



Plan Management Navigator

Analytics For Health Plan Administration

August 2004

Administrative Expense Benchmarks for Publicly Traded Companies Published by Sherlock Company

Sherlock Company's recently published benchmarks for publicly traded health plans report median costs of \$30.61 for all comprehensive products. The reporting firms, three publicly traded health plans with an average membership of 5.7 million members, reported expenses which ranged from \$17.95 for Commercial HMO, ASO/ASC to \$51.04 for Medicare Advantage. Marketing comprised the largest component of health plan administrative expenses. The complete results are published in the 2004 *Sherlock Expense Evaluation Report (SEER) Public Company Edition*.

Marketing expenses included Rating and Underwriting, Product Development / Market Research, Sales and Marketing, Commissions and Advertising and Promotion. These expenses represented \$9.98 of the total administrative costs. At the 75th percentile, these costs were \$11.01 and \$7.54 at the 25th percentile. Commissions paid to brokers comprised the majority of these expenses at \$3.00 PMPM.

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 \$3.83. At the 75th percentile, these costs were \$4.33, but were as low as \$3.63 at the 25th percentile. For those comparing these with Blue Cross Blue Shield Plan results (published in July), it is notable that 32.4% of members served by public companies are in insured HMO products compared with 9.0% of those served by Blue Cross Blue Shield Plans. These expenses were more closely clustered than that of any other high-level area.

Account & Membership Administration represented \$8.89 per member per month of administrative expenses in 2003. 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 \$11.10 at the 75th percentile and \$8.42 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 \$7.18 in administrative expenses. Fewer than 25% exceeded \$9.10 or were less than \$5.75.

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

Figure 1. Benchmarks for Public Plans' Administrative Expenses: 2004
Cost Per Member Per Month - By Function, Comprehensive Products

| | 25th % | 75th % | Median | σ/Mean |
|-------------------------------|---------|---------|---------|--------|
| Marketing | \$7.54 | \$11.01 | \$9.98 | 39.53% |
| Medical and Provider Mgmt. | \$3.63 | \$4.33 | \$3.83 | 17.93% |
| Account and Membership.Admin. | \$8.42 | \$11.10 | \$8.89 | 28.45% |
| Corporate Services | \$5.75 | \$9.10 | \$7.18 | 44.83% |
| Total Expenses | \$26.37 | \$34.88 | \$30.61 | 27.79% |

Expenses varied significantly between products. The most expensive product to administer, by far, was Medicare Advantage, which had a median cost of \$51.04. The least expensive was Stand-alone Dental, which had expenses of \$2.50. Among comprehensive products, the lowest cost plan to administer was Commercial HMO, ASO/ASC at \$17.95. The next lowest comprehensive product to manage was Indemnity & PPO, ASO/ASC at \$18.03.

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 \$26.33 for Indemnity & PPO, to a low of \$8.19 for Commercial HMO.

Figure 2. Benchmarks for Public Plans' Administrative Expenses: 2004
Cost Per Member Per Month - By Product Line

| | 25th % | 75th % | Median | σ/Mean |
|-----------------------|---------|---------|---------|--------|
| Commercial HMO | | | | |
| Insured | \$24.35 | \$28.67 | \$26.14 | 16.27% |
| ASO / ASC | \$17.25 | \$18.65 | \$17.95 | 11.04% |
| Commercial POS | | | | |
| Insured | \$32.62 | \$35.14 | \$33.88 | 10.55% |
| ASO / ASC | \$17.48 | \$18.73 | \$18.10 | 9.78% |
| Indemnity & PPO | | | | |
| Insured | \$38.70 | \$45.11 | \$44.36 | 17.05% |
| ASO / ASC | \$17.36 | \$18.69 | \$18.03 | 10.42% |
| Medicare + Choice | \$43.27 | \$63.22 | \$51.04 | 37.26% |
| Medicaid HMO | NM | NM | NM | NM |
| Medicare Supplemental | NM | NM | NM | NM |
| Stand-alone Dental | \$2.18 | \$2.83 | \$2.50 | 36.58% |

Health plan administrative expenses varied by product when measured as a percent of revenues as well. Despite its high per member costs, Medicare Advantage is the lowest cost to administer, at 7.28% of revenues. Among commercial insured

