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Independent-Provider Sponsored Plans Post Increase in Administrative Costs, and Decline in Ratios, in 2008

Summary

While raw per member administrative cost trends increased from 4.9% in 2007 to 11.5% in 2008, adjusting for product mix, the rate of cost increase grew more modestly to 6.2% from 3.1% last year. For the entire universe of Independent – Provider / Sponsored (IPS) plans, administrative expenses comprised 8.3% of premium equivalents in 2008 compared with 9.4% in 2007.

Managing administrative costs is an increasing priority for health plans. If not successfully managed, the weak membership trends due to a difficult employment environment will lead to negative operating leverage. Also, the current political environment creates a particularly high degree of scrutiny of health plan administrative costs.

The administrative expenses of IPS plans participating in our performance benchmarking study was $30.37, but varied greatly by product. In 2008, the Commercial POS ASO/ASC administrative expenses were 6.7% of premium equivalents, the lowest such ratio, followed by Medicare Advantage at 7.7%. Medicare Supplemental had the highest ratio at 13.7% of premiums.

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 but not in individual functional area clusters. These results are excerpted from the IPS edition of the 2009 *Sherlock Expense Evaluation Report*, comprising 2008 data.

Administrative Costs and Trends

For convenience of analysis, we group various functional areas into clusters, and standardize for size 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 2008, and comprises 2007 data.

Marketing expenses were $8.66 and grew by 14.3% PMPM, accelerating from 10.3% growth in 2007. (All rates of change hold constant the universe of participants.) Broker Commissions was the fastest growing, high dollar value expense in that cluster of expenses. Internal Sales and Marketing Costs followed in importance. Rating and Underwriting grew fastest overall. Advertising and Promotion cost growth was relatively modest in 2008. The 75th percentile value for this cluster was $9.53 and the 25th percentile value was $7.73 PMPM.

Marketing expense trends, along with those of other plans, were affected by the growth of Medicare Advantage, discussed later. On a product mix adjusted basis, PMPM costs increased by 6.0%, much closer to the 5.5% in 2007's constant mix growth rate. On this basis, the commitment to Product Development / Market Research was especially strong.

Medical and Provider Management grew by 22.7% (compared with 11.3% last year) to $5.08 PMPM. Medical Management costs soared by 27.7%. This functional area heavily reflects the increasing propensity of plans to offer Medicare Advantage. Accordingly, this cluster's cost increased by 14.4% on a product mix adjusted basis, compared with a decline of 3.2% last year. Still, the high rate of increase suggests an increasing commitment to medical management. The growth of Provider Network Management and Services actually declined. The costs of Medical and Provider Management at the 25th percentile was $4.03 PMPM and $5.62 PMPM at the 75th percentile.

Account and Membership Administration cost increased to $9.34, up 6.0% from last year. The value at the 25th percentile for Account and Membership Administration was $7.89 PMPM, while the costs at the 75th percentile were $12.11 PMPM. The rate of growth, on an as-reported basis, was 4.8% in 2007, an indicator that the rates of growth of costs accelerated in this cluster. The fastest growing area was the Claim and Encounter Capture and Adjudication area, followed by Enrollment Membership and Billing and Customer Services. Information Systems expense growth was modest.

Figure 1. Benchmark Summary
Independent / Provider-Sponsored Costs by Functional Area Cluster, 2008 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	$7.73	$9.53	$8.66	35.4%
Provider & Medical Management	4.03	5.62	5.08	40.9%
Account & Mem. Administration	7.89	12.11	9.34	32.0%
Corporate Services	4.14	7.10	4.80	45.3%
Total	$25.49	$35.00	$30.37	29.0%

Adjusting for product mix changes, the Account and Membership Adjudication cluster increased by 8.5%, which seems very high, but on this basis it is *down* from 14.7% in 2007. On this adjusted basis, each functional area's costs grew more slowly or even declined, except for Information Systems.

