



Administrative Expense Comparisons of Noridian Mutual Insurance Company

October 28, 2009

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Introduction

Noridian Mutual Insurance Company administers health benefit plans at low cost compared to its peers. Its costs are below that of universes of Blue Cross Blue Shield Plans, Independent / Provider-Sponsored Plans and Public Companies. This low cost is in evidence regardless of whether it is measured on a reported basis or adjusted for product mix. It is evident in nearly every product offered by the company and regardless of whether costs are measured in dollars or as a percent of premiums.

In addition, Noridian Mutual Insurance Company's Corporate Executive / Governance costs appear low, notwithstanding its relatively small size, and its premium rates are also low.

Background

We have been asked by Noridian Mutual Insurance Company (Noridian) to compare its costs with those of its peers. Peer groups include Blue Cross Blue Shield (Blue) Plans¹, Independent / Provider-Sponsored² (IPS) plans, and national publicly-traded firms (Public).

¹ There were 22 Blue Plans in our survey universe. Of these, 21 were primary licensees of the names and marks of the BlueCross BlueShield Association, of which there are 39. One additional plan operates independently but under another plan's primary license.

² Independent / Provider-Sponsored plans in our universe are most often operated as subsidiaries of not-for-profit hospital systems. There are a few plans in this universe whose relationships with providers are historic and fall short of control. There are 16 plans in this universe.



The source of our information for IPS and Blue universes are surveys completed by these plans in our performance benchmarking studies. Filings with the U.S. Securities and Exchange Commission were the source of information regarding the Public universe. We consider our survey information to be more reliable since participants segment their costs by product and report their administrative expenses in ways that are uniform with respect to other plans in their peer groups.

Figure 1. Noridian Mutual Insurance Company
Administrative Expense Comparison
Per Member Per Month

	(a)(d) Blue Cross and Blue Shield Plans	(a)(d) Independent/Provider- Sponsored Plans	(b)(c)(d) Public Companies
Noridian	\$16.28	\$16.28	\$16.28
Median	\$25.95	30.35	\$30.03
Difference	(\$9.66)	(\$14.07)	(\$13.74)

(a) Source: 2009 Sherlock Expense Evaluation Report.
(b) Source: SEC 10-Q and 10-K filings. Commercial plans only. Excludes Triple-S.
(c) Some public company administrative expenses and members include TRICARE and PDP.
(d) Includes pharmacy and mental health administrative expenses.

Administrative expenses include all operating costs associated with providing services to customers of insurance plans. They do not include health benefit costs, capital costs and miscellaneous business taxes.

Sherlock Company assists health plans, their business partners and their investors in the treasury, strategic and control functions of finance. Since its founding in 1987, Sherlock Company has been known for its impartiality and technical competence in service to its clients. With 397 health plan years of experience, the *Sherlock Expense Evaluation Reports* are the definitive benchmarks for health plan administrative expenses and operational performance.

Overall Comparison with Peer Groups

Noridian's per member per month³ (PMPM) administrative costs are \$9.66 lower than the median value of the Blue universe, \$14.07 lower than the median value of IPS firms and \$13.74 lower than that of Public firms. This is shown in Figure 1.

³ When comparing firms of different sizes, it is customary to standardize costs. Member months are the most common denominator for such comparisons. One member served for one month equals one member month. Members are people served. Revenues or premium equivalents are another denominator used for this purpose. Member months are total "comprehensive" members. That is, members are only



As shown in Figure 2, when costs are expressed as premium and premium equivalents⁴, Noridian's costs are also low. Compared with Blue plans, Noridian's costs are 3.28 percentage points lower than the median value. Noridian is 1.62 percentage points lower than the median value for IPS plans. Noridian is also 3.45 percentage points lower than its public company counterparts.

Figure 2. Noridian Mutual Insurance Company			
Administrative Expense Comparison			
<i>Percent of Premium Equivalents</i>			
	(a)(d) Blue Cross and Blue Shield Plans	(a)(d) Independent/Provider- Sponsored Plans	(b)(c)(d) Public Companies
Noridian	6.67%	6.67%	6.67%
Median	9.95%	8.29%	10.12%
Difference	-3.28%	-1.62%	-3.45%
(a) Source: 2009 Sherlock Expense Evaluation Report.			
(b) Source: SEC 10-Q and 10-K filings. Commercial Plans only. Excludes Triple-S.			
(c) Public company insured administrative expenses estimated based on proportion of insured membership. This has the effect of underestimating the administration to premium ratio.			
(d) Includes pharmacy and mental health administrative expenses.			

those served through "comprehensive" physician and hospital plans. For instance, stand-alone dental, Medicare Part D and other specialty products are excluded from the denominator for comparison purposes.

