



MEDICARE PLANS' ADMINISTRATIVE COSTS DECLINED IN 2009

Summary

Raw per member administrative cost trends decreased from 8.3% in 2008 to negative 4.1% in 2009. Adjusting to eliminate the effects of changes in product mix, trends also declined, from 4.1% to negative 4.1%. Sales and Marketing costs sharply reversed from raw per member growth of 18.0% to a decline of 8.6%. All clusters of expenses declined in growth or declined per member per month.

For the universe of Medicare plans submitting 2009 data, administrative expenses comprised 9.0% of premium equivalents, compared with 10.2% for plans submitting data in 2008. Administrative expenses of Medicare Advantage were 7.9% of premiums in 2009.

The administrative expenses of comprehensive products for Medicare plans participating in our performance benchmarking study was \$44.71 PMPM, but varied greatly by product. Medicare SNP cost \$159.77 PMPM while the commercial ASO costs were \$20.03 PMPM. Medicare Advantage administrative expenses were \$86.47 PMPM.

In 2009, the commercial ASO administrative expenses were 6.3% of premium equivalents, the lowest ratio for comprehensive products in this universe. Medicare Advantage's administrative expenses were 7.9% of premiums, Medicare SNP was at 15.4% of premiums and Medicare PFFS was at 9.4% 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 administrative costs are included in the Account and Membership Administration cluster. These results are excerpted from the Medicare edition of the 2010 *Sherlock Expense Evaluation Report*, comprising 2009 data.

Background on Medicare

Medicare covers 47 million Americans, according to the Kaiser Family Foundation. Of these, 24% or 11.1 million are enrolled in Medicare Part C, the Medicare Advantage program. In 2009, there were 10.8 million Medicare Advantage members, also 24% of the total. The recent growth is especially remarkable considering the unflattering comments by elected leaders

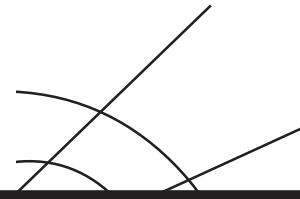
about health plans serving this program and health plans generally.

While membership in Medicare Advantage plans has doubled since 2005, participation varies by state. While Medicare Advantage share is in single digits in nine states, participation exceeds one-third in eight, including California, Minnesota and Pennsylvania.

Under health care reform Medicare Advantage is subject to two new pressures. First, "medical loss ratios" must be at least 85%. (We use quotations as "medical loss ratio" has a developing regulatory definition that may differ from a health plan's operating usage.) Also the amounts paid by the government are slated to fall over time, to approach levels equal to the regular Medicare program. Because health plans incur disproportionately high administrative costs in their start-up phases, the new rules would seem to be especially significant for new entrants.

The higher payments for Medicare Advantage, often along with payments by beneficiaries, help to cover the costs of benefits beyond the core included with traditional Medicare. Thus, Medicare Advantage can be viewed as an alternative to other programs that supplement coverage. According to Kaiser Family Foundation, approximately 4% of beneficiaries have private insurance under which Medicare is a secondary payer because the beneficiary or his spouse is employed. Employer-provided Supplemental Insurance is received by nearly 30% of beneficiaries. Another 20% of beneficiaries purchase their own supplemental insurance. Medicaid pays some premiums and cost sharing for 9 million low income people, or 19% of beneficiaries. Only 10% of beneficiaries, typically very poor people, had no supplemental coverage in 2008.

While MedPAC believes that per member total costs to Medicare are higher under Medicare Advantage, it also believes that HMOs participating in the Medicare Advantage program are able to employ their efficiencies to enhance benefits. MedPAC estimates that for every dollar of enhanced benefits, \$0.24 comes from plan efficiencies. Approximately two-thirds of Medicare Advantage enrollment was in HMOs in late 2009. If MedPAC is correct in its assessment, then Medicare Advantage HMOs have these efficiencies as a cost advantage when compared to the alternative



packages of basic Medicare plus supplemental policies available to consumers.

Membership Trends and Mix Changes

Of the eleven plans participating in our benchmarking study this year, eight also participated in 2009. These continuing plans grew more rapidly in their Medicare products than the overall Medicare Advantage (MA) program, at 7.2% membership growth, on average. This is a decline from last year in which continuous participants posted growth of 29.5%.

Collectively, the Medicare-focused plans served 1.2 million MA beneficiaries on average over the course of 2009. We also include with the benchmarks the MA cost attributes of plans offering but not focused on MA. These Blue Cross Blue Shield and Independent / Provider-Sponsored Plans served 1.1 million and 0.1 million members, respectively. In all, SEER reports on a total of 2.4 million Medicare Advantage beneficiaries, or approximately 22% of the total in the Medicare Advantage program.

