



## BLUE CROSS BLUE SHIELD PLANS' ADMINISTRATIVE COSTS GREW MODESTLY IN 2009

### Summary

Administrative expenses of Blue Cross Blue Shield Plans continued their trend of modest growth in 2009. Administrative expenses were 9.7% of premiums in 2009 compared with 9.9% in 2008 and 10.4% in 2007. While raw per member administrative cost trends decreased from 2.7% in 2008 to 2.5% in 2009, after eliminating the effect of product mix differences, the rate of cost increase increased from 1.6% to 3.8%.

The weak economic environment and health care reform has made the management of administrative expenses an increasing priority for health plans. If not successfully managed, weak membership trends due to a difficult employment environment leads to negative operating leverage. Also, the minimum "medical loss ratios" introduced as part of health care reform exemplify the heightened scrutiny of administrative costs by federal and state regulators.

The administrative expenses of Blue Cross Blue Shield Plans (Blue plans) participating in our performance benchmarking study in 2009 was \$28.02 per member per month (PMPM), but varied greatly by product. In 2009, the FEP product, offered to Federal Employees, had administrative costs of \$17.62 PMPM. Also with low marketing costs Indemnity & PPO ASO / ASC had administrative expenses of \$20.77 PMPM. Medicare Advantage was the highest cost product, at \$72.72 PMPM.

All values in this article exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. Pharmacy and Mental Health costs are included in total administrative cost calculations and allocated to the Account and Membership Administration cluster. These results are excerpted from the Blue Cross Blue Shield edition of the 2010 *Sherlock Expense Evaluation Report (SEER)*, comprising 2009 data.

### Administrative Costs and Trends

For convenience of analysis, we group various functional areas into clusters, and standardize for the size of the health plans by expressing expenses on a per member basis. Values and rates of change for these clusters and overall are shown in Figures 1 and 2. Appendix A provides values for all plans participating in 2009, and comprises 2008 data.

**Marketing** expenses were \$7.49 and sharply decelerated to 0.5% growth in 2009 from 3.5% in 2008. (All rates of change hold constant the universe of participants.) Eliminating the effect of product mix differences, the decline in growth fell from 3.8% in 2008 to 2.0% in 2009. The higher constant mix change, compared with as reported, in part reflects a mix shift in favor of the relatively low marketing cost ASO / ASC products.

The most important factor in the growth of this cluster of functions was broker Commissions. On both an as-reported basis and on a constant-mix basis, its it had the greatest change

(increase in this instance) and comprised the greatest dollar change, year over year. Broker Commissions are often calculated as a percent of premiums so, in part, reflect some degree of medical inflation.

Advertising and Promotion declined sharply on both an as-reported and constant-mix basis. In terms of its downward effect on overall costs, this function carried the greatest weight. Product Development / Market Research also declined on an as-reported basis but was the second lowest growing functional area on a constant mix basis. This is a relatively modest function in size.

Internal Sales and Marketing growth was in the mid-single digits, both as-reported and on a constant-mix basis. Using either approach, it followed Commissions in its upward influence.

Rating and underwriting growth was in the mid-single digits on both an as-reported and constant mix basis but, as a small function, had only a modest impact on trend for this cluster.

The 75<sup>th</sup> percentile value for this cluster was \$10.17 and the 25<sup>th</sup> percentile value was \$5.96 PMPM.

*2009 was a very fluid year for Blue Cross Blue Shield plans participating in our benchmarking study. Year-over-year, for the 21 continuous plans, the median comprehensive product membership growth increased by 0.3%, for an average growth of 1.6%. While commercial membership growth was at approximately those rates, insured membership declined by 4.5% on average as ASO/ASC grew by 10.8%. FEP membership was essentially unchanged. Of the eleven plans offering Medicare Advantage, the median membership growth was 8.6%. By contrast, Medicare Supplemental declined on average by 3.0%.*

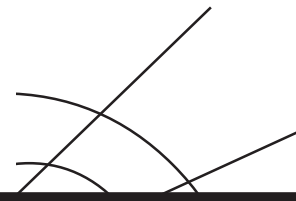
**Provider and Medical Management** grew by 3.3% (compared with 11.3% last year) to \$3.41 PMPM. On a constant mix basis per member growth fell from 12.0% to 5.4%. Medical Management both increased faster than, and was more responsible for, the increase in these costs. This is true on both an as-reported and constant-mix basis.

The muted decline in Medical Management growth on a constant-mix basis compared with the steeper decline on an as reported basis suggests that this function remains a relatively high priority for the plans.