⁴ Health plans often provide business process outsourcing (BPO) services, as well as insurance services, to their health benefit plan sponsor customers. Unlike insurance services, the business process outsourcing relationships are rendered to employer groups who act as insurers of their own employees. Such customers are typically larger than their insured counterparts so that they have the necessary statistical scale. Within the health plan industry these BPO services are sometimes called Administrative Services Only (ASO) arrangements.

To the extent that a health plan offers such services to benefit plan sponsors, health plan financial reporting plays havoc with the intuition that administrative costs, when expressed as a percent, are a proportion of the premium dollar. That is because, under ASO relationships, employers are only billed for the administrative services that they provide but not for the cost of care, which is borne by the self-insured groups.

The solution to this calculation problem is to express expenses as a percent the sum of premiums and premium equivalents, if the plan offers such ASO services. Note that, as with premiums, fees charged to ASO clients reflect a profit assumption. Therefore, to estimate premium equivalents it is appropriate to add the fees rather than the administrative expenses to directly compare costs with the insured business.

Since each of the plans submits the health care expenses for the self-insured groups (which plans know since they process groups' self-insured claims), by adding this amount to the administrative service fees actually billed, we are able to estimate the premium equivalents of the ASO arrangements. Note that this information is unavailable for Public plans so that a proportional assumption is used.



Overall Comparison with Peer Groups, Adjusting for Product Mix

Administrative cost comparisons between health plans may be affected by differences between the product mix of each plan. For example, a high exposure to Medicare Advantage products will yield higher PMPM administrative costs because the resources required to support the senior population's health care needs are greater. If health care costs are higher, then the number of claims submitted and the claims processing costs will be greater as well. For our surveys, participants segment their costs into their various products. Accordingly, to eliminate the effect of product mix differences, we have reweighted each universe so that each matches the product mix of Noridian.

As shown in Figure 3, Noridian's administrative costs are \$8.86 lower than those of its Blue peers. Its expenses are 64.5% of the value of this peer group. Compared with IPS plans, Noridian operates at \$9.92 lower than its peers, or at 62.0% of such plans.

When compared with Figure 1, the differences narrow but Noridian's costs remain lower. The change in the difference is much greater for the IPS, reflecting that the IPS universe is much more heavily committed to the Medicare product than Blue plans.

Ranking each of the 22 Blue plans by their performance relative to their universe, after matching the universe's mix to each plan's product mix, Noridian would be the second lowest cost plan among Blue Cross Blue Shield plans. If we include Noridian among the 16 Independent / Provider-Sponsored plans and compare it to other plans in that universe using the same procedure as for Blue plans, Noridian would rank the third lowest.

Figure 3. Noridian Mutual Insurance Company		
<u>Administrative Expense Comparison: Mix-Adjusted</u>		
<i>Per Member Per Month</i>	(a)(b)	(a)(b)(c)
	Blue Cross and Blue Shield Plans	Independent/Provider-Sponsored Plans
Noridian	\$16.12	\$16.21
Mix-Adjusted Median	\$24.98	\$26.13
Difference	(\$8.86)	(\$9.92)
Percent of Mix-Adjusted Median	64.5%	62.0%
(a) Source: 2009 Sherlock Expense Evaluation Report.		
(b) Excludes pharmacy and mental health administrative expenses.		
(c) Noridian's value excludes the FEP product, which is not included in the IPS Universe.		



We have not used this procedure to compare Noridian with the universe of Public companies since the Public company mix cannot be reliably known with the same degree of precision and granularity as available through our surveys of the Blue and IPS universes.

Product by Product Comparison

Sherlock Company's performance benchmarks require that participants segment their costs into broad categories of products. Noridian offers six products that are directly comparable to those of other Blue plans in its universe. In all but one product, Noridian's PMPM costs were lower than its peers. Administrative costs that were lower ranged from \$3.23, or 18.5%, lower for the FEP product, to \$21.00, or 65.0%, lower for its Indemnity and PPO insured product. The exception was indemnity and PPO ASO/ASC costs, which were \$7.08, or 35.4%, higher.

Noridian had similarly favorable product-by-product comparisons with the IPS universe. Of the four products that were directly comparable, only Noridian's ASO product had higher costs. Medicare Supplemental was the least favorable, at \$13.23, or 43.3%, lower. The highest Noridian favorable variance in administrative costs was in the Indemnity and PPO insured product in which its costs are \$27.73, or 71.0%, less. ASO cost were 12.1%, or \$2.21, higher. (Noridian's two ASO products were combined in this comparison to mirror the preferred reporting of the IPS panel.)



