



A MILLIMAN GLOBAL FIRM

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August 10, 2006

Gwyn Davidson  
Associate Director  
Navigant Consulting, Inc.  
161 N. Clark Street  
Suite 1700  
Chicago, IL 60601

**RE: ADMINISTRATIVE COST ASSUMPTIONS – REVISED**

Dear Gwyn:

Milliman, Inc. (Milliman) was retained by Navigant Consulting, Inc. (Navigant) to perform services as a subcontractor under Navigant's contract with the State of Illinois Department of Public Health. This letter addresses the assumptions used by Milliman with regard to administrative costs for various insurance programs, both public and private.

This letter fully replaces the correspondence from Milliman dated August 7, 2006.

**LIMITATIONS**

The information contained in this letter has been prepared for Navigant Consulting, Inc., and its advisors and consultants. The letter may not be distributed to any other party without the prior written consent of Milliman. Milliman understands that this letter will be shared with the Insurance Industry Working Group as well as the Adequate Health Care Task Force.

Although Milliman may consent to the distribution of this letter to third parties, Milliman makes no representations or warranties regarding the contents of this letter to third parties. Likewise, third parties are instructed that they are to place no reliance upon this letter prepared for Navigant by Milliman that would result in the creation of any duty or liability under any theory of law by Milliman or its employees to third parties. Other third parties receiving this letter must rely upon their own experts in drawing conclusions about the results that have been presented in this letter.

**ADMINISTRATIVE COST ASSUMPTIONS**

Administrative costs, for purposes of this analysis, consist of all non-claim related items such as administrative expenses, risk margins, and profit.

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In developing the estimated administrative cost percentages assumed in the Adequate Health Care Task Force modeling, Milliman used information contained in the 2005 Milliman Group Health Insurance Survey (Survey), general market knowledge, and our judgment.

The Survey contains a compilation of key health industry metrics including, among other items, the range of medical loss ratios submitted by participating carriers. The survey provided medical loss ratio data from approximately 50 PPO carriers. The administrative cost ratio was defined as the complement to the medical loss ratio. Statistics are captured by geographic region and certain metrics segregate large and small employer groups.

***Large Employer Group***

Large employers are defined in the context of this analysis as fully insured groups containing more than 50 employees eligible for benefits under the plan. Self-funded groups were not considered in the estimate of the large employer administrative cost.

Milliman used a point estimate of 15% to represent the reasonable range of administrative cost observed in the large employer group market. This assumption was estimated from the Survey taking into account both the nationwide average as well as the Illinois specific results. Table 1 contains the results of the Survey that were considered in the estimate of the large employer group administrative cost assumptions.

**Table 1**

**Navigant Consulting, Inc.  
 Large Employer Administrative Cost Assumptions**

	Straight Average	Percentile	
		25 <sup>th</sup>	75 <sup>th</sup>
Nationwide PPO	15.1%	11.0%	19.0%
Illinois PPO	13.2%	10.7%	17.1%

A portion of the variance between carriers may be due to, among other items, the mix of large groups by size. Smaller large groups, such as those containing 51 to 250 eligibles, generally observe administrative costs approaching the small group levels while “jumbo” large groups generally observe significantly lower administrative costs.

***Small Employer Group***

Small employers are defined in the context of this analysis as fully insured groups containing less than or equal to 50 employees eligible for benefits under the plan.

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Milliman used a point estimate of 25% to represent the reasonable range of administrative cost observed in the small employer group market. This assumption was estimated from the Survey taking into account both the nationwide average as well as the Illinois specific results. Table 2 contains the results of the Survey that were considered in the estimate of the small employer group administrative cost assumptions.

**Table 2**

**Navigant Consulting, Inc.  
 Small Employer Group Administrative Cost Assumptions**

	Straight Average	Percentile	
		25th	75 <sup>th</sup>
Nationwide PPO	19.7%	13.5%	26.2%
Illinois PPO	21.6%	18.8%	23.2%

Milliman recognizes that the point estimate assumed is at the higher end of the reported range. This assumption was selected in anticipation that the uninsured populations will be at the smallest group sizes, that is less than 10 lives.

***Average Employer***

Milliman used a point estimate of 20% to represent the reasonable range of administrative cost observed in the group health market. This estimate was chosen to coincide with the administrative costs assumed for the large employer and small employer markets as previously discussed.

***Individual***

Milliman used a point estimate of 30% to represent the reasonable range of administrative cost observed in the individual market. This estimate was based on our judgement derived from extensive experience in working with individual health carriers.

***Medicaid***

Milliman used a point estimate of 4% to represent the reasonable range of administrative cost observed in the fee-for-service Medicaid program. This estimate was based on our judgement derived from extensive experience in working with state Medicaid agencies, including Illinois.

Milliman recognizes that a direct comparison between Medicaid and commercial carriers is difficult due to the variance of administrative functions, profit goals, premium base, and

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accounting practices. However, the scope of this analysis was to provide a reasonable estimate of the current costs under each of the programs.

**RESPONSE TO INSURANCE INDUSTRY WORKING GROUP**

Milliman reviewed the correspondence provided by the Insurance Industry Working Group dated July 31, 2006 and titled “Administrative Cost Differentials Between Public/Private Market Health Insurance”. This document stated opposition to the administrative cost assumptions utilized by Milliman. The document also referenced several sources outlining alternative administrative cost assumptions.

It should be emphasized that administrative cost assumptions are not absolute and a range of assumptions may be appropriate for various purposes. Milliman provided a point estimate for the purpose of modeling. The sources stated by the Insurance Industry Working Group assist in illustrating that there are numerous ranges of administrative costs quoted by various sources. Each reference provided contains different assumptions and most sources would be considered reliable in the industry.

For example, Table 3 of the Council for Affordable Health Insurance (CAHI) document provided by the Insurance Industry Working Group contains estimates of the total administrative cost for the private market. Table 3 below contains a comparison of the administrative cost assumptions used by Milliman and the estimated administrative costs contained in the CAHI document.

**Table 3**

**Navigant Consulting, Inc.  
 Comparison of Administrative Cost Assumptions**

	<b>Milliman</b>	<b>CAHI<sup>1</sup></b>
Individual	30%	30.0%
Small Group	25%	23.0%
Large Group	15%	12.5%
Public Program <sup>2</sup>	4%	5.2%

1. Source: “*Medicare’s Hidden Administrative Costs: A Comparison of Medicare and the Private Sector*”; Merrill Matthews, Ph.D.; January 10, 2006.
2. Milliman’s value represents the Medicaid program while the CAHI value represents the Medicare program.

The results of the Milliman Survey formed the basis of our administrative cost assumptions and are reasonably consistent with the CAHI information shown in Table 3.

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Ms. Gwyn Davidson  
August 10, 2006  
Page 5



Please do not hesitate to contact me at (317)524-3512 if you have any further questions regarding this information contained in this letter.

Sincerely,

  
ELECTRONIC  
SIGNATURE

Robert M. Damler, FSA, MAAA  
Principal and Consulting Actuary

RMD/sdm

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