

## NEW TPA BENCHMARKS PUBLISHED

### Summary

Core Administrative expenses of surveyed TPAs were 84% of fees in 2009. This was \$11.56 Per Employee Per Month (PEPM) or \$6.06 Per Member Per Month (PMPM).

TPAs offer many products and costs vary greatly between them. In 2009, expressed PEPM, the most expensive product was the Medical product at \$25.28 while the least expensive product, Vision, was \$0.44. Expressed PMPM, the costs for the Medical and Vision products were also at the extremes at \$11.56 and \$0.16. Expressed as a percent of fees, expenses of Medical were 92% of fees while Vision and Dental were 82% and 64%, respectively.

These results are excerpted from the TPA edition of the 2010 *Sherlock Expense Evaluation Report*, comprising 2009 data. Because of TPAs unique flexibility, all product costs are segmented into *core* and *non-core* expenses. Summary descriptions of core and non-core services are found in Appendices A and B. Core expenses relate to services that are required to be offered to all employers using their services, such as claims processing and enrollment. Non-core services are supplemental, separately costed services such as medical management, mental health administration and provider network and services. All expenses reported in this article are for core services, exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. These costs also exclude from both revenues and expenses the costs of any broker commissions, as is the reporting convention of TPAs.

### Introduction

Among the more important competitors in the self-insured market are Third Party Administrators. These organizations provide administrative services to self-insured groups in exchange for a fee. These organizations are distinguished from health insurers in that they do not bear risk for medical cost variance. They are similar to services provided by health plans to self-insured groups through Administrative Services Only contracts.

TPAs are distinguished from other means of providing health benefits to employees by their flexibility. TPAs emphasize highly personalized, not merely customized, services. Other advantages to employers of using TPAs cited by the Health Care Administrators Association include employer control over the health plan reserves to maximize interest income, improved cash flow, reduction in state regulatory burdens, exemption from premium taxes and flexibility with respect to provider contracts. We believe that these attributes may prove to be especially attractive in the current challenging economic

environment and possibly also due to the effects of health care reform.

We do not know how many TPAs there are but the Society of Professional Benefit Administrators lists 291. They range in size from less than \$500,000 in annual revenues to more than \$100 million. Many of them are quite small, with nearly one-half of them at less than \$2.5 million in revenues annually. If the average TPA charges \$11.00 PMPM for its core Medical product, nearly half of them serve fewer than 19,000 members. So, as with health plans, we suspect that success in the TPA business is the result of superior execution, with scale as a distinctly secondary factor.

### Administrative Costs of TPAs – Per Employee Per Month

Total core costs per employee served were \$11.56, with the 25<sup>th</sup> percentile value of \$8.33 and the 75<sup>th</sup> percentile value of \$14.16. For convenience of analysis, we group various functional areas into clusters, and standardize for the size of the TPA by expressing expenses on a per employee basis. Standardizing by employees served is commonplace in the TPA industry. Values for these clusters and overall are shown in Figure 1.

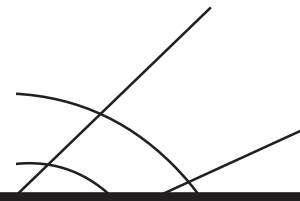
Sales and Marketing expenses were \$2.61 in 2009, with 25% of the respondents over \$2.86 and 25% less than \$1.88. The largest element in Sales and Marketing costs was Sales. This cluster of functions had the smallest dispersion, with a coefficient of variance (“ $\sigma$  / Mean”) of 43.5%.

Account and Membership Administration costs had a median value of \$6.32. One quarter of the respondents had costs of \$9.07 or higher while one quarter had costs of less than or equal to \$4.45. The highest cost functional area in this cluster of functions was Claim and Encounter Capture and Adjudication, and the sub-function Claims Processing in particular.

Corporate Services had median costs of \$2.38 per employee per month. The highest 25% had costs of \$2.49 or greater while the lowest cost 25% had costs of \$2.00 or less. The function representing the greatest proportion of this cluster was Facilities.

