had costs of \$2.15 or less. The *function* representing the greatest proportion of this cluster was Corporate Services.

Administrative Costs of TPAs – Per Member Per Month

While it is customary in the TPA industry to standardize costs on a per employee per month

Figure 2. Benchmark Summary
Core TPA Costs By Functional Area Cluster, 2010 Data
Per Employee Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Sales and Marketing	\$1.14	\$3.90	\$2.42	60.2%
Account and Membership Admin.	4.67	12.53	8.56	61.0%
Corporate Services	2.15	4.39	3.94	65.7%
Total Core Services	\$8.68	\$20.64	\$18.72	52.3%

basis, in our view, the use of members as a method of standardization better captures resource utilization. The functional costs of Claims and Customer Services, for instance, stem from *member* health needs for claims to be processed or customer service inquiries to be responded to. Moreover, in achieving comparability between the TPAs, differences in contract size can affect ratios. Contract size varied from TPA to TPA ranging, in the case of Medical, from a low of 1.83 to a high of 2.25. Members are employees served plus dependents.

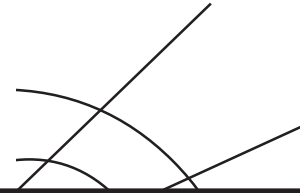
Figure 3. Benchmark Summary
Core TPA Costs By Functional Area Cluster, 2010 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Sales and Marketing	\$0.67	\$2.00	\$1.29	57.9%
Account and Membership Admin.	2.61	6.38	3.69	58.5%
Corporate Services	1.21	2.19	2.06	53.4%
Total Core Services	\$4.86	\$10.52	\$8.08	48.6%

Total Core costs per member month was \$8.08, with the 25th percentile value of \$4.86 and the 75th percentile value of \$10.52. Values for all clusters and overall are shown in Figure 3.

Sales and Marketing expenses were \$1.29 PMPM in 2010, with 25% of the respondents over \$2.00 and 25% less than \$0.67.

Account and Membership Administration costs had a median value of \$3.69. One quarter of the respondents had costs of \$6.38 or higher while one quarter had costs of less than or equal to \$2.61. This cluster of functions had the greatest disper-



sion, with a coefficient of variance (σ / Mean) of 58.5%.

Corporate Services had median costs of \$2.06 per member per month. The highest 25% had costs of \$2.19 or greater while the lowest cost 25% had costs of \$1.21 or less.

Administrative Costs as a Percent of Fees

TPAs and other organizations often express administrative costs as a percent of revenue. As shown in Figure 4, administrative expenses were 98.4% of fees for products sold by TPAs. The 25th percentile value was 88.2% and the value at the 75th percentile was 100.5%.

Sales and Marketing costs comprised 18.4% of fees, with the 25th percentile value at 17.5% and the value at the 75th percentile was 19.6%. This cluster of expenses, measured as a percent of fees, was broadly disbursed with a coefficient of variance of 34.7%.

The costs of Account and Membership Administration was 52.0% of fees. The value at the 25th percentile was 46.6% of fees and 60.9% of fees at the 75th percentile.

The median proportion of fees spent on to Corporate Services was 20.7%. Twenty-five percent of TPAs had values below 19.8% of fees or above 27.2% of fees in 2010.

The median profit margin for the TPAs in the survey was 1.6%. The highest 25% had margins of 11.8% or above while the lowest margin TPAs were negative 0.5% or less. Margins varied by product and that fact contributed to the differ-

ences between them. The proportion of fees that were attributable to the Medical product varied from 72.8% to 100%.

Figure 4. Benchmark Summary
Core TPA Costs By Functional Area Cluster, 2010 Data
Percent of Revenues

	25th PCTL	75th PCTL	Median	σ / Mean
Sales and Marketing	17.5%	19.6%	18.4%	34.7%
Account and Membership Admin.	46.6%	60.9%	52.0%	24.4%
Corporate Services	19.8%	27.2%	20.7%	26.5%
Total Core Services	88.2%	100.5%	98.4%	13.2%
Note: Profit Margin	-0.5%	11.8%	1.6%	220.4%

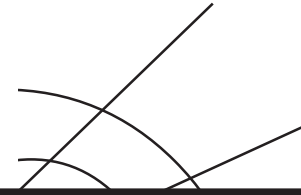
Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by more than 25 core functions and 10 non-core functions. This segmentation is important since, for instance, dental products cost much less to administer than medical products. For example, our TPAs report that their members in Medical products submit more than 5 times as many claims per member as their members in dental products.