For plans included in the core benchmarks, Medicare products comprised a mean value of 63.3% of premium equivalents and median value of 42.5%. Commercial comprised a mean of 30.2% and a median of 39.2%.

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 for 2009 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 includes 2008 data.

Sales and Marketing expenses were \$16.10 PMPM and declined by 8.6%, down from 18.0% growth in 2008. (All rates of change hold constant the universe of participants.) Holding the product mix constant, Sales and Marketing expenses fell by 10.4% PMPM versus growth of 13.8% in 2008. At the 25th percentile, Sales and Marketing costs were \$9.52 and at the 75th percentile were \$32.56 PMPM.

The decline in the Sales and Marketing cluster of expenses explained a high proportion of the cost decline in 2009. On an as-reported basis, it explained nearly all of the administrative cost decline and more than half of the decline on a constant-mix basis.

Calculation of Premium Equivalents

Administrative services relationships comprise a relatively small part of the business mix of Medicare Advantage plans. On average, they comprise 13.6% of members and most plans in our survey do not serve this market at all. Nevertheless, to the extent such relationships exist, they 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.

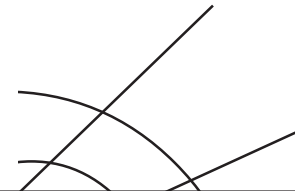
Product Development / Market Research declined at a high double-digit rates on both an as-reported and constant-mix basis. This function also comprised a low double-digit proportion of the overall and Sales and Marketing cluster decline, again on an as-reported and constant-mix basis. It was the fastest decline in any functional area both as-reported and constant-mix.

Advertising and Promotion costs declined at a double-digit rate, as-reported and constant-mix. The decline in the dollar costs was the highest of all functions, using either reporting convention.

Rating and Underwriting expenses also declined at low double-digit rates, as-reported and mix adjusted. This is a relatively small function so the impact was modest under either reporting convention.

During 2009, Medicare plans shifted from external to internal distribution systems. While the Sales and Marketing function expenses increased slightly, broker commissions fell, both as-reported and





constant-mix. In fact, Sales and Marketing was among only five of seventeen total functions that showed growth in 2009. The decline in Commissions is especially notable in that it has tended to grow at double-digit rates in the past.

Provider and Medical Management grew by 8.8% (compared with 13.6% last year) to \$9.23 PMPM. Management / Quality Assurance / Wellness functional area grew rapidly and was responsible for offsetting more than 30% of the overall decline in costs, both on a constant-mix and as-reported basis. Provider Network Management and Services grew modestly and, as it is a smaller functional area, had only a modest impact on the costs of the cluster and the enterprises as a whole.

On a constant-mix basis, Medical and Provider Management also increased by 8.8%. The costs of Medical and Provider Management at the 25th percentile was \$6.82 PMPM and \$12.66 PMPM at the 75th percentile.

Account and Membership Administration expenses increased to \$14.91, up 3.0% from last year. On a constant-mix basis, growth declined from 5.2% last year to 1.7% in 2009. The value at the 25th percentile was \$11.37 PMPM, while the costs at the 75th percentile were \$28.16 PMPM.

Information Systems costs increased at low double-digit rates and comprised the overwhelming proportion of the increase in the Account and Membership Administration cluster of expenses. This is true on both a constant-mix and on an as-reported basis.

Claim and Encounter Capture and Adjudication costs also increased but at mid-to-low single-digit rates, constant-mix or as-reported. The effect on cost trends was minimal because of the function's modest growth and its relatively small size.

However, both Enrollment and Customer Services costs *decreased* in 2009, both at high single-digit, low double-digit rates, and regardless of whether as-reported or constant-mix. While they reinforced the overall declining trend in costs,

the size of the impact was small in the context of overall expense changes.

Corporate Services costs increased by only 1.1% PMPM, compared with 1.8% in 2008 on an as-reported basis. These costs include such support areas as Finance and Accounting, Actuarial, Corporate Services (e.g., Facilities, Legal, Printing and Mailroom and OPEB), Corporate Executive & Governance and Association Dues and License / Filing Fees.

The Corporate Services function grew at high single-digit rates on an as-reported basis and mid single-digits on a constant-mix basis. Corporate Executive & Governance grew at high double-digit rates both on an as-reported basis and mid double-digit rates on a constant-mix basis. These two functions are the dominant ones in this cluster and largely explain its trend.

While still relatively small, Miscellaneous Business Taxes was the fastest growing expense function for the participating firms, both as-reported and constant-mix.

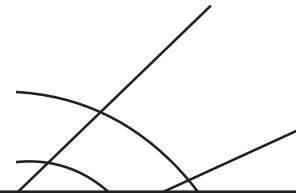
By contrast, Finance and Accounting declined at double-digit rates, sufficient to have outweighed the cost growth in other functions. This was the case both on an as-reported and a constant-mix basis. This decline may reflect some scalability through health plan growth.

