



PERFORMANCE BENCHMARKS FOR LARGER PLANS RELEASED BY SHERLOCK COMPANY

Median costs of Larger Plans, reported in Sherlock Company's benchmarks, are \$25.14 Per Member Per Month (PMPM) for all comprehensive products in 2006 or 10.3% of premium equivalents. Larger Plans at the 25th percentile reported costs of \$21.42 PMPM (9.8% of premium equivalents), and at the 75th percentile, Larger Plans reported costs of \$28.96 PMPM (12.7% of premium equivalents).

Larger Plan universe is a subset of the Blue Cross Blue Shield universe. The median plan serves 2.7 million comprehensive members and the mean membership is 3.0 million comprehensive members. The average plan in this set is thus larger than eight of the fourteen publicly-traded companies, and the two largest firms in our Larger plan universe are comparable in size as two of the remaining six. There are six plans in this universe and they serve members on both coasts and upper mid-west.

Why are Larger Health Plans Interesting?

Conventional wisdom holds that a large health plan may be able to realize economies of scale, and thus a sustainable competitive advantage over other health plans. Health plans contemplating business combinations sometimes cite these benefits as they execute strategies designed to achieve best practices in operations management. This is especially important in cases in which other types of economies of scale, such as bargaining power are, for whatever reason, unavailable. In the race to meet consumer demand for greater efficiency, many Blue Cross Blue Shield Plans have attempted to execute this strategy, and the number of Blue plans has declined from 47 in 2000 to 39 today.

However, it is difficult to conclusively state that technical economies of scale exist in health insurance operations. Excluding miscellaneous business taxes (which we do throughout this analysis) the median comprehensive total costs were \$25.14 for larger plans, which is only 2.3% lower compared with \$25.72 for the Blue universe as a whole. Also, when we perform scale studies, we find that few functions are scalable and the slopes of scalability are rather gradual in those instances. Our September edition of *PULSE* will illustrate this in greater detail.

On the other hand, it appears that larger plans may operate in high cost geographic areas. The median PMPM premium (including equivalents) at \$229.27 was 3.8% higher; this

SUMMER READING: *RATING AND UNDERWRITING FOR HEALTH PLANS*

The focus of managerial attention in health plan administration has swung like a pendulum from aggressive management of administration in the 60s and 70s, to aggressive management of health care in the 80s and 90s, and now back to management of administration. Similarly, managerial talents rewarded by health plans have shifted from visionary to execution.

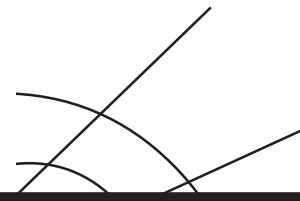
Among functional areas, rating and underwriting exists at center of these trends, both reflecting the management of health care and recognizing that its trends exist independently, and must be priced accordingly. John van Steenwyk's authoritative *Rating and Underwriting for Health Plans* is an execution-oriented guide to this functional area.

While *Rating and Underwriting* is accessible to generalists, it is thorough. Mr. van Steenwyk, places the "art and science" in an historical context, builds on the foundational regulatory context, leading to capitation and finally to premium rate development. He highlights the interaction between variation in outcomes with capitation setting, and the interaction between risk assumption and managerial incentives. He offers many treatments of the credibility of estimates, focusing on the statistical reliability of samples for costs for a population and for a health care need. Because it is designed for application, van Steenwyk provides examples of rating methodologies and detailed worksheets for experience rating.

Rating and Underwriting is not without van Steenwyk's gentle humor and commentary: Rate negotiations are a form of "controlled combat: fencing matches, soccer games, etc." Commenting on the importance of accurate estimates he notes that "many former health plan executives can date the end of their leadership careers to a misjudgment ... of total claims expenses." Regarding data sources, "There is a code for everything."

John van Steenwyk, a friend and a professional acquaintance (who by the way cites us) has written a fine technical treatment of this essential function. It is nevertheless accessible background for generalist health plan executives, health benefit plan sponsors and their advisors. Since some of those advisors earn \$15 PMPM, at \$28.00 hardback (www.healthplanrates.us) *Rating and Underwriting* should provide readers an enormous ROI.