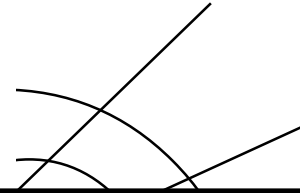


Figure 3. Benchmarks for Public Plans' Administrative Expenses: 2004
Costs as a Percent of Revenue - By Product Line

| | 25th % | 75th % | Median | σ /Mean |
|-----------------------|--------|--------|--------|----------------|
| Commercial HMO | | | | |
| Insured | 12.24% | 13.89% | 13.87% | 14.77% |
| ASO / ASC | 76.94% | 83.97% | 80.45% | 12.35% |
| Commercial POS | | | | |
| Insured | 14.27% | 15.51% | 14.89% | 11.74% |
| ASO / ASC | 77.41% | 86.20% | 81.80% | 15.20% |
| Indemnity & PPO | | | | |
| Insured | 14.86% | 16.65% | 16.19% | 11.87% |
| ASO / ASC | 78.42% | 98.84% | 88.63% | 32.58% |
| Medicare + Choice | 6.12% | 9.70% | 7.28% | 45.05% |
| Medicaid HMO | NM | NM | NM | NM |
| Medicare Supplemental | NM | NM | NM | NM |
| Stand-alone Dental | 17.11% | 17.37% | 17.24% | 2.12% |

plans, Indemnity & PPO was the highest cost to administer, at 16.19%, compared to 14.89% for Commercial POS and 13.87% for Commercial HMO.

Publicly traded health plans appeared to enjoy healthy margins in insurance products provided on an ASO / ASC basis. Revenues generally exceeded expenses in these product areas.

BACKGROUND ON THE PUBLIC COMPANIES AND SEER

There are 12 publicly traded plans focused on commercial members with approximately 44.9 million insured members. The three plans in our universe serve 8.5 million insured members, or approximately 19% of the membership and 25% of the plans themselves, based on recent *PULSE* data. Because of confidentiality agreements we are not able to disclose the identities of the participants. There is no overlap between the companies in this universe and a similar study of Blue Cross Blue Shield Plans.

Information contained in *SEER* is from extensive surveys of the participants, who report to us administrative costs as well as certain operational metrics. This is the seventh year that we have been performing benchmarking studies. In addition to these universes, we have recently completed Volumes I of the Larger Plans edition and the Provider-sponsored plans edition; our second year of the Medicaid-oriented health plans edition will be out in September.

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 Public Companies contains approximately 2,500 analyses of fourteen principle product areas and eighteen functional areas, plus nineteen subcategories. All information is as of December 31, 2003. Separate analyses include outsourced functions such as mental health, pharmacy

and COB / Subrogation. Products offered by the plans include HMO, Point-of-Service, Indemnity and PPO, Medicare HMO, Medicaid HMO and Medicare Supplemental.

WHAT'S NEXT FOR SEER?

To date we have distributed to participants four *SEER* volumes, including financial metrics (Volume I) for public, Blue and provider sponsored universes, as well as operating metrics (Volume II) for the Blue universe. Summaries for the Volumes I are above for public companies and in *Navigator* for July 2004 for Blue Plans.

Blue Cross Blue Shield Edition, Volume II.

This volume does not lend itself to easy summarization, but suffice to say that the approximately 2,300 analyses permit the user to drill down to sources of financial variances. It contains analyses of ten 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.

Larger Plans Edition, Volumes I & II. These volumes offer a combination of the three largest Blue Cross Blue Shield Plans and the three largest Public Companies. The analyses in Volumes I & II are similar to those found in the Blue Cross Blue Shield Edition. Next month's *Navigator* will look at this universe more in depth.

Provider Sponsored Plans Edition, Volumes I & II. This is similar to the Blue Cross Blue Shield and Public Volumes I. The results are interesting in that these firms appear to have surprisingly low costs, especially considering that they are significantly smaller than typical companies in other universes. We will touch on this in future editions of *Navigator*.

Medicaid-oriented Plans Edition, Volumes I & II. This will be our second year of our Medicaid edition, which examines plans that primarily deal with Medicaid. We have added one participant since last year, as well as strengthening the definitions of our operational metrics.

| VOLUME | PUBLICATION DATE |
|----------------------------|------------------|
| BCBS, Volumes I & II | Now Available |
| Public Companies, Vol I | Now Available |
| Larger Plans, Vol I | Now Available |
| Larger Plans, Vol II | End of August |
| Provider Sponsored, Vol I | Now Available |
| Provider Sponsored, Vol II | End of August |
| Medicaid, Vol I | Mid-September |
| Medicaid, Vol II | Early October |