



Benchmarking Survey Materials Going Out: Still Time to Join!

We are now launching our 2007 *Sherlock Expense Evaluation Report (SEER)* surveys, with publication dates of July-August of 2007. All together, 45 health plans have already committed to participation in this year's studies, and they are in the universes below. (Because of their unique characteristics, a few plans are found in more than one universe.) Our universes provide a uniquely robust sample size.

<i>Universe</i>	<i>Committed Participants</i>
Blue Cross Blue Shield	22
Provider-Sponsored*	12
Medicaid-Oriented	11
Medicare Advantage	5

*This also includes other independent plans.

Since the survey materials will not have to be returned to us until late May or early June, there is **still**

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New Innovations in SEER

While we are now in the midst of our tenth annual survey, as the industry changes, we continue to improve. Some of the changes apparent to participants are as follows. The implementation of these changes varies somewhat across the various universes.

- Marketing.** We are providing better segmentation of the components of changes in membership. The 2007 edition will segment growth into changes in number of groups and changes in average group size. (A group, distinct from an account, is defined as capable of negotiating premium rates.) The increase in the number of groups is segmented by Groups Lost and New Groups. A group persistency rate is also calculated.

Membership changes are also segmented by the membership impacts of new groups, the membership impact of lost groups and the

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Benchmarking and Business Combinations

SEER performance benchmarks are useful for planning the integration two health plans contemplating a business combination. One rough indicator of this applicability is a comparison between the control premium offered for a company and our estimate of the likely synergies that would emerge. It turns out that our benchmarks explain, in general direction, the modest control premium in a recently announced merger between UnitedHealth and Sierra.

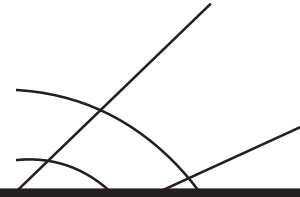
It is important to recognize that Sherlock Company, unlike the potential business partners, does not possess any insider information concerning the two companies. Our analysis is based solely on their respective financial statements and our studies of the administrative costs of similar firms.

Historically, the control premium for publicly traded health plans has been in the 30% range. In that sense, the actual premium of 15.9% offered by UnitedHealth Group for Sierra Health Services was remarkably low. So why is that?

A control premium represents the additional payment above the stock market price for the prerogatives of control. One of those prerogatives is the ability to implement changes that result in synergies between the suitor and the acquisition candidate. Thus one aspect of the control premium must be the anticipated synergies between the business partners, to the degree that it is realized through negotiations. Accordingly, we believe that the main reason for the modest control premium is that UnitedHealth is so large that Sierra offers it little additional scale so that the combined reduction in costs resulting from a business combination is limited.

Back in January, we published estimates of control premiums between all combinations of publicly traded companies, assuming that each control premium represented the percent improvement in operating profits attributable to the reduction in administrative expenses. To do this, we performed a series of regression analyses between membership and per member costs to estimate scalability of each of the functional areas for companies in the SEER universe. Only approximately 6% of administrative costs display statistically significant scalability and

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even in those cases, a doubling of the size of the enterprise leads to a 76% increase in those scalable costs. Naturally, the effect of the economies of scale depends in part on the relative size of the two organizations, and smaller firms are a smaller increment in size than larger ones.

The calculated improvement in operating profits, and hence control premium) reflected the application of the relationships identified in the SEER data to the financial information provided by the public companies. Since health insurers sell similar products and operate similarly, these results are applicable to other health plans. In this case, in January we estimated that the likely premium, should such a merger be announced between UnitedHealth and Sierra would approximate 3%. This is considerably lower than the historic levels.

SEER does not endeavor to quantify synergies other than those purely linked to scale, and plainly other factors must have played a part in the control premium offered for Sierra. These may include the benefits of the introduction of complementary products, like Medicare Advantage, the elimination of the economics of any preexisting relationships between them, the adoption by Sierra of any better practices now employed by UnitedHealth or other factors. Notwithstanding, the size difference and the few functional areas subject to scale help to explain the modest control premium. ❖

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time for your plan to participate. Participants receive customized copies of the *Sherlock Expense Evaluation Report* at a significant cost savings.

The strengths of our benchmarks include ten consecutive years of experience, absence of conflicts of interest, the quality assurance advantages of users as participants, other rigorous methodological quality assurance procedures, participation-governed metrics with a high ratio of "insight to effort", enterprise-wide metrics, flexibility in reporting plus low costs and discounts.

If you think this would interest you, we invite you to contact us as soon as possible.

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New Innovations in SEER: *From Previous Page*

membership impact of lost groups and the net change in membership in groups that have been retained. From this, we calculate a persistency rate (the combined effect of groups lost and growth within groups retained) and a growth rate in the membership of groups retained.

- 2. Information Systems.** There were numerous improvements in the operational metrics for this key functional area. They include a more rigorous segmentation of costs by platform, better analysis of IS capital expenditures by platform, segmentation of "spend" into capital expenditures and accrual expenses. We also added some new metrics including Prime Shift Peak Utilization. To better reflect the interaction between IS and its supported functional areas, we offered a more intuitive methodology for their allocation. In general, we endeavored to understand and correspond with the broadly accepted analytical framework, Control Objectives for Information and related Technology (COBIT), in this section.
- 3. Claims.** The main changes in the metrics for this functional area were refinements in data collection to promote more comparable reporting. The one exception is that we now ask for the number of clean claims submitted in electronic form subject to automatic processing. We also ask for actual values rather than self-reported ratios to compute Auto-Adjudication Rate, Suspense Rate and Percent Reworked. We have also better delineated receipts versus claims in productivity calculations. Finally, we have added requests for data to calculate two additional metrics, the Adjudication Pass Rate and the Total Pass Rate.
- 4. Employees and Outsourcing.** We are now providing breakouts of employees and costs by employed and outsourced. This should provide a better gauge of the extent of outsourcing among health plans.

All of these innovations were the result of a series of conference calls and meetings with the participants, and reflected the application of their findings. This methodology promotes consistency and high insight-to-effort ratios. ❖