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Larger Plans Benchmarks: *Continued from Page 1*

combined with the lower PMPM costs translate into a more dramatic difference of 10.3% of premiums. Also true economies of scale could be obscured by management actions. Investments can resemble expenses as seen by Larger Plans having information systems costs that are roughly 9% higher than for the Blues universe. Finally, it is possible that some operating expenses resemble luxury goods: Facilities costs in Larger Plans, at \$1.10, are more than 17% higher per member per month than for Blues.

Background

Sherlock Company's Larger Plan edition is the third release of a series of five universes of benchmarks of performance metrics for health plans, and is the tenth annual performance benchmarks compiled and analyzed by Sherlock Company. Other universes include Medicare Advantage, Medicaid, Provider-Sponsored and Blue Cross Blue Shield Plans.

The six Plans included in this study serve 17.8 million people under comprehensive health benefit plans. Their members are more likely to served under ASO arrangements than Blue Cross Blue Shield Plans. Commercial members are served through six types of health coverage products. In addition, these plans also provided products including Medicare Advantage, Medicare Part D, Stand-Alone Dental, Medicaid HMO and Medicare Supplement.

Of the respondents participating in this year's larger plan study, one is new and all of the others have five or more years of experience participating in SEER. This "practice effect," along with the extensive documentation and data review, helps to assure the reliability of our metrics.

The financial metrics summarized here are complemented by extensive operational metrics in companion volumes, facilitating more in-depth analyses. Typically, expenses are parsed into factors of user demand, employee productivity, unit cost, staffing ratios and cost per employee. For instance, Provider Network Management and Service includes such metrics as provider inquiries per member, productivity of provider service representatives, cost per inquiry and per-employee costs of provider service. Numerous drivers of costs and quality are also provided. In the provider service area, for example, these include metrics of mixes of media of inquiries, average speed of answer and provider satisfaction.

Expenses by Functional Area Cluster

In addition to their size, it appears that the larger plans operate somewhat differently than the universe as a whole. Mainly, marketing costs are lower and medical management costs are higher. As developed later, the lower marketing costs seem to comport with the higher ASO mix, but the higher medical management costs are not associated with an especially high mix of managed care.

In the Larger Plans edition of *Sherlock Expense Evaluation Report*, administrative expenses for each product are segmented into nearly sixty different functional areas. For the purpose of the *Plan Management Navigator*, we have summarized these functional areas into "clusters" of Marketing, Medical and Provider Management, Account and Membership Administration, and Corporate Services.

Marketing expenses represented a median value of \$6.60 PMPM (2.8% of premium equivalents) of the total administrative costs. At the 75th percentile, these costs were \$8.80 PMPM but only \$5.58 PMPM at the 25th percentile.

Marketing costs were less than the median value of \$7.46 for the Blue universe as a whole. Significantly, commissions paid to brokers were \$4.25 PMPM, less than the \$5.16 for the Blues universe. The higher mix of ASO members, which are often sold directly rather than through brokers, is the likely explanation. Other expenses in this cluster include Rating and Underwriting, Product Development / Market Research, Sales and Marketing, and Advertising and Promotion.

Medical & Provider Management is the cluster combining Provider Network Management and Services with Medical Management. Provider contracting, provider service, case and disease management and precertification are among the activities provided by functions in this cluster. These expenses had a median value of \$3.52 PMPM (1.5% of premium equivalents), substantially higher than the median value of \$2.89 for the Blue universe. At the 75th percentile, these costs were \$3.67 PMPM, but were as low as \$3.19 PMPM at the 25th percentile.