Figure 4. Noridian Mutual Insurance Company
Administrative Expense Comparison, Blue Universe, by Product
Per Member Per Month

	Blue Universe	Noridian	Difference	Percent Difference	Note: Percent of Total Membership
Commercial HMO					
Insured	\$30.81	NA	NM	NM	0.0%
ASO / ASC	\$21.73	NA	NM	NM	0.0%
Commercial POS					
Insured	\$29.84	\$16.33	(\$13.51)	-45.3%	16.6%
ASO / ASC	\$20.13	\$13.03	(\$7.10)	-35.3%	17.9%
Indemnity & PPO					
Insured	\$32.30	\$11.30	(\$21.00)	-65.0%	32.0%
ASO / ASC	\$20.02	\$27.10	\$7.08	35.4%	20.1%
FEP	\$17.49	\$14.26	(\$3.23)	-18.5%	4.5%
Total Commercial	\$25.18	\$16.18	(\$9.00)	-35.7%	91.1%
Medicare Advantage	\$78.05	NA	NM	NM	0.0%
Medicaid HMO	\$20.67	NA	NM	NM	0.0%
Medicare Supplemental	\$30.04	\$17.33	(\$12.71)	-42.3%	8.9%
Comprehensive Total	\$25.95	\$16.28	(\$9.66)	-37.2%	100.0%

Source: 2009 Sherlock Expense Evaluation Report.

Figure 5. Noridian Mutual Insurance Company
Administrative Expense Comparison, IPS Universe, by Product
Per Member Per Month

	IPS Universe	Noridian	Difference	Percent Difference	Note: Percent of Total Membership
Insured					
Commercial HMO	\$28.31	NA	NM	NM	0.0%
Commercial POS	\$31.77	\$16.33	(\$15.45)	-48.6%	16.6%
Indemnity & PPO	\$39.03	\$11.30	(\$27.73)	-71.0%	32.0%
Commercial ASO / ASC	\$18.25	\$20.46	\$2.21	12.1%	38.0%
Total Commercial	\$26.60	\$16.18	(\$10.42)	-39.2%	91.1%
Medicare Advantage	\$75.14	NA	NM	NM	0.0%
Medicaid HMO	\$22.06	NA	NM	NM	0.0%
Medicare Supplemental	\$30.56	\$17.33	(\$13.23)	-43.3%	8.9%
Comprehensive Total	\$30.35	\$16.28	(\$14.07)	-46.4%	100.0%

Source: 2009 Sherlock Expense Evaluation Report.



Corporate Executive / Governance Costs

Noridian's costs for the function of Corporate Executive / Governance⁵ were in line with the Blue and IPS peer groups. PMPM costs for Noridian were essentially the same as those in the Blue universe and \$0.13, or 16.4%, lower than the IPS universe.

The higher cost of the IPS Corporate Executive / Governance expenses compared with the Blue peer group likely reflect the scalability of this function. The average size of the plans in the Blue universe was 1.4 million members, as compared with 357,000 for the IPS plans. Noridian, by contrast, has 429,000 average members. Noridian is the sixth smallest plan in the Blue universe and, if included among the IPS plans, would be the fifth largest plan.

Figure 6. Noridian Mutual Insurance Company

Comparison of Corporate Executive / Governance Administrative Expenses

Per Member Per Month

	Blue Cross and Blue Shield Plans	Independent/Provider- Sponsored Plans
Noridian	\$0.65	\$0.65
Median	\$0.66	\$0.78
Difference	(\$0.00)	(\$0.13)
Percent Difference	-0.4%	-16.4%

Source: 2009 Sherlock Expense Evaluation Report.

We have found that the Corporate Executive / Governance function is among the relatively few that is consistently scalable.⁶ That is, this function is subject to economies

⁵ The Corporate Executive / Governance function is limited to executives who are not directly tied to a function or department, and Board of Directors costs. Thus, in our definition for this functional area, expenses should not include those incurred for people such as CFOs, CIOs and CMOs since they are associated with a specific function. This functional area also includes functions that support Corporate Executive / Governance such as strategic planning and business analysis, as well as related support staff and non-staffing costs.

The Corporate Executive / Governance function directs the health plan. It is to act in its interests and that of its owners and is held accountable to them for the use of corporate assets. Activities include: Makes rules and procedures for making decisions on corporate affairs; Provides the structure through which the corporate objectives are set; Provides a means of achieving the set objectives; Monitors the corporate performance against the set objectives; Strategic Planning.



of scale. We annually regress PMPM administrative costs for this and all other functions against member months and, in each of the past nine years, the p-Value (chance of there being no relationship between scale and costs) has been less than 10%. Accordingly, a value higher than average for Blue Cross Blue Shield Plans could have been reasonably anticipated for Noridian.

