



Transcript

TPA Administrative Costs: A Review of 2010 Results

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<Title Page>

Welcome, and thank you for attending our second annual web conference on the administrative costs of TPAs. Today we'll discuss the summary as published in the *Plan Management Navigator*.

<Topic Page>

In this presentation I'll try to present some background on the study, discuss the expense levels and provide a comparison with comparable products of the forty-two health plans in other Sherlock Company universes.

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Sherlock Company is focused on performance benchmarking of health benefit organizations. We think that the combined effects of the weak economy and regulatory flux make this effort especially timely.

We are the leader in performance benchmarking for health benefit organizations, having done this for fourteen consecutive years. Fifty-nine organizations participated this year, collectively serving 50 million Americans.

While we have literally thousands of analyses in the TPA benchmark reports, the content reflects the preferences of the panelists, which keep us to a high insight to effort



ratio. We are great believers in the wisdom of markets so that is some significant gratification that organizations serving 60% of Americans with health coverage are already users of our 2011 editions of our benchmarks. We began publishing them only two months ago.

<Slide 4>

I am going to touch on the numbers shortly but before I do, I wanted to discuss the universe itself. There were only seven participants. While this is an increase over last year's five participants, it is very small compared with our 27 Plan universe of Blue Cross Blue Shield Plans and our 15 plan universe of Independent/Provider-Sponsored plans. TPAs' focus is medical administration, but they also offer products like dental, pharmacy and vision.

However, we suspect that these TPAs may be superior performers. First, five of the TPAs fall in the top 20% of TPAs, measured by size. According to the Society of Professional Benefit Administrators, there are only 65 TPAs that fall into those top brackets.

Second, as we'll discuss later, when we do compare these firms to Independent/Provider-Sponsored plans or Blue plans with similar product lines and similar functions, their costs are notably less.

Third, if a TPA can participate in the benchmarking study, it means that they are committed to cost management. After all, as the saying goes, "you manage what you measure."

So, while the results of our TPA benchmarks may not be representative of all TPAs, they could have the quality of best in class.

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Segmenting by product is especially important in this universe because of TPAs' "calling card:" because they are so flexible, TPAs may offer radically different mixes of their products. So, we have segmented costs for every function and total into Medical, Dental, Vision and so forth, as you can see in the row headings. The result is a high degree of comparability since each product/function cell is precisely comparable to



others the universe. While no TPA is comparable to any other TPA, each function/product expense cell is.

Besides the various products that I mentioned, there are also supplemental services like Medical Management, Provider Services, COBRA and Mental Health Administration. Together with the core products, there are in theory more than 4,000 possible combinations of products and supplemental services that can be offered by the participating TPAs.

So, to permit accurate comparisons, we segment costs into those products and services, totaling approximately 320. This slide shows a schematic of these offerings. The top chart shows “core services,” that is, services provided to all customers if they elect any of the products. These include claims processing, enrollment and so forth. The “non-core-services,” shown below, are the extra services that may be elected by the customer. Again, those are medical management and so forth.

While actionable information requires this level of specificity, in today’s discussion we’ll summarize by solely reporting high-level metrics. I’ve identified them in pink on this slide. We’ll speak about total TPA costs and their functional components, shown in the far right column. And we’ll also talk about total core product expenses, shown in the row on the bottom of the top chart. Because this is simply a summary, we won’t go into the non-core services at all or core services by product.

My second observation about today’s cost reporting is that we have accommodated the TPA convention of standardizing based on the total reported members and employees. For individual plan results we have two ways of taking mix differences into account, but for the purpose of today’s discussion, we are reporting values that reflect the typical mix offered by the seven-TPA universe.

<Figure 6>

My third observation is that we are exceedingly careful in our data collection and reporting.

We codified reporting in a set of *Guidelines* and imbedded these *Guidelines* as comments in the survey form itself. Even though we sought consensus on these definitions,



reporting to us almost always entailed reclassifications of their own expenses by the reporting TPAs.

After the initial data submission, we identified outlying responses and pursued them to make sure that the submissions were an accurate representation of the actual performance of the TPAs. This normally entailed multiple refinements of the original submission by each TPA.

To double check the data, we asked that it be reconciled with the audit, which the participants supplied to us, after having adjusted for the peer group's reporting conventions. This reconciliation amplifies the effect of our check for outliers by magnifying differences.

So, before I go any further, let me offer a hearty thanks to our TPA participants who made these benchmarks happen. I know it is a lot of work. But I suspect that you will find that your organization will benefit greatly from this new tool. And, one more thing I can assure you, there is a learning curve. So you will find that it will be much easier the next time around.

<Slide 7, with Figure 2>

TPAs classically report costs standardized by employees served, and this slide shows the values of the reporting TPAs using this approach. Core costs have a median value of \$18.72 PEPM, and the largest portion of those costs are Account and Membership Administration. At \$8.56, this cluster of expenses exceeds the other two clusters combined. No surprise here though. This is the area that one normally visualizes in thinking about the health benefits business: claims, enrollment, customer service and information systems are the functions included here.

<Slide 8, with Figure 5>

In thinking about these per-employee served metrics, and all of the other metrics of costs that combine the products, it is important to bear in mind that these represent mix-weighted values. Each of the products has different cost values as shown in this slide. The Medical product has costs of \$22.15 per employee per month, and it dwarfs the next highest cost product, Flexible Spending Account Administration, at \$5.54 per



employee per month. For the TPAs in our universe, fees attributable to the Medical product ranged from 73% to 100% of the total.