Figure 1. Benchmark Summary
Larger Plan Costs by Functional Area Cluster
Per Member Per Month

	25th Pctl	75th Pctl	Median	σ /Mean
Marketing	\$5.58	\$8.80	\$6.60	34.5%
Provider & Medical Management	3.19	3.67	3.52	22.3%
Account & Mem. Administration	9.39	12.24	10.82	21.3%
Corporate Services	3.86	5.44	4.68	23.9%
Total	\$21.42	\$28.96	\$25.14	21.9%

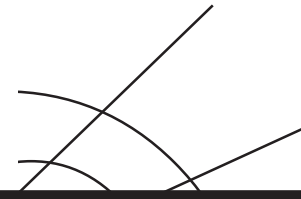


Figure 2. Benchmark Summary
Larger Plan Costs by Functional Area Cluster

Percent of Premium Equivalents	25th Pctl	75th Pctl	Median	σ /Mean
Marketing	2.5%	3.9%	2.8%	29.6%
Provider & Medical Management	1.4%	1.6%	1.5%	18.0%
Account & Mem. Administration	4.3%	5.1%	4.4%	17.0%
Corporate Services	1.6%	2.2%	2.0%	24.5%
Total	9.8%	12.7%	10.3%	16.9%

These expenses collectively represented \$4.68 PMPM (2.0% of premium equivalents) in administrative expenses, compared with \$4.70 that Blue Cross Blue Shield Plans see. Fewer than 25% of plans exceeded \$5.44 PMPM or were less than \$3.86 PMPM.

Expenses for Medical & Provider Management are sensitive to the mix of products offered. Among Larger Plans' insured commercial products, PMPM medical management is more than 25% higher than its ASO counterparts. Also HMO Medical Management costs are at least 50% higher than their less managed other products. But there is evidently an additional factor that the product mixes cannot explain since the mix of managed care is substantially the same across the two universes. Larger Plans seem willing to commit more resources to medical management, regardless of the product offered.

Account & Membership Administration represented \$10.82 per member per month of administrative expenses (4.4% of premium equivalents) in 2006, the largest share of Larger Plans' administrative costs. It was higher than the \$9.90 reported by the universe of Blue Cross Blue Shield Plans. This cluster of expenses includes many of health plans' core functions such as Enrollment (including Membership and Billing), Customer Services, Information Systems and Claims (including Encounter Capture and Adjudication). Plans reported \$12.24 at the 75th percentile and \$9.39 at the 25th percentile.

The costs of many of the functional areas within this cluster are the same between the Blue and Larger universe. Information systems costs are \$5.51 PMPM, roughly 9% higher than for the Blues universe, and comprise nearly one-half of the difference.

Corporate Services represented the final cluster of expenses. It included expenditures for 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.

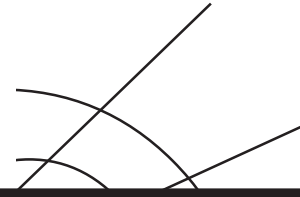
These expenses are more susceptible to economies of scale than other groups of functional expenses, based on Sherlock Company's economies of scale studies. While the median values are only \$0.02 less than the Blues, the components evidence scalability. The median costs for Corporate Services is less by 6%, Finance is less by 19% and Corporate Executive and Governance is less by 22%.

Expenses by Product

As previously noted, the median comprehensive total product offered by Larger Plans is \$25.14, slightly lower than the \$25.72 of the Blue Cross Blue Shield universe. However, the products offered by the Larger Plans varied in cost because they have different functional requirements. Managed care products tend to require a much greater commitment to medical management, and ASO products operate with lower marketing and medical management costs than their insured counterparts.

Figure 3. Benchmark Summary
Larger Plan Costs by Product

Per Member Per Month	25th Pctl	75th Pctl	Median	σ /Mean
Commercial HMO				
Insured	\$31.01	\$42.35	\$38.59	32.1%
ASO / ASC	\$23.53	\$39.63	\$29.02	50.5%
Commercial POS				
Insured	\$26.49	\$29.47	\$27.91	10.7%
ASO / ASC	\$20.32	\$20.46	\$20.45	0.8%
Indemnity & PPO				
Insured	\$27.65	\$40.28	\$30.99	26.7%
ASO / ASC	\$17.74	\$19.71	\$18.67	18.6%
Medicare Advantage	\$48.16	\$75.29	\$55.88	34.0%
Medicaid	\$18.46	\$20.57	\$19.34	10.8%
Medicare Supplemental	\$22.76	\$32.00	\$25.97	31.4%
Comprehensive Total	\$21.42	\$28.96	\$25.14	21.9%
Stand Alone Dental	\$2.51	\$3.30	\$2.91	38.4%
Medicare Part D	\$14.41	\$20.42	\$20.02	52.6%



Among comprehensive products offered by Larger Plans, Medicare Advantage have the highest costs at \$55.88 PMPM, less than \$59.87 incurred by the Blues universe.