Figure 1. Medicare Advantage Benchmark Summary
 Medicare-Oriented Costs by Functional Area Cluster, 2009 Data
 Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Sales and Marketing	\$9.52	\$32.56	\$16.10	63.4%
Provider & Medical Mgmt.	6.82	12.66	9.23	61.4%
Account & Mem. Admin.	11.37	28.16	14.91	52.2%
Corporate Services	6.53	17.64	11.30	65.8%
Total	\$38.03	\$91.55	\$44.71	55.2%

Figure 2. Medicare Advantage Benchmark Summary
 Medicare-Oriented Percent Change in Costs by Functional Area Cluster

	2008 Data		2009 Data	
	% Change	% Change, Mix-Adjusted	% Change	% Change, Mix-Adjusted
Sales and Marketing	18.0%	13.8%	-8.6%	-10.4%
Provider & Medical Mgmt.	13.6%	9.6%	8.8%	8.8%
Account & Mem. Admin.	5.0%	5.2%	3.0%	1.7%
Corporate Services	1.8%	-4.2%	1.1%	-4.1%
Total	8.3%	4.1%	-4.1%	-4.1%



Calculation of Mix-Adjusted Rates of Expense Growth

To make the most useful comparisons of administrative expenses between years, it is advantageous 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.

To do this, since Medicare 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.

Actuarial grew at high single digits on an as-reported basis and was essentially flat on a constant-mix basis. This is a very small function and had next to no effect on trend.

Association Dues and License/Filing Fees decreased at a low double-digit pace on both an as-reported and constant-mix basis. Because the expense levels themselves are so modest, the impact on overall trend was modest as well.

On a constant-mix basis, costs decreased by 4.1%, compared with a decline of 4.2% in 2008. Total costs for this cluster were \$11.30 PMPM in 2009, while the 25th percentile value was \$6.53 PMPM and the value at the 75th percentile was \$17.64 PMPM.

Expressing 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 9.0% of premium equivalents for comprehensive products sold by Medicare plans. The 25th percentile value was 7.5% and the value at the 75th percentile was 11.4%. Comparing these results to those in Appendix B, administrative expenses were 120 basis points lower as a percent of premium

equivalents. The sharp decrease in marketing costs is likely responsible for this.

Sales and Marketing costs comprised 3.1% of premium equivalents, with the 25th percentile value at 2.1% and the value at the 75th percentile was 3.8%. The comparable median percent in 2008 was 3.5% or 40 basis points lower.

The value at the 25th percentile for Provider and Medical Management was 1.4% of premium equivalents, while the 2.1% of premium equivalents represented the 75th percentile. The median value, at 1.6% was 10 basis points lower than the 1.7% posted last year.

The cost of Account and Membership Administration was 2.8% of premium equivalents, identical to the 2.8% reported last year. The value at the 25th percentile was 2.4% of premium equivalents and 3.5% of premium equivalents at the 75th percentile.

The median proportion of premium equivalents due to Corporate Services was 2.0%, 40 basis points lower than last year's value of 2.4%. Twenty-five percent of plans had values below 1.6% of premium equivalents and twenty-five percent of plans had values above 2.6% of premium equivalents in 2009.

Figure 3. Medicare Advantage Benchmark Summary
 Medicare-Oriented Costs by Functional Area Cluster,
 as a Percent Premiums or Equivalents, 2009 Data
 Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ / Mean
Sales and Marketing	2.1%	3.8%	3.1%	40.3%
Provider & Medical Mgmt.	1.4%	2.1%	1.6%	38.1%
Account & Mem. Admin.	2.4%	3.5%	2.8%	29.4%
Corporate Services	1.6%	2.6%	2.0%	44.9%
Total	7.5%	11.4%	9.0%	30.5%

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, suppose commercial HMO products have 40% of the claims volume as Medicare Advantage

products. Commercial products administrative expenses will be accordingly lower. Similarly, ASO products have lower overall costs than their insured counterparts since ASO arrangements are normally provided only to 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 Medicare plans is their Medicare SNP product at \$159.77 PMPM. Medicare Advantage and PFFS followed at \$86.47 and \$82.13, respectively. The least expensive comprehensive product offered by these health plans was the ASO product at \$20.03 PMPM. This is shown in Figure 4. Medicare Part D was lower still, at \$16.64 PMPM.

As shown in Figure 5, the ranking of administrative expenses by product is different on a percent of premium basis. The ASO product remained among the lowest cost on a percent basis, at 6.3% of premium equivalents, but it was followed by Medicare Advantage and Medicaid at 7.9% and 8.1%, respectively. The high cost products, calculated based on a percent of premium equivalents, were Medicare SNP at 15.4% and Indemnity and PPO Insured at 15.0%.