*Product mixes also changed, which may have affected this cluster. On average, continuous plans had a 2.9 percentage point decline in the proportion of their business represented by commercial insured and a 2.4*

**Figure 1. Benchmark Summary**  
Blue Cross Blue Shield Costs by Functional Area Cluster, 2009 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	\$5.96	\$10.17	\$7.49	39.9%
Provider & Medical Management	2.27	4.52	3.41	41.4%
Account & Mem. Administration	10.82	13.51	12.21	20.0%
Corporate Services	4.06	5.83	4.96	31.4%
Total	\$24.60	\$32.73	\$28.02	22.4%



percentage point increase in their business that is commercial ASO / ASC. On average, these products comprised 44.8% and 37.5%, respectively, of these plans' product mix. We think that the difficult credit environment may have played a factor in this shift. ASO/ASC products typically have lower Medical Management Costs. Medicare comprised 3.1% of comprehensive membership and on average increased by 0.5 percentage points in the mixes of the Plans.

**Figure 2. Benchmark Summary**  
Blue Cross Blue Shield Percent Change in Costs by Functional Area Cluster, 2009 Data

	2008 Percent Change		2009 Percent Change	
	As Reported	Constant Mix	As Reported	Constant Mix
Marketing	3.5%	3.8%	0.5%	2.0%
Provider & Medical Management	11.3%	12.0%	3.3%	5.4%
Account & Mem. Administration	3.1%	0.7%	4.1%	4.2%
Corporate Services	-0.1%	-0.6%	5.5%	5.7%
Total	2.7%	1.6%	2.5%	3.8%

The costs of Medical and Provider Management at the 25<sup>th</sup> percentile was \$2.27 PMPM and \$4.52 PMPM at the 75<sup>th</sup> percentile.

**Account and Membership Administration** cost increased to \$12.21, up 4.1% from last year. The value at the 25<sup>th</sup> percentile for Account and Membership Administration was \$10.82 PMPM, while the costs at the 75<sup>th</sup> percentile were \$13.51 PMPM. In 2008, the rate of growth, on an as-reported basis, was 3.1% so cost growth increased this year. On a constant-mix basis, the change in cost growth was more dramatic in 2009, 4.2% as against 0.7% in 2008.

Information systems was far and away the most important reason for this increase. It grew fastest and, on a weighted basis, had the greatest upward affect on costs. This is similar to investments anticipated under health care reform. Enrollment costs also grew rapidly though, as a small function, its growth had only a modest affect on overall trend. It is

possible that membership churn in the weak economic environment may have had an impact. Customer service costs declined and Claims increased second slowest.

*There were significant shifts in staffing between the various components of Account and Membership Administration. Customer Services and Claims staffing ratios declined while Information Systems' increased.*

**Corporate Services** costs grew by 5.5%, and by 5.7% on a constant mix basis. These growth rates were both higher than for 2008 when costs for this cluster decreased by 0.1% on an as-reported basis and by 0.6% on a constant mix basis. Each function increased on an as-reported basis and on a constant-mix basis.

*Corporate Executive and Governance cost growth was the fastest growing function on both a constant-mix and as-reported basis. Because this function is small, it trailed in its affect on the total cost increase broker Commissions, Information Systems, Claims processing, Corporate Services, and Enrollment, depending upon the measurement context. However, like Information Systems, the growth in this function may reflect changes in the industry, such as health care reform and weak employment trends. We identified three factors in the growth of this function. Plans generally had more staff in this area-this function includes strategic planning, Six Sigma, corporate planning, business process improvement, all things that may be associated with responses to the current environment. The proportion of outsourced FTEs also increased somewhat. The average compensation in this function also increased in the mid single digits though significant increases only edged out significant decreases. Severance and turnover, new hires and in two cases, incentive compensation were responsible for increases in plans where increases were significant.*

Total costs for this cluster were \$4.96 PMPM in 2009, while the 25<sup>th</sup> percentile value was \$4.06 PMPM and the value at the 75<sup>th</sup> percentile was \$5.83 PMPM.

### Accounting for Costs as a Percent of Premium Equivalents

Notwithstanding its important drawbacks, health plans and others often express administrative costs as a percent of premiums. As shown in Figure 3, administrative expenses were 9.7% of premium equivalents for comprehensive products sold by Blue Cross Blue Shield Plans. The 25<sup>th</sup> percentile value was 7.9% and the value at the 75<sup>th</sup> percentile was 10.2%.

Comparing these results to those in Appendix B, administrative expenses were 20 basis points lower as a percent of premium equivalents. On a product-by-product basis, ratios were slightly higher, with the greatest increases in the diminishing commercial HMO products. The overall decline appears to reflect in part a shift towards low administrative cost ASO / ASC business.

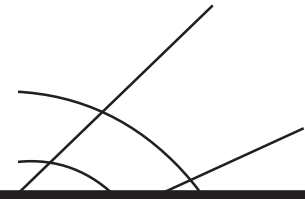
Marketing costs comprised 2.4% of premium equivalents, with the 25<sup>th</sup> percentile value at 1.9% and the value at the 75<sup>th</sup> percentile was 3.4%.