Differences in resource use are manifest in their overall cost differences. The most expensive product offered by TPAs is their Medical product, at \$22.15 per employee per month, distantly followed by the FSA product at \$5.54 per employee per month and Student Health Administration at \$3.07. Dental, Vision, Pharmacy and Short-Term Disability costs were much lower. (We have omitted the "Other" product from this narrative

Figure 5. Benchmark Summary
Core TPA Costs By Product, 2010 Data
Per Employee Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Medical	\$19.11	\$26.38	\$22.15	38.8%
Dental	1.69	2.60	1.84	43.4%
Vision	0.45	0.48	0.47	11.3%
Pharmacy	0.43	1.07	0.64	93.6%
Short-Term Disability	0.47	1.56	0.87	82.5%
FSA Administration	4.70	5.90	5.54	33.9%
Student Health Administration	3.07	3.07	3.07	NM
Other	3.20	5.33	4.27	70.7%
Total, All Lines	\$8.68	\$20.64	\$18.72	52.3%



since the actual product varies from TPA to TPA.) This is shown in Figure 5.

We performed a similar analysis standardizing Core costs on a per member per month basis. As discussed previously, we prefer this approach. The most expensive product offered by TPAs is their Medical product, at \$10.99 per employee per month, followed by FSA Administration and Student Health costs of \$5.54 and \$3.03, respectively. Again, the costs of Dental, Vision, Pharmacy and Short-Term Disability costs were much lower. This is shown in Figure 6.

As shown in Figure 7, on a percent of fee basis, the ranking of administrative expenses is different. The lowest cost product, based on the median percent of fees, was Pharmacy at 25.5%. The highest cost product, measured by the percent of fees attributable to administration, was Vision at more than 130.3%. Medical was slightly higher than average with expenses at 98.9% of fees. Dental and FSA Administration administrative expenses were at 72.0% and 117.5% of fees, respectively.

Core Activity Costs of Competitor Organizations

While TPAs and providers of Administrative Service Only arrangements agree that their products differ, they also agree that they compete with each other. Thus, it is illustrative to compare the costs of administrative activities provided by both sets of organizations.

Figure 6. Benchmark Summary
Core TPA Costs By Product, 2010 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Medical	\$9.69	\$13.21	\$10.99	32.5%
Dental	0.79	1.73	0.86	74.9%
Vision	0.24	0.29	0.26	29.9%
Pharmacy	0.22	0.50	0.32	82.9%
Short-Term Disability	0.47	1.56	0.87	82.5%
FSA Administration	4.70	5.90	5.54	33.9%
Student Health Administration	3.03	3.03	3.03	NM
Other	2.54	3.36	2.95	39.2%
Total, All Lines	\$4.86	\$10.52	\$8.08	48.6%

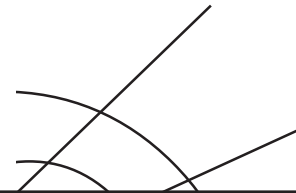
Figure 7. Benchmark Summary
Core TPA Costs By Product, 2010 Data
Percent of Revenues

	25th PCTL	75th PCTL	Median	σ / Mean
Medical	96.0%	101.5%	98.9%	5.9%
Dental	65.0%	157.8%	72.0%	83.0%
Vision	119.2%	141.3%	130.3%	24.1%
Pharmacy	16.1%	37.8%	25.5%	68.9%
Short-Term Disability	78.3%	103.2%	97.6%	45.3%
FSA Administration	103.9%	132.5%	117.5%	16.3%
Student Health Administration	33.4%	33.4%	33.4%	NM
Other	98.2%	125.6%	111.9%	34.6%
Total, All Lines	88.2%	100.5%	98.4%	13.2%

To appropriately compare, we reflected in comparisons only those activities that were provided by TPAs and through ASO/ASC contracts of TPA competitors. For example, in accordance with the reporting conventions preferred by TPAs, broker commissions are excluded from all peer groups. Services that are non-core in relationships with TPAs, such as Medical Management and Provider Management and Services, are excluded from both TPAs and their ASO/ASC competitors.