<Slide 9, with Figure 3>

For those of you participating in this web conference who work for health plans as opposed to TPAs, you may be more familiar with costs standardized by member months. This slide expresses costs standardized in this way. The median costs per member per month is \$8.08, about half the value of the per employee value shown earlier. This is not surprising since the average contract size (members per employee) ranges from 1.83 to 2.25 for the Medical product. Actually, the range in values is one of the reasons why we like the per member per month approach: because of that 0.42 contract size difference I just mentioned, 20-25% of the differences between TPA using the per employee served values could stem from differences in contract size! Put a different way, if costs relate to *people's* needs for their claims to be processed or their phone calls answered, then the membership relates well to those TPA activities.

Again, Account and Membership Administration comprise the lion's share of Core Service costs, at \$3.69 PMPM. Sales and Marketing costs which, by the way, includes employer group reporting, was the third largest component of the costs at \$1.29 PMPM.

<Slide 10, with Figure 6>

Again, it is important to note that costs vary greatly by product, as shown in this slide. The Medical product is again the high cost product at \$10.99 PMPM. But while the PMPM value of the Medical product is 50% of its per-employee value, the Vision product, at \$0.26 PMPM, is 55% of the per-employee value. So, not only the does the size of the contract make a difference in the benchmarks for TPAs products as a whole but *how* the size of the contract varies within each of the products also makes a difference. In my view, this is an especially important slide in that it shows the per member costs of the Medical product, the central product for this universe, in a way that is directly comparable to the metrics reported by other health benefit organizations such as health plans.

Let me reemphasize that the values in this chart are only for core services like enrollment, claims and so forth. It does not include medical management, provider service and other supplemental (or non-core) services that may be elected in addition to



the core services by the health benefit plan sponsor. We calculate the non-core costs separately and denominate their costs by the members or employees who use them. For instance, the non-core Medical Management service costs for the Medical product is \$2.25 PMPM or \$4.52 PEPM, where those medical employees and members are users of these non-core services.

<Slide 11, with Figure 4>

The costs of all organizations, including TPAs, are sometimes measured as a percent of revenues. Core costs for these TPAs have a median value of 98.4% of fee revenue. Again Account and Membership Administration costs dominate TPAs' cost structure, comprising nearly one half of revenues, at 52.0%.

Note that Corporate Services costs, which include finance, legal, HR, Corporate Executive and Governance, have a median of 20.7% of fees. As you may know, Sherlock Company believes that economies of scale in health plans are few and modest. When we compare TPAs levels to the approximately 22-23% of ASO fees for similar Corporate Service activities of much larger Independent/Provider-Sponsored and Blue plans, I think we have another mosaic piece supporting our belief; after all, if there were important economies of scale, this is where you would find it. Success in administrative cost management for health benefit organizations is all about the execution.

Speaking of percents, these TPAs showed relatively modest profits in 2010 in their core services. The median value is 1.6%, with 25th percentile value of negative 0.5% and a 75th percentile value of 11.8%. We don't publish trend data for this universe but I would be remiss if I did not add that the TPAs that participated in 2009 and 2010 showed a sharp decline in profit margins.

The non-core services offered by these TPAs enhance their profitability above this level. By the way, note that 100% minus the 98.4% cost equals the 1.6% profit margin. In its precision, this is a bit of a statistical fluke since we are using medians but provides a bit of additional insight on the next slide.

<Slide 12, with Figure 7>

As with the other cost metrics, operating costs as a percent of revenues varies for the core products offered by these TPAs. Pharmacy is the low cost product with costs of



25.5% of revenues while Vision administration is the high cost product at 130.3%. Operating costs are 98.9% of the Medical product. You can get a rough sense of the profitability of each product by subtracting the median costs from 100%.

<Slide 13, with Figure 8>

I earlier mentioned my suspicion that the TPAs that participated in our benchmarks are relatively elite performers. This slide helps illustrate why I believe this. When we compare the costs of our TPAs with similar products offered by Blue and Independent / Provider- Sponsored plans we find that the TPAs' costs are usually lower than those of the other health benefit organizations. In fact, there appears to be no overlap between the TPAs and their Blue competitors.

In this comparison, we matched as best as we were able, the functions between the universes. For instance, the costs of broker commissions were excluded from the costs of all of the peer groups, as is the TPA reporting convention. Similarly, we excluded medical management and other services like that TPAs consider non-core. So, if these TPAs comprise a universe that is statistically small, they nevertheless are organizations that appear elite, function for function. That is also why I would recommend caution in extrapolating this in comparing the different sectors of health benefit organizations. Plus, the Blues are normally insured though no health costs are included here.

<Slide 14>

When we look at core costs for their products as a whole, per employee monthly costs are \$18.72 and per member costs are \$8.08. More meaningfully, total core monthly administrative expenses for the Medical product are \$22.15 per employee and \$10.99 per member. Costs run 98% of revenues overall, and 99% for their medical products. While these are generally profitable organizations, their profits have been under pressure and supplemental services are important to their overall returns.

Function for function, these selected TPAs have lower costs than are typically found in competitor organizations. By this comparison, these TPAs are superior performers.

Now I would like to open this for questions about the results of the benchmarking study.



Questions

I want to again thank you for your participation in this web conference. More in depth and actionable information is available in the benchmarking study itself, which anyone can license. Please contact me directly if you are considering licensing these materials.

In October, we will have similar web conferences on the results of the Medicare and Medicaid plans. We hope that you will consider participating in those web conferences as well.

Finally, I want to close by once again thanking all of you who participated in this study for your efforts. Your participation not only enhances your own firm's performance but also raises the bar for all other health benefit organizations.

This is Doug Sherlock of Sherlock Company.