### Calculation of Premium Equivalents

Administrative services relationships, comprising 46% of all Blue Cross Blue Shield commercial members, play 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 health plans provide rather than for the cost of care, which is borne by the self-insured groups. In other words, under GAAP accounting, if expressed as a percent of revenues, administrative expenses under ASO arrangements will have a denominator that is a small fraction of the premium dollar, dashing the intuitive appeal of the administrative expense ratio. This is a common problem that became increasingly visible during health care reform discussions.

In the context of *Plan Management Navigator*, our solution to mitigating this potential misunderstanding is to express expenses as a percent of premium equivalents. Since each of the plans submits the health care expenses for the self-insured groups (which they know since they process their 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, as with premiums, fees charged to ASO clients reflect a profit assumption. Since revenues less expenses equal profits, to estimate premium equivalents it is appropriate to add the fees rather than the administrative expenses to directly compare costs with the insured business.



**Figure 3. Benchmark Summary**  
**Blue Cross Blue Shield Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2009 Data**  
*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	1.9%	3.4%	2.4%	43.2%
Provider & Medical Management	0.8%	1.4%	1.1%	34.8%
Account & Mem. Administration	3.6%	4.4%	4.0%	21.2%
Corporate Services	1.4%	2.0%	1.7%	26.4%
Total	7.9%	10.2%	9.7%	21.2%

The comparable median percent in 2008 was 2.4% so it was relatively unchanged in 2009.

The value at the 25<sup>th</sup> percentile for Provider and Medical Management was 0.8% of premium, while 1.4% of premium equivalents represented

the 75<sup>th</sup> percentile. The median value, at 1.1% was 10 basis points lower than the 1.2% posted last year.

The costs of Account and Membership Administration were 4.0% of premium equivalents compared with 4.0% last year, so it was relatively unchanged. (Both 2009 and 2008 figures reflect our new inclusion of the direct costs of Pharmacy and Mental Health administration within these clusters.) The value at the 25<sup>th</sup> percentile was 3.6% of premium equivalents and 4.4% of premium equivalents at the 75<sup>th</sup> percentile.

The median proportion of premium equivalents due to Corporate Services was 1.7%, 10 basis points higher than last year's value. Twenty-five percent of plans had values below 1.4% of premium equivalents or above 2.0% of premium equivalents in 2009.

### Calculation of Constant Mix Rates of Expense Growth

To make the most useful comparisons of administrative expenses, it is helpful to eliminate the effects of product mix differences. This improves comparability both between organizations with different product mixes and also between periods.

Accordingly, in comparing expenses between periods, we hold constant the product mix between the two years. This is especially important since Medicare Advantage and ASO/ASC products have increased in the product portfolios of Blue Cross Blue Shield Plans. Medicare Advantage consumes far more resources per member than comparable products for people under 65 years of age, and marketing costs are sharply lower for ASO/ASC products versus their insured counterparts.

To do this, since Blue Cross Blue Shield plans report to us by product, we reweight their expenses so that the product mix existing in the prior period is the same as in the current one. We then recalculate the rates of change based on these reweighted estimates.

### Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by over forty functional areas. Our participants normally have quite robust activity-based costing systems to facilitate this. For example, members in Medicare Advantage products submit far more claims per commercial members so their costs per member may be adjusted on that basis. Because of lower Marketing costs, ASO PMPM costs are usually well less than for comparable insured products.

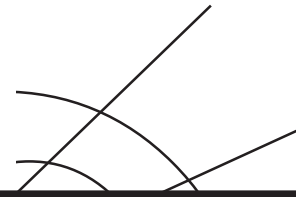
These differences are manifest in their overall cost differences. The most expensive product offered by Blue plans is their Medicare Advantage product, at \$72.72 PMPM, followed by Indemnity & PPO products at \$33.99 PMPM and Commercial Insured HMO at \$33.91. Excluding FEP, the least expensive comprehensive product was Commercial Indemnity

and PPO ASO/ASC at \$20.77 PMPM. The FEP product cost \$17.62 PMPM to administer. This is shown in Figure 4.

As shown in Figure 5, on a percent of premium equivalent basis, the ranking of administrative expenses is different. As with the PMPM costs, the lowest median percent of premium equivalents was Commercial Indemnity and PPO ASO/ASC at 7.3%. Commercial POS ASO/ASC was next at 7.5%. (FEP, a unique product, was 5.4%.)