As shown in Figure 8, surveyed TPAs have lower costs in when comparing of Medical product costs. At a median value of \$10.99 PMPM for core services of Medical products, surveyed TPAs are lower than ASO products offered by Independent / Provider-Sponsored plans and Blue Cross Blue Shield plans. In fact, there appears to be little overlap between the Blue and TPA health benefit organizations. The 25th percentile value for Blue





Cross Blue Shield plans is 10% higher than the 75th percentile value for TPAs. The results of Independent / Provider-Sponsored TPAs are also typically higher than those of the TPAs.

Staffing and Compensation

The median staffing ratio for this universe was 14.32 FTEs per 10,000 adjusted total members, for core services. (Adjusted total members converts all non-medical members into medical equivalents.) TPAs at the 75th percentile had a staffing ratio of 15.28, while those at the 25th percentile had a staffing ratio of 13.37.

Figure 8. Benchmark Summary
Core Medical Activity Costs by Organization, 2010 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
TPAs	\$9.69	\$13.21	\$10.99	32.5%
Blue Cross Blue Shield Plans	14.49	17.91	16.83	21.9%
Independent / Provider-Sponsored Plans	\$10.25	\$15.83	\$12.52	38.9%

Figure 9 shows that surveyed TPAs appear to have lower costs in stand-alone dental products. At a median value of \$0.86 for core services of Dental products, surveyed TPAs have lower costs than similar products offered by Blue Cross Blue Shield plans.

Median staffing costs per FTE was \$59,148 for TPAs, with 25% at or above \$64,950 and 25% at or below \$54,794. While not shown in *Navigator*, these metrics are reported in *SEER* for each of the functional areas shown in Appendices A and B.

Figure 9. Benchmark Summary
Core Dental Activity Costs by Organization, 2010 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
TPAs	\$0.79	\$1.73	\$0.86	74.9%
Blue Cross Blue Shield Plans	\$1.81	\$2.44	\$2.03	89.3%

Both of these comparisons should be viewed with caution. First, while we have taken pains to assure that the functions match, the scope of services may well vary between the universes. Second, as discussed later, it may be that the TPAs included in this survey are stronger than average. Since the Blue Cross Blue Shield universe comprises 70% of the total, it is more likely that this set of plans represents its universe as a whole. Third, it should be noted that, for the most part, the Blue Cross Blue Shield dental products are insured, while the TPAs are not. Accordingly, the Blue Cross Blue Shield plans may have administrative activities that contribute to health benefit cost savings (excluding those in medical and provider management which we have already excluded) not found in the TPAs.

Cost Trends

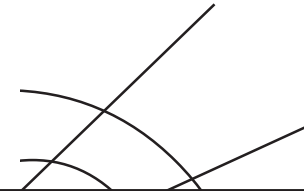
We do not publish cost trends for this universe chiefly because the sample size of continuously participating TPAs is modest. Having said

this, we have included in appendix the 2009 values for the *SEER* universe. These are shown as Appendices C through F.

The increase in reported costs from 2009 to 2010 occurred notwithstanding the 4.9% lower costs for the Medical product. One reason for this is that the Medical product typically comprised 95% of total core costs in 2010 compared with 91% in 2009. Profit margins for continuous plans declined sharply in 2010.

Background on TPAs

Among the more important competitors in the self-insured market are Third Party Administrators. These organizations provide administrative services to self-insured groups in exchange for a fee. These organizations are distinguished from health insurers in that they do not bear risk for



medical cost variance. They offer similar to services provided by health plans to self-insured groups through Administrative Services Only contracts.

TPAs believe they are distinguished from other organizations providing health benefits to employees by their flexibility. TPAs believe they emphasize highly personalized, not merely customized, services. Other advantages to employers of using TPAs cited by their trade associations include employer control over the health plan reserves to maximize interest income, improved cash flow, reduction in state regulatory burdens, exemption from premium taxes and flexibility with respect to provider contracts. We believe that these attributes may prove to be especially attractive in the current challenging economic and credit environment and possibly also due to the effects of health care reform.

We do not know how many TPAs there are but the Society of Professional Benefit Administrators lists 281. They range in size from less than \$500,000 in annual revenues to more than \$100 million. Many of them are quite small, with 46% of them at less than \$2.5 million in revenues annually. If the average TPA charges \$11.00 PMPM for its Medical product, nearly half of them serve fewer than 19,000 members. So, as with health plans, we suspect that success in the TPA business is the result of superior execution, with scale as a distinctly secondary factor.