**Figure 1. Benchmark Summary**  
Core TPA Costs By Functional Area Cluster, 2009 Data  
Per Employee Per Month

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Sales and Marketing	\$1.88	\$2.86	\$2.61	43.50%
Account and Membership Admin.	4.45	9.07	6.32	59.88%
Corporate Services	2.00	2.49	2.38	47.82%
Total Core Services	\$8.33	\$14.16	\$11.56	53.25%



## Administrative Costs of TPAs – Per Member Per Month

While it is customary in the TPA industry to standardize costs on a per employee per month basis, the use of members as a method of standardization may better capture resource utilization. Claims, for instance, relates to *member* health needs. Moreover, in achieving comparability between the TPAs, differences in contract size can affect ratios. Contract size varied from TPA to TPA ranging, in the case of Medical, from a low of 1.98 to a high of 2.20. Members are employees served plus dependents.

Total Core costs per member served were \$6.06, with the 25<sup>th</sup> percentile value of \$3.74 and the 75<sup>th</sup> percentile value of \$7.32. Values for all clusters and overall are shown in Figure 2.

Sales and Marketing expenses were \$1.35 in 2009, with 25% of the respondents over \$1.50 and 25% less than \$0.84.

Account and Membership Administration costs had a median value of \$3.32. One quarter of the respondents had costs of \$4.69 or higher while one quarter had costs of less than or equal to \$2.00. This cluster of functions had the greatest dispersion, with a coefficient of variance of 54.94%.

Corporate Services had median costs of \$1.25 per member per month. The highest 25% had costs of \$1.29 or greater while the lowest cost 25% had costs of \$0.90 or less.

Sales and Marketing costs comprised 16% of fees, with the 25th percentile value at 15% and the value at the 75th percentile was 17%. This cluster of expenses, measured as a percent of fees, was tightly grouped with a coefficient of variance of 17.64%.

The costs of Account and Membership Administration was 48% of fees. The value at the 25th percentile was 46% of fees and 51% of fees at the 75th percentile.

The median proportion of fees due to Corporate Services was 17%. Twenty-five percent of TPAs had values below 14% of fees or above 22% of fees in 2009.

The median core profit margin for the TPAs in the survey was 16%. The highest 25% had margins of 21% or above while the lowest margin TPAs were 12% or less. It is important to know that margins varied by product and that helped contribute to the differences between them. The proportion of fees that were attributable to the Medical product varied from 76% to 98%.

## Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by more than 25 core functions and 10 non-core functions. This segmentation is important since, for instance, dental products cost much less to administer than medical products. We believe our participants to be relatively select

group of TPAs in that they exhibit robust activity-based costing systems to facilitate this segmentation. For example, our TPAs report that their members in Medical products submit eleven times as many claims per member as their members in dental products.

These differences are manifest in their overall cost differences. The most expensive product offered by TPAs is their Medical product, at \$25.28 per employee per month, distantly followed by the FSA product at \$4.20 per employee per month and Student Health Administration at \$3.58. Dental, Vision, Pharmacy and Short-Term Disability costs were much lower. (We have omitted the "Other" product from this narrative since the actual product varies from TPA to TPA.) This is shown in Figure 4.

We performed a similar analysis standardizing Core costs on a per member per month basis. The most expensive product offered by TPAs is their Medical product, at \$11.56 per employee per month, followed by Student Health and FSA Administration costs of \$3.52 and \$3.49, respectively. Again, the costs of Dental, Vision, Pharmacy and Short-Term Disability costs were much lower. This is shown in Figure 5.

**Figure 2. Benchmark Summary**  
Core TPA Costs By Functional Area Cluster, 2009 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Sales and Marketing	\$0.84	\$1.50	\$1.35	40.60%
Account and Membership Admin.	2.00	4.69	3.32	54.94%
Corporate Services	0.90	1.29	1.25	41.39%
Total Core Services	\$3.74	\$7.32	\$6.06	48.24%

## Administrative Costs as a Percent of Fees

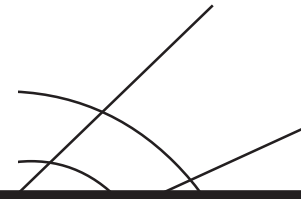
TPAs and others often express administrative costs as a percent of revenue. As shown in Figure 3, administrative expenses were 84% of fees for products sold by TPAs. The 25th percentile value was 79% and the value at the 75th percentile was 88%.

