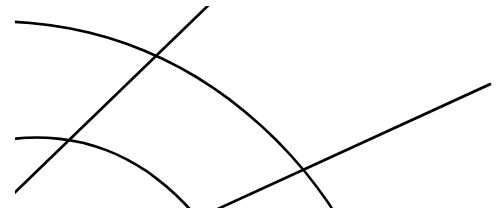


Plan Management Navigator



Analytics For Health Plan Administration

April 2004

ADMINISTRATIVE EXPENSE BENCHMARKS FOR LARGER HEALTH PLANS

PUBLISHED BY SHERLOCK COMPANY

Background

Industry lore holds that there are substantial economies of scale in the administration of health plans. Business combinations and outsourcing are strategic initiatives employed by health plans to capitalize on this perceived advantage. Advantages of scale may be observable in all types of health plans.

In our analyses of scale we have tended to focus on Blue Cross Blue Shield Plans. However, health plans participating in Sherlock Company's benchmarking studies include public, Blue Cross Blue Shield, provider-sponsored and Medicaid-oriented plans. While participants in each universe have many common characteristics, they all compete in a common health coverage market (with the possible exception of Medicaid-oriented health plans).

Accordingly, one way of determining the advantages of scale is to focus on larger health plans, regardless of our segmentation. We looked at six of the largest firms ("Larger Health Plans") in our universes, three Public and three Blue Cross Blue Shield Plans. At over three million members each, they were twice the size of the average Blue Cross Blue Shield Plan and more than one-third larger than the average public company in our universes.

Results

Sherlock Company's recently published benchmarks for Larger Health Plans report median costs of \$19.31 for all comprehensive products. *By contrast, median costs for comprehensive products of Blue Cross Blue Shield Plans and public companies were \$22.46 and 24.13, respectively.* (Please see other Sherlock Company research for additional information.)

The participating firms reported expenses which ranged from \$3.53 for Stand-alone Dental to a high of \$44.20 for Medicare + Choice. Medicaid HMO had the lowest cost to administer among comprehensive products at \$10.93. On a percent of revenue basis, insured comprehensive products ranged from 7.21% for Medicare + Choice to a high of 11.92% for commercial POS. Account and membership administration comprised the largest component of health plan administrative expenses.

The data included in Figure 1 are summaries of the expense classifications. Plans provided us with information on forty-four functional areas including subtotals, detailed in the SEER report itself.

Marketing expenses included Rating and Underwriting, Product Development / Market Research, Sales and Marketing, Commissions and Advertising and Promotion. These expenses represented \$6.30 of the total administrative costs. At the 75th percentile, these costs were \$6.77 but only \$4.83 at the 25th percentile. Commissions paid to brokers comprised \$2.93, the lion's share of these expenses.

Medical & Provider Management was composed of Provider Network Management and Services and Medical Management (including Quality Assurance, Wellness Programs and Grievance / Appeals). These expenses had a median value of \$2.54. At the 75th percentile, these costs were \$2.97, but were as low as \$2.38 at the 25th percentile. Expenses for Medical & Provider Management are highly sensitive to the mix of products offered: Managed care products such as HMOs tend to require a higher commitment to this function. These expenses were more clustered than the other breakouts.

Account & Membership Administration represented \$7.53 per member per month of administrative expenses in 2002, the largest share of administrative costs. This category of expenses includes many of the core functions such as Enrollment (including Membership and Billing), Customer Services, Information Systems and Claims (including Encounter Capture and Adjudication). Plans reported \$7.97 at the 75th percentile and \$6.62 at the 25th percentile.

Corporate Services represented the final category. It included investments in HIPAA compliance as well as Finance and Accounting, Actuarial, Corporate Services (including Human Resources, Facilities, Legal and Regulatory, Corporate / Executive and Association Dues and Miscellaneous Business Taxes). These expenses collectively represented \$4.76 in administrative expenses. Fewer than 25% exceeded \$6.06 or were less than \$3.54.

Expenses varied significantly between products. The most expensive product to administer, by far, was Medicare + Choice, which had a median cost of \$44.20. The least expensive was Stand-alone Dental, which had expenses of \$3.53. Among comprehensive products, the lowest cost plan to administer was Medicaid HMO: The median cost was \$10.93. Indemnity & PPO sold on an ASO / ASC basis was the lowest cost commercial product to administer at \$13.88.

Health plan administrative expenses varied by product when measured as a percent of revenues as well. Despite its high per member costs, Medicare + Choice is the lowest cost to administer, at 7.21% of revenues: Medicare beneficiaries have higher underlying health costs, leading to higher claim processing and customer service calls. Among commercial plans, the POS was the highest cost to administer, at 11.92%, compared to 10.51% for the HMO and 11.23% for the Indemnity and PPO. Medicaid HMO had administrative expenses of 7.94% of revenues.

Among commercial products, the costs to administer insured products were significantly higher than for comparable products sold on an ASO / ASC basis. Differences ranged from a high of \$10.65 in Indemnity and PPO, to a low of \$6.62 for Commercial HMO.

Figure 1. Benchmarks for Larger Plans' Administrative Expenses: 2003
Cost Per Member Per Month - By Function, Comprehensive Products

	25th %	75th %	Median	σ / Mean
Marketing	\$4.83	\$6.77	\$6.30	41.63%
Medical and Provider Management	\$2.38	\$2.97	\$2.54	20.16%
Account and Membership Administration	\$6.62	\$7.97	\$7.53	22.69%
Corporate Services	\$3.54	\$6.06	\$4.76	46.59%
Total Expenses	\$18.56	\$26.45	\$19.31	27.26%

Larger Plans generally appeared to enjoy better margins in health products provided on an ASO / ASC basis. In two of the products, revenues exceed expenses and in one costs approximated revenues.