Figure 2. Benchmark Summary
Independent / Provider-Sponsored Percent Change in Costs by Functional Area Cluster

	2007 Data		2008 Data	
	% Change	% Change, Mix-Adjusted	% Change	% Change, Mix-Adjusted
Marketing	10.3%	5.5%	14.3%	6.0%
Provider & Medical Management	11.3%	-3.2%	22.7%	14.4%
Account & Mem. Administration	4.8%	14.7%	6.0%	8.5%
Corporate Services	-3.4%	-8.7%	6.1%	-6.8%
Total	4.9%	3.1%	11.5%	6.2%

Corporate Services costs grew by 6.1%, but declined by 6.8% on a product mix adjusted basis. Finance and Accounting, and Corporate Executive and Governance increased on an as-reported basis but decreased on a product mix adjusted basis. Actuarial costs increased, and more so on a mix adjusted basis. Modestly growing Corporate Services diminished on a mix adjusted basis.

Total costs for this cluster were $4.80 PMPM in 2008, while the 25th percentile value was $4.14 PMPM and the value at the 75th percentile was $7.10 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 8.3% of premium equivalents for comprehensive products sold by IPS plans. The 25th percentile value was 7.5% and the value at the 75th percentile was 10.1%. Comparing these results to those in Appendix B, administrative expenses were 110 basis points lower as a percent of premium equivalents. This decline is in part attributable to the heavier mix of Medicare, which has lower costs relative to premium.

Marketing costs comprised 2.4% of premium equivalents, with the 25th percentile value was 2.0% and the value at the 75th percentile was 3.1%. The comparable median percent in 2007 was 2.6% or 20 basis points higher than for 2008.

Calculation of Premium Equivalents

Administrative services relationships, typically comprising one-third of all IPS 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 they provide rather than for the cost of care, which is borne by the self-insured groups.

Our solution to this 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. 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.

The value at the 25th percentile for Provider and Medical Management was 1.1% of premium, while the 1.7% of premium equivalents represented the 75th percentile. The median value, at 1.5% was 20 basis points higher than the 1.3% posted last year.

Figure 3. Benchmark Summary
Independent / Provider-Sponsored Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2008 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	2.0%	3.1%	2.4%	31.0%
Provider & Medical Management	1.1%	1.7%	1.5%	33.4%
Account & Mem. Administration	2.4%	3.4%	2.9%	25.6%
Corporate Services	1.2%	2.1%	1.4%	37.3%
Total	7.5%	10.1%	8.3%	21.7%

The costs of Account and Membership Administration were 2.9% of premium equivalents, substantially identical to 2.8% reported last year. The value at the 25th percentile was 2.4% of premium equivalents and 3.4% of premium equivalents at the 75th percentile.

Calculation of Mix-Adjusted Rates of Expense Growth

To make the most useful comparisons between administrative expenses, it is helpful to eliminate the effects of product mix differences. This is beneficial 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 has increased in the product portfolios of some IPS plans and this product consumes far more resources per member than its comparable products for people under 65 years of age.

To do this, since IPS 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.

The median proportion of premium equivalents due to Corporate Services was 1.4%, 30 basis points lower than last year's value of 1.7%. Twenty-five percent of plans had values below 1.2% of premium equivalents or above 2.1% of premium equivalents in 2008.

Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by over forty functional areas. Overall, the resources consumed in these products are reflected in varying administrative expenses that differ quite sharply between the various products. Our participants normally have quite robust activity-based costing systems to facilitate this. For example, among Blue Cross Blue Shield Plans, members in Medicare Advantage products submit 2.5 times as many claims as members in insured HMO products so their costs per member are accordingly higher. Similarly, ASO products have lower overall costs than their insured counterparts since ASO arrangements are normally sought by larger groups that tend to be less costly to market to.

These differences are manifest in their overall cost differences. The most expensive product offered by IPS plans is their Medicare SNP products, at $116.71 PMPM, followed by Medicare Advantage products at $76.35 PMPM. The least expensive comprehensive product was Commercial ASO at $18.35 PMPM. This is shown in Figure 4.

As shown in Figure 5, on a percent of premium basis, the ranking of administrative expenses is different. As with the PMPM costs, the lowest median percent of premium equivalents was Commercial ASO at 6.7%. But Medicare Advantage and Medicare SNP are the next lowest at 7.7% and 7.9%, respectively. Medicare Supplemental, at 13.7%, has the highest ratio of administration to premiums.