**Figure 3. Benchmark Summary**  
Core TPA Costs By Functional Area, 2009 Data  
Percent of Revenues

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Sales and Marketing	14.62%	17.43%	16.30%	17.64%
Account and Membership Admin.	45.81%	50.89%	48.23%	25.78%
Corporate Services	14.02%	21.75%	17.28%	23.56%
Total Core Services	79.46%	87.55%	83.84%	20.35%

Note: Profit Margin

	12.45%	20.54%	16.16%	98.58%
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**Figure 4. Benchmark Summary**  
Core TPA Costs By Product, 2009 Data  
Per Employee Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Medical	\$15.24	\$28.95	\$25.28	36.83%
Dental	0.95	1.52	1.17	46.19%
Vision	0.36	0.58	0.44	47.54%
Pharmacy	0.48	0.76	0.62	49.78%
Short-Term Disability	0.50	0.55	0.52	12.28%
FSA Administration	2.26	6.08	4.20	65.50%
Student Health Admin.	3.58	3.58	3.58	NM
Other	5.40	9.28	7.34	74.72%
Total, All Lines	\$8.33	\$14.16	\$11.56	53.25%

**Figure 5. Benchmark Summary**  
Core TPA Costs By Product, 2009 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Medical	\$7.63	\$14.24	\$11.56	39.39%
Dental	0.47	0.68	0.54	46.35%
Vision	0.15	0.24	0.16	50.87%
Pharmacy	0.23	0.39	0.31	54.35%
Short-Term Disability	0.50	0.55	0.52	12.28%
FSA Administration	1.05	6.08	3.49	88.72%
Student Health Admin.	3.52	3.52	3.52	NM
Other	4.41	6.31	5.36	50.13%
Total, All Lines	\$3.74	\$7.32	\$6.06	48.24%

**Figure 6. Benchmark Summary**  
Core TPA Costs By Product, 2009 Data  
Percent of Revenues

	25th PCTL	75th PCTL	Median	σ/ Mean
Medical	78.33%	97.04%	92.35%	21.44%
Dental	58.15%	78.49%	64.48%	28.83%
Vision	70.14%	135.91%	81.95%	63.73%
Pharmacy	15.80%	48.67%	31.44%	68.30%
Short-Term Disability	53.84%	100.14%	76.99%	85.06%
FSA Administration	72.51%	128.68%	101.63%	63.46%
Student Health Admin.	39.98%	39.98%	39.98%	NM
Other	91.53%	110.33%	100.93%	26.34%
Total, All Lines	79.46%	87.55%	83.84%	20.35%

As shown in Figure 6, on a percent of fee basis, the ranking of administrative expenses is different. The lowest cost product, based on the median percent of fees, was Pharmacy at 31%. The highest cost product, measured by the percent of fees attributable to administration, was FSA Administration at more than 100%. Medical was the second highest cost product, with expenses at 92% of Fees. Dental and Vision administrative expenses were at 64% and 82% of Fees, respectively.

## Core Activity Costs by Organization

While TPAs and providers of Administrative Service Only arrangements agree that their products differ, they also agree that as organizations they compete with each other. Thus, it is illustrative to look at the costs of administrative activities that are provided by both sets of organizations.

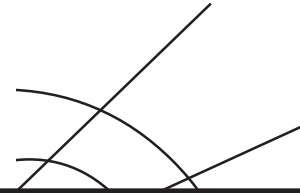
To appropriately compare, we matched the activities provided by TPAs with those provided through ASO/ASC contracts with other health benefit organizations. For example, in accordance with the reporting conventions preferred by TPAs, broker commissions are excluded from all peer groups. (Apparently TPAs structure their engagements so that all broker commissions are passed through to benefit plan sponsors.) Services that are non-core in relationships with TPAs, such as Medical Management and Provider Management and Services, are excluded from both TPAs and their ASO/ASC competitors.

As shown in Figure 7, surveyed TPAs are cost leaders in this comparison of Medical product costs. At a median value of \$11.56 for core services of Medical products, surveyed TPAs are lower than ASO products offered by Independent / Provider-Sponsored plans and Blue Cross Blue Shield plans. In fact, there appears to be little overlap between the health benefit organizations. The 75<sup>th</sup> percentile value for TPAs is only 7% higher than the 25<sup>th</sup> percentile value for Blue Cross Blue Shield plans. The median value for Independent / Provider-Sponsored Plans is only 6% less than the 75<sup>th</sup> percentile value for TPAs.

It may be that the TPAs included in this survey are stronger than average, as discussed later. If they are in fact superior performers among TPAs, it is difficult to generalize across universes from these results.