Continued on Page 2

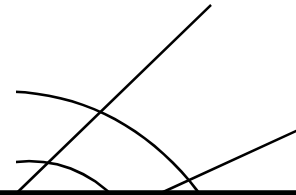


Figure 2. Benchmarks for Larger Plans' Administrative Expenses: 2003
Costs Per Member Per Month - By Product Line

	25th %	75th %	Median	σ / Mean
Commercial HMO				
Insured	\$21.16	\$21.83	\$21.61	9.26%
ASO / ASC	\$13.97	\$16.72	\$14.99	16.90%
Commercial POS				
Insured	\$21.74	\$27.12	\$25.55	15.53%
ASO / ASC	\$15.70	\$18.69	\$17.08	11.00%
Indemnity & PPO				
Insured	\$23.37	\$29.86	\$24.53	29.21%
ASO / ASC	\$13.39	\$15.41	\$13.88	20.53%
Medicare + Choice	\$37.17	\$48.70	\$44.20	17.22%
Medicaid HMO	\$10.93	\$10.93	\$10.93	NM
Medicare Supplemental	\$11.66	\$14.91	\$12.29	25.30%
Stand-alone Dental	\$3.38	\$3.68	\$3.53	12.08%

Figure 3. Benchmarks for Larger Plans' Administrative Expenses: 2003
Costs as a Percent of Revenue - By Product Line

	25th %	75th %	Median	σ / Mean
Commercial HMO				
Insured	10.36%	11.82%	10.51%	12.90%
ASO / ASC	76.74%	90.76%	85.70%	18.70%
Commercial POS				
Insured	11.68%	12.00%	11.92%	7.43%
ASO / ASC	86.98%	110.26%	97.19%	34.48%
Indemnity & PPO				
Insured	10.53%	12.21%	11.23%	10.57%
ASO / ASC	78.08%	101.98%	91.84%	23.66%
Medicare + Choice	5.97%	7.44%	7.21%	21.18%
Medicaid HMO	7.94%	7.94%	7.94%	NM
Medicare Supplemental	10.06%	12.51%	11.89%	23.00%
Stand-alone Dental	23.26%	42.32%	32.79%	82.20%

By contrast, Blue Cross Blue Shield Plans tended to report losses, at best, in these self-insured product areas.

Background on the Larger Plan Reports

The six Larger Plans surveyed serve 18 million individuals. The surveyed items, the survey instrument, the definitions and the process are developed through the active participation of the surveyed plans. SEER data is provided by the companies who receive copies of the report in return for participation.

Volume I of SEER for Larger Plans contains 2,425 analyses of ten principle product areas and sixteen functional areas, plus subcategories. All information is as of December 31, 2002. Separate analyses include individual products and national accounts, outsourced functions such as mental health, pharmacy and COB / Subrogation and information systems allocations. Products offered by the plans include HMO, Point-of-Service, Indemnity and PPO, Medicare HMO, Medicaid HMO and Medicare Supplemental.

Volume II, provides over 1,000 operational analyses of eight key functional areas, including marketing, customer service, claims, enrollment and provider relations. Examples include average cost per inquiry, average speed of answer and the average cost, speed and accuracy of processed claims.

OUTSOURCING

We have recently completed an analysis of outsourcing for health plans in the April, 2004 issue of *PULSE*. The shift toward a more consumer-directed model of health care, changes in health care delivery, and increasing demand for choice of provider has made reduction in health care costs only incremental. While administrative cost control can be achieved through a variety of strategies, outsourcing provides an opportunity for health plans to achieve economies of scale while retaining autonomy.

Outsourcing allows health plans to focus on their core lines of business and core competencies. By shifting such processes as mail room operations and claims capture to third parties, managers can focus their resources toward core functions that differentiate the plan. Health plans can also experience the benefits of technological innovation and expertise without having to make risky investments that could soon become outdated. Other benefits include reduced costs of execution and greater ease and speed of growth.

The primary downside of outsourcing may be a loss of flexibility and control of operations. Since managers are no longer directly supervising processes, their ability to respond to changes could be limited. Other downsides include the cost of finding an appropriate vendor, possible decreases in employment, and ethical concerns about outsourcing overseas.

The types of outsourcing provided by the eighteen firms in our analysis include Business Process Outsourcing, Information Technology Outsourcing, Application Service Provider, and Consulting. Some of the firms surveyed in our analysis are Accenture, Ltd., Adaptis Inc., CSC, EDS, IBM Global Services, McKesson Corporation, and The Trizetto Group, Inc.

2004 PRODUCTION SCHEDULES

We are anticipating an active season of benchmarking this year. We have four universes at this point, as described below. The dates refer to distribution of results to participants. We expect general editions, available for purchase, to be available a few weeks later.

Public I (Financial Metrics)	Late June
Public II (Operational Metrics)	Late July
Blue I	Late June
Blue II	Late July
Provider Sponsored I	Early August
Provider Sponsored II	Early August
Medicaid-Oriented Plans I	August
Medicaid-Oriented Plans II	August

In addition, we are contemplating the introduction of other universes. We will keep readers informed as these develop. *Finally, if your plan has an interest in participating in any of these universes, kindly give us a call as soon as possible.*