Premium and Premium Equivalent Comparisons

Noridian's premiums are lower than those of its peers in the Blue and IPS universes. As shown in Figure 7, they are lower in each product. The smallest variance is FEP, which is \$1.43 PMPM, or 0.4%, lower. The greatest difference is in its insured POS product, which has premiums that are \$32.74, or 11.3%, lower.

Figure 7. Noridian Mutual Insurance Company
Premium and Premium-Equivalent Comparisons, Blue Universe, by Product
Per Member Per Month

	Blue Universe	Noridian	Difference	Percent Difference
<i>Commercial HMO</i>				
Insured	\$300.40	NA	NM	NM
ASO/ASC	\$302.48	NA	NM	NM
<i>Commercial POS</i>				
Insured	\$289.01	\$256.27	(\$32.74)	-11.3%
ASO/ASC	\$262.95	\$248.84	(\$14.11)	-5.4%
<i>Indemnity & PPO</i>				
Insured	\$271.11	\$248.76	(\$22.34)	-8.2%
ASO/ASC	\$272.02	\$245.90	(\$26.12)	-9.6%
FEP	\$337.20	\$335.77	(\$1.43)	-0.4%
Total Commercial	\$281.09	\$253.80	(\$27.29)	-9.7%
Medicare Advantage	\$847.34	NA	NM	NM
Medicaid HMO	\$241.15	NA	NM	NM
Medicare Supplemental	\$168.09	\$145.08	(\$23.02)	-13.7%
Comprehensive Total	\$278.96	\$244.16	(\$34.80)	-12.5%

Source: 2009 Sherlock Expense Evaluation Report.

⁶ Economies of Scale in Health Plan Administrative Expenses, PULSE, September 2009. Sherlock Company is the publisher of PULSE.



We have made a similar comparison with products offered by IPS plans. Premium equivalent differences range from \$23.98, or 8.8%, lower for premium equivalents of its commercial ASO/ASC product, to \$76.43, or 23.0%, lower for its insured POS product. Premiums and equivalents are lower than average in each product.

Figure 8. Noridian Mutual Insurance Company
Premium and Premium-Equivalent Comparisons, IPS Universe, by Product
Per Member Per Month

	IPS Universe	Noridian	Difference	Percent Difference
<i>Insured</i>				
Commercial HMO	\$316.41	NA	NM	NM
Commercial POS	\$332.70	\$256.27	(\$76.43)	-23.0%
Indemnity & PPO	\$292.14	\$248.76	(\$43.38)	-14.8%
Commercial ASO / ASC	\$271.27	\$247.29	(\$23.98)	-8.8%
Total Commercial	\$301.48	\$253.80	(\$47.68)	-15.8%
Medicare Advantage	\$926.54	NA	NM	NM
Medicaid HMO	\$228.01	NA	NM	NM
Medicare Supplemental	\$190.60	\$145.08	(\$45.52)	-23.9%
Comprehensive Total	\$354.84	\$244.16	(\$110.68)	-31.2%

Source: 2009 Sherlock Expense Evaluation Report.

No product-by-product comparisons are available for the Public companies because their segmentation provided to investors in their financial statements is not sufficiently precise or granular to do so. Also, since health benefits of ASO products are also not disclosed, it is not possible to calculate premium equivalents.

Both premiums and fees of Noridian are less than that of Public companies. Premiums are less by \$25.68, or 9.0%, while ASO costs are less by \$8.91, or 38.3%.



Figure 9. Noridian Mutual Insurance Company
Premium and Premium-Equivalent Comparisons, Public Companies, by Product
Per Member Per Month

	(a)(b) Public Companies	(a) Noridian	Difference	Percent Difference
<i>Commercial</i>				
Insured	\$284.13	\$258.45	(\$25.68)	-9.0%
ASO / ASC	\$23.25	\$14.34	(\$8.91)	-38.3%

(a) Source: 2009 Sherlock Expense Evaluation Report.

(b) Source: SEC 10-Q and 10-K filings. Commercial plans only. Excludes Triple-S.

NOTE ON DATA USED IN THIS ANALYSIS

Sherlock Company completed this analysis at the request of Noridian Mutual Insurance Company. This is based in part upon information supplied by Noridian pertaining to its 2008 fiscal year ended December 31. All data from comparison universes was from calendar 2008. Sherlock Company reviewed the information supplied to test its accuracy, including reconciling its administrative expenses with that of its audit. We also believe that, since the company originally submitted its information to us without anticipation that it would be used for any external purpose but solely for the management of its operations, it had strong incentives to supply accurate information. Sherlock Company has relied upon the information furnished to it by Noridian and certain other public and proprietary sources and has assumed the accuracy and completeness of such information and has not, other than as noted above, attempted to independently verify any of such information.