The Increasing Importance of Medicare Advantage

The very rapid growth of Medicare Advantage, combined with its high costs has lead to a significant acceleration in administrative expense trends. As noted previously, many IPS plans increased their participation in Medicare Advantage products in 2008. The median Medicare Advantage membership growth was 18.5% compared to 1.3% for commercial products. Notably, the membership growth was broadly disbursed ranging from 2.5% at the 25th percentile to 36.8% at the 75th percentile, both higher than 2007 levels. While the values for the shares of premiums and equivalents did not change from approximately 25% in 2007, the 75 percentile values increased from 28.6% in 2007 to 37.6% in 2008. In other words, growth was concentrated in a heavily committed subset of the plans.

This product shift has resulted in significant changes in the operating characteristics of plans offering Medicare Advantage, in ways that vary by the function. So while total expenses for Medicare Advantage are 2.7 times larger than its commercial equivalent, Medical Management costs are approximately 2.9 times larger and Customer Services costs are 3.3 times larger.

Figure 4. Benchmark Summary
Independent / Provider-Sponsored Costs by Product, 2008 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Commercial Insured				
HMO	$25.13	$32.69	$28.66	32.1%
POS	$28.44	$32.79	$31.83	23.8%
Indemnity & PPO	$28.50	$45.58	$39.03	27.0%
Commercial ASO	$16.09	$23.67	$18.35	29.5%
Medicare Supplemental	$25.25	$38.00	$30.56	35.0%
Medicare				
Medicare Advantage	$64.60	$96.06	$76.35	37.0%
Medicare SNP	$116.46	$146.56	$116.71	25.4%
Medicare Cost	$26.41	$42.32	$31.71	46.0%
Medicaid	$19.78	$28.75	$22.06	20.6%
Comprehensive Total	$25.49	$35.00	$30.37	29.0%
Medicare Part D	$9.41	$12.28	$10.25	28.4%

Background

The peer group universe in this analysis consisted of sixteen Independent / Provider-Sponsored plans, which together had 5.7 million members. Ten of this year's participants participated in the previous year and 75.0% of this year's participants have three or more years of experience participating in *SEER*.

The selected plans served 5.7 million people under comprehensive health benefit plans. More than 1.3 million of the commercial members were served under some form of self-insurance arrangements, comprising approximately 23.2% of the total commercial members. Medicare Advantage, offered by thirteen plans, comprised 6.3% of the total membership, Medicaid HMO, offered by 9 plans, comprised 8.4%, and Medicare Supplemental, offered by seven plans, comprised 0.2% of the total membership.

Figure 5. Benchmark Summary
Independent / Provider-Sponsored Costs by Product, 2008 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Commercial Insured				
HMO	7.4%	10.1%	9.1%	27.4%
POS	7.4%	9.7%	8.4%	23.3%
Indemnity & PPO	9.8%	15.5%	13.4%	26.6%
Commercial ASO	5.6%	7.2%	6.7%	37.4%
Medicare Supplemental	11.3%	15.1%	13.7%	49.8%
Medicare				
Medicare Advantage	6.9%	10.8%	7.7%	36.2%
Medicare SNP	6.4%	10.8%	7.9%	50.9%
Medicare Cost	7.0%	9.5%	8.2%	29.7%
Medicaid	7.5%	14.1%	12.5%	35.2%
Comprehensive Total	7.5%	10.1%	8.3%	21.7%
Medicare Part D	8.3%	10.5%	9.5%	18.8%

Appendix A. Benchmark Summary
Independent / Provider-Sponsored Costs by Functional Area Cluster, 2007 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	$6.97	$10.18	$8.23	34.9%
Provider & Medical Management	2.59	5.86	4.39	46.6%
Account & Mem. Administration	5.96	9.70	9.30	30.8%
Corporate Services	3.98	9.15	4.36	49.8%
Total	$23.09	$35.13	$29.49	29.2%

Costs comparisons are based on the results for plans that participated in each of the comparison years. PMPM values are actual for all plans in the universes. We employed median values throughout this process as the best measure of central tendency.

Overall, our benchmarks in 2009 will reflect the experience of approximately 396 health plan years. We also have universes of Blue Cross Blue Shield Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. We will be reporting on those results in the next three months.

Appendix B. Benchmark Summary
Independent / Provider-Sponsored Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2007 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	2.1%	3.0%	2.6%	33.4%
Provider & Medical Management	1.0%	1.8%	1.3%	37.5%
Account & Mem. Administration	2.4%	3.4%	2.8%	26.8%
Corporate Services	1.3%	2.7%	1.7%	41.0%
Total	7.6%	10.0%	9.4%	20.1%