## Staffing and Compensation

The median staffing ratio for this universe was 17.66 FTEs per 10,000 Medical members. TPAs at the 75<sup>th</sup> percentile had a staffing ratio of 18.52, while those at the 25<sup>th</sup> percentile had a staffing ratio of 13.67. Median staffing costs per FTE was \$62,836 for TPAs, with 25% at or above \$63,813 and 25% at or below \$59,836. While not shown in *Navigator*, these metrics are reported in *SEER* for each of the functional areas shown in Appendices A and B.



**Figure 7. Benchmark Summary**  
Core Medical Activity Costs by Organization, 2009 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
TPAs	\$7.63	\$14.24	\$11.56	39.39%
Blue Cross Blue Shield Plans	13.30	18.98	16.93	23.66%
Independent / Provider-Sponsored Plans	\$10.03	\$16.65	\$13.38	38.60%

area. Geographic market differences are also quantifiable through compensation differences. So, while we do not claim to have addressed each of the factors that may limit comparability, we think we have sharply reduced their effects.

## Background on TPA Benchmarks

The peer group universe in this analysis consisted of five Third Party Administrators, which collectively served 1.7 million members. Of those members 687,000 were Medical, 276,000 Dental and 333,000 were Pharmacy. Each product costs and members are segmented to reflect that each of these products are sold on a stand-alone basis.

At an average size of \$26.9 million, these TPAs were typically in the top 20% of all TPAs, based on a list published by the Society of Professional Benefit Administrators. On average, participants in the TPA benchmarking study had 67,000 medical employees served and 137,000 medical members, which we also believe to be larger than average. Because participation in our benchmarks was voluntary and entailed detailed reporting, we think that participation self-selected for organizations that have better than average information/accounting systems. It is also possible that these firms had better than average performance on the common-sense grounds that "you manage what you measure."

On its web site, the Society of Professional Benefit Administrators states that (hopefully only here-to-fore), "there are no apples-to-apples statistics," for operational metrics in the TPA industry. In our benchmarks, we have made an intense effort to address the issues that SPBA identifies.

First, in its view, "The culprit for this lack of reliable data is one word: vocabulary." To address this, we have developed a set of definitions, called *Guidelines*. Our *Guidelines* are based on similar ones that we have developed for other universes of health benefit organizations for many years and, like those other *Guidelines* and their respective participants, the TPA edition reflects the input of the TPAs themselves. This method of reporting means that, normally, TPAs must reclassify some of their activities but, because of the collaborative approach to the definitions, the required reclassification by each organization is minimized.

Second, SPBA notes that comparability is a challenge because, "Each TPA's structure, services, client mix, philosophy of service and market is different." We do not address all of these issues but two, services and client mix, we endeavor to control for. With respect to client mix, to the degree that that is manifest in product selection, we control for that by reporting operational costs, by function, for *each* product that the TPAs offer. In addition, while we do not address philosophy of service directly, we are able to quantify how that is reflected in staffing ratios, compensation costs and non-labor costs for each functional

## Sherlock Company Benchmarks

Overall, our benchmarks in 2010 will comprise the cumulative experience of approximately 450 health benefit organization years. In addition to TPAs, we also have universes of Independent / Provider-Sponsored Plans, Blue Cross Blue Shield Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. We have published results on the Blue Cross Blue Shield Plans and the Independent / Provider-Sponsored Plans and we will be reporting on results for the other peer groups within the month.

### Appendix A. Benchmark Summary Functions in Each Cluster

#### Sales and Marketing

- Employer Group Reporting
- Marketing (except Advertising and Promotion)
- Sales
- Advertising and Promotion

#### Account and Membership Administration

- Enrollment / Membership / Billing
- Customer Services
- Claim and Encounter Capture and Adjudication
- Total Information Systems Expenditures (as expensed)

#### Corporate Services

- Finance and Accounting
- Corporate Services
- Corporate Executive & Governance
- Miscellaneous Business Taxes

### Appendix B. Benchmark Summary Non-Core Services Also Found in Benchmarks

- Direct Cost of Medical Management / Quality Assurance / Wellness
  - (a) Pre-Certification
  - (b) Case Management
  - (c) Disease Management
  - (d) Health and Wellness
  - (e) Other Medical Management
- Direct Cost of Provider Network Management and Services
  - (a) Provider Relations Services and Provider Contracting
  - (b) Other Provider Network Management and Services
- Direct cost of COBRA and HIPAA Administration
- Direct Cost of Mental Health Administration
- Direct Cost of Stop Loss Insurance