**Figure 4. Benchmark Summary**  
**Blue Cross Blue Shield Costs by Product, 2009 Data**  
*Per Member Per Month*

	25th PCTL	75th PCTL	Median	σ/ Mean
<b>Commercial HMO</b>				
Insured	\$28.59	\$39.35	\$33.91	25.6%
ASO / ASC	\$19.53	\$28.53	\$23.61	28.2%
<b>Commercial POS</b>				
Insured	\$27.12	\$35.37	\$29.33	29.0%
ASO / ASC	\$17.55	\$24.10	\$21.63	28.6%
<b>Indemnity &amp; PPO</b>				
Insured	\$29.45	\$44.33	\$33.99	26.7%
ASO / ASC	\$18.15	\$24.17	\$20.77	27.5%
FEP	\$15.17	\$20.54	\$17.62	30.5%
Medicare Advantage	\$62.27	\$83.52	\$72.72	21.3%
Medicaid	\$22.21	\$24.97	\$23.25	18.9%
Medicare Supplemental	\$21.57	\$39.33	\$28.93	40.3%
Comprehensive Total	\$24.60	\$32.73	\$28.02	22.4%
Stand Alone Dental	\$2.18	\$3.32	\$2.80	100.1%
Medicare Part D	\$13.42	\$17.69	\$15.38	41.5%



The highest cost product, measured by the percent of premiums attributable to administration was Medicare Supplemental at 17.4%. Medicare Advantage, the high cost plan on a PMPM is lower than average measured as a percent of the premium dollar.

## Background

The peer group universe in this analysis consisted of twenty-four Blue Cross Blue Shield Plans, which collectively served 32.5 million members. There are thirty-nine primary licensees and twenty-three of them, or 59%, participated in this year's study. Twenty-one of this year's participants participated in the previous year and 75.0% of this year's participants have six or more years of experience participating in SEER.

Approximately 13.1 million of the commercial members were served under some form of self-insurance arrangement, comprising approximately 49% of the total commercial members. Medicare Advantage, offered by 14 plans, on comprised 3.3% of their total membership. In six of the Plans Medicare Advantage comprised more than 20% of their total revenues, and in 10 cases, their Medicare Advantage revenues exceeded their historically important Medicare Supplemental revenues.

Costs comparisons are based on the results for plans that participated in both of the comparison years. PMPM values are actual for all plans in the universes. We employed median values throughout this analysis as the measure of central tendency because it minimized the effects of outlying responses.

There were modest changes in the values for 2008 data between how they were originally reported and how they are reported in this year's edition. Besides minor late corrections, we incorporated the direct administrative costs of mental health and pharmacy administration into Account and Membership Administration. Also, rates of change are calculated medians

**Figure 5. Benchmark Summary**  
**Blue Cross Blue Shield Costs by Product, 2009 Data**  
*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
<b>Commercial Insured</b>				
Insured	9.9%	12.5%	11.7%	20.1%
ASO / ASC	5.4%	8.8%	7.8%	30.5%
<b>Commercial Insured</b>				
Insured	8.1%	12.6%	10.9%	37.4%
ASO / ASC	6.9%	9.0%	7.5%	20.7%
<b>Indemnity &amp; PPO</b>				
Insured	9.7%	13.7%	11.5%	29.9%
ASO / ASC	6.4%	9.0%	7.3%	27.6%
FEP	4.4%	6.1%	5.4%	40.0%
Medicare Advantage	6.6%	10.1%	8.4%	32.8%
Medicaid	10.1%	11.8%	11.0%	10.3%
Medicare Supplemental	13.2%	24.0%	17.4%	34.0%
<b>Comprehensive Total</b>	7.9%	10.2%	9.7%	21.2%
Stand Alone Dental	14.0%	21.1%	15.6%	54.2%
Medicare Part D	10.7%	15.6%	13.8%	49.0%

while last year they were calculated as rates of changes in median values.

Overall, our benchmarks in 2010 will comprise the experience of approximately 450 health plan years. We also have universes of Independent / Provider-Sponsored Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. In July, we published results on the Independent / Provider-Sponsored Plans and we will be reporting on the rest of the results in the next two months.

**Appendix A. Benchmark Summary**  
**Blue Cross Blue Shield Costs by Functional Area Cluster, 2008 Data**  
*Per Member Per Month*

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Marketing	\$5.23	\$9.78	\$7.40	44.9%
Provider & Medical Management	2.23	4.45	3.34	40.5%
Account & Mem. Administration	9.35	12.73	11.19	18.8%
Corporate Services	3.83	5.18	4.46	27.5%
<b>Total</b>	<b>\$23.15</b>	<b>\$29.84</b>	<b>\$25.95</b>	<b>22.9%</b>

**Appendix B. Benchmark Summary**  
**Blue Cross Blue Shield Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2008 Data**  
*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Marketing	1.7%	3.5%	2.4%	45.2%
Provider & Medical Management	0.9%	1.5%	1.2%	38.5%
Account & Mem. Administration	3.4%	4.7%	4.0%	22.6%
Corporate Services	1.3%	1.9%	1.6%	29.6%
<b>Total</b>	<b>7.8%</b>	<b>10.5%</b>	<b>9.9%</b>	<b>23.7%</b>