The peer group universe in this analysis consisted of seven Third Party Administrators, which collectively served 1.4 million members. Of those members 608,000 were Medical, 175,000 were Dental and 345,000 were Pharmacy. Each product costs and members are segmented to reflect that

Appendix A. Benchmark Summary
Functions in Each Cluster

Sales and Marketing

- Employer Group Reporting
- Marketing (except Advertising and Promotion)
- Sales
- Advertising and Promotion

Account and Membership Administration

- Enrollment / Membership / Billing
- Customer Services
- Claim and Encounter Capture and Adjudication
- Total Information Systems Expenditures (as expensed)

Corporate Services

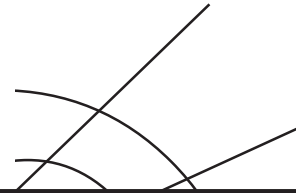
- Finance and Accounting
- Corporate Services
- Corporate Executive & Governance
- Miscellaneous Business Taxes

Appendix B. Benchmark Summary
Non-Core Services Also Found in Benchmarks

- Direct Cost of Medical Management / Quality Assurance / Wellness
 - (a) Pre-Certification
 - (b) Case Management
 - (c) Disease Management
 - (d) Health and Wellness
 - (e) Other Medical Management
- Direct Cost of Provider Network Management and Services
 - (a) Provider Relations Services and Provider Contracting
 - (b) Other Provider Network Management and Services
- Direct cost of COBRA and HIPAA Administration
- Direct Cost of Mental Health Administration
- Direct Cost of Stop Loss Insurance

Appendix C. Benchmark Summary
Core TPA Costs By Product, 2009 Data
Per Employee Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Medical	\$15.24	\$28.95	\$25.28	36.8%
Dental	0.95	1.52	1.17	46.2%
Vision	0.36	0.58	0.44	47.5%
Pharmacy	0.48	0.76	0.62	49.8%
Short-Term Disability	0.50	0.55	0.52	12.3%
FSA Administration	2.26	6.08	4.20	65.5%
Student Health Administration	3.58	3.58	3.58	NM
Other	5.40	9.28	7.34	74.7%
Total, All Lines	\$8.33	\$14.16	\$11.56	53.3%



each of these products are sold on a stand-alone basis.

At an average size of \$13.0 million, all these TPAs were in the top 40% of all TPAs, and five were among the top 20% of all TPAs, based on a list published by the Society of Professional Benefit Administrators. On average, participants in the TPA benchmarking study had 43,000 medical employees served and 87,000 medical members. Because participation in our benchmarks was voluntary and entailed detailed reporting, we think that participation self-selected for organizations that have better than average information/accounting systems. It is also possible that these firms had better than average performance on the common-sense grounds that "you manage what you measure."

Appendix D. Benchmark Summary

Core TPA Costs By Product, 2009 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Medical	\$7.63	\$14.24	\$11.56	39.4%
Dental	0.47	0.68	0.54	46.4%
Vision	0.15	0.24	0.16	50.9%
Pharmacy	0.23	0.39	0.31	54.3%
Short-Term Disability	0.50	0.55	0.52	12.3%
FSA Administration	1.05	6.08	3.49	88.7%
Student Health Administration	4.49	4.49	4.49	NM
Other	4.41	6.31	5.36	50.1%
Total, All Lines	\$3.74	\$7.32	\$6.08	48.2%

Appendix E. Benchmark Summary

Core TPA Costs By Functional Area Cluster, 2009 Data

Per Employee Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Sales and Marketing	\$1.88	\$2.86	\$2.61	43.5%
Account and Membership Admin.	4.45	9.07	6.32	59.9%
Corporate Services	2.00	2.49	2.38	47.8%
Total Core Services	\$8.33	\$14.16	\$11.56	53.3%

Sherlock Company Benchmarks

Overall, our benchmarks in 2011 will comprise the cumulative experience of approximately 514 health benefit organization years. In addition to TPAs, we also have universes of Independent / Provider-Sponsored Plans, Blue Cross Blue Shield Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. We have published results on the Blue Cross Blue Shield Plans and the Independent / Provider-Sponsored Plans and we will be reporting on results for the other peer groups within the month.

Appendix F. Benchmark Summary

Core TPA Costs By Functional Area Cluster, 2009 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Sales and Marketing	\$0.84	\$1.50	\$1.35	40.6%
Account and Membership Admini	2.00	4.69	3.32	54.9%
Corporate Services	0.90	1.29	1.25	41.4%
Total Core Services	\$3.74	\$7.32	\$6.08	48.2%