Among commercial products, the insured HMO was the most expensive to administer at \$38.59. Notably, its costs were approximately \$9.00 higher than the other insured products offered by these larger plans. It was also considerably higher than its Blue Cross Blue Shield counterparts at \$29.85.

Generally, commercial ASO products cost typically \$10.00 PMPM less than their insured counterparts. Notably, the Indemnity and PPO ASO product cost \$18.67 compared with \$30.99 for its insured counterpart. Marketing costs are the primary reason for this as Commercial Insured broker commissions were \$8.90, \$8.49 higher than their ASO counterparts. Medical Management costs are also lower for ASO products. Blue Cross Blue Shield Plans as a group posted costs of \$19.27 for Indemnity and PPO insured.

Medicaid and Medicare Supplemental plans typically cost \$19.34 PMPM and \$25.97 PMPM, respectively to administer. Blues, by contrast, reported \$18.93 and \$26.94 for these products.

Larger Plans' Stand-alone Dental had costs of \$2.91 PMPM, compared with \$3.08 for the Blues, while the median administrative costs for the new Medicare Part D was \$20.02, compared with \$20.55 for the Blue universe as a whole.

Percent of Premiums or Equivalents by Product

Expressing administration as a percent of premium is controversial since both the numerator and the denominator can be subject to factors other than efficiency. Business mix, differences between the relative cost of health care and the relative cost of administrative services can limit the usefulness of such calculations. However, such ratios are a common and intuitively appealing shorthand.

In this analysis we have also expressed administrative expenses as a percent of premium. To make ASO/ASC arrangements comparable to their insured counterparts, we have expressed administrative expenses as a percent of "premium equivalents." That is, we have employed as a denominator the sum of the ASO/ASC fees and the medical costs associated with this product.

Figure 4. Benchmark Summary
Larger Plan Costs by Product
Percent Premiums or Equivalents

	25th Pctl	75th Pctl	Median	σ /Mean
Commercial HMO Insured	13.0%	15.4%	14.9%	18.3%
ASO / ASC	11.3%	23.1%	16.2%	67.6%
Commercial POS Insured	10.8%	12.1%	11.9%	12.6%
ASO / ASC	9.0%	9.5%	9.0%	6.6%
Indemnity & PPO Insured	12.6%	14.9%	13.9%	13.6%
ASO / ASC	7.8%	9.0%	8.0%	17.7%
Medicare Advantage	6.6%	9.6%	6.8%	28.8%
Medicaid	9.4%	11.3%	9.7%	19.2%
Medicare Supplemental	16.0%	21.7%	17.1%	31.3%
Comprehensive Total	9.8%	12.7%	10.3%	16.9%
Stand Alone Dental	15.9%	17.6%	16.8%	14.0%
Medicare Part D	8.3%	17.8%	13.6%	60.5%

Overall, administrative expenses were 10.3% of premiums or equivalents, as compared with 11.3% for the Blue Cross Blue Shield universe as a whole. In general, we think this difference is largely explained by the fact that the larger plans have 47.9% of their comprehensive members in ASO arrangements versus 38.4% for the Blue Cross Blue Shield universe.

Excluding the effect of services that are commonly capitated or outsourced such as behavioral health and prescription drugs, Medicare Advantage had the lowest costs at 6.8% of premiums, with the high among Comprehensive products of 17.1% for Medicare Supplemental. Among the commercial products, HMO had the highest costs at 14.9% of premiums followed by Indemnity and PPO at 13.9% of premiums and POS at 11.9% of premiums. For the most part, the ASO/ASC products comprised a lower percent of premium equivalents than their insured counterparts. Indemnity and PPO were 8.0% and 9.0% for POS. But HMO ASO/ASC was 16.2% of premium equivalents. This notable exception should be understood in the context of its median share of 3.4%.

Further information concerning the results of our benchmarking studies are available from Sherlock Company. Other summaries will be published in coming editions of *Plan Management Navigator*.