Comparisons Across Universes

Health plans in other Sherlock Company benchmark universes also offer Medicare products. Figure 6 compares them. It is notable that while the Independent / Provider - Sponsored (IPS) plans and the Blue Plans are fairly similar in their costs, the Medicare universe has costs that are much higher. These firms operate somewhat differently, as discussed below.

Sales and Marketing: Medicare-focused plans have higher Sales and Marketing costs than do IPS plans and much higher than Blue plans. Blue plans are far more heavily reliant on external brokers than either IPS of Medicare-focused plans. Advertising and Promotion and Rating and Underwriting (which contains the

Figure 4. Medicare Advantage Benchmark Summary

Medicare-Oriented Costs by Product, 2009 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
HMO	\$27.27	\$46.71	\$36.42	31.4%
POS	36.75	45.45	40.79	30.8%
Indemnity & PPO	35.60	42.62	42.60	20.8%
Total Comm. Ins.	\$28.62	\$43.90	\$39.44	24.5%
ASO	15.96	24.66	20.03	39.0%
Total Commercial	\$25.00	\$34.89	\$30.98	24.9%
Medicare Advantage	62.44	110.83	86.47	39.4%
Medicare Advantage PFFS	68.86	88.06	82.13	25.4%
Medicare SNP	132.72	198.73	159.77	39.6%
Medicare Total	\$65.50	\$101.86	\$89.11	29.0%
Medicaid	22.62	25.66	25.16	13.7%
Comprehensive Total	\$38.03	\$91.55	\$44.71	55.2%
Medicare Part D	\$16.18	\$20.15	\$16.64	23.3%

HCC costs) for the Medicare-focused plans is higher than either of the comparison universes.

Provider and Medical Management: Medicare-focused plans also have higher costs in this cluster, especially over the Blue universe. While the costs of Medical Management are similar across universes, the costs of Provider Network Management and Service is much higher. Both Provider Services and Provider Contracting are notably higher for the Medicare-focused plans.

Account and Membership Administration: Medicare-focused plans have costs below the Blues but higher than the IPS plans. Versus the Blues, IS and Claims costs are much lower, but Enrollment and Customer Services are higher. Versus the IPS, their claims and IS are higher.

Figure 5. Medicare Advantage Benchmark Summary

Medicare-Oriented Costs by Product, 2009 Data

Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
HMO	9.6%	12.6%	10.7%	20.2%
POS	9.1%	13.0%	11.0%	26.4%
Indemnity & PPO	12.0%	16.2%	15.0%	25.2%
Total Comm. Ins.	9.3%	13.0%	11.9%	22.6%
ASO	5.7%	6.7%	6.3%	24.4%
Total Commercial	8.3%	10.5%	9.9%	16.3%
Medicare Advantage	6.8%	11.7%	7.9%	43.1%
Medicare Advantage PFFS	7.4%	11.1%	9.4%	40.2%
Medicare SNP	11.2%	16.1%	15.4%	40.2%
Medicare Total	6.6%	12.0%	7.9%	36.7%
Medicaid	7.4%	8.2%	8.1%	11.2%
Comprehensive Total	7.5%	11.4%	9.0%	30.5%
Medicare Part D	8.9%	13.8%	11.6%	43.3%

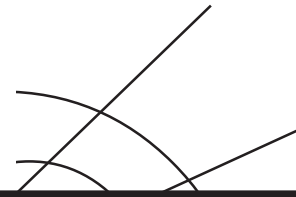


Figure 6. Medicare Advantage Benchmark Summary
 Medicare-Oriented Characteristics by Universe, 2009 Data

	Medicare	Independent / Provider-Sponsored	BCBS	Combined Universes*
Administrative Expenses PMPM				
25th PCTL	\$62.44	\$63.53	\$62.27	\$63.98
Median	86.47	73.80	72.72	75.86
75th PCTL	\$110.83	\$79.00	\$83.52	\$88.84
σ/ Mean	39.4%	25.3%	21.3%	31.2%
Administrative Expenses as a Percent of Premiums				
25th PCTL	6.8%	6.8%	6.6%	6.9%
Median	7.9%	7.9%	8.4%	8.2%
75th PCTL	11.7%	9.3%	10.1%	10.0%
σ/ Mean	43.1%	22.6%	32.8%	34.6%
Plans Offering Medicare Advantage	11	13	14	32
Medicare Comprehensive Members	1,186,320	420,381	1,080,466	2,403,810
Medicare Comprehensive Revenue	\$13,983,573,442	\$5,019,479,141	\$12,433,801,968	\$28,050,486,618
Comprehensive Total Revenues	\$20,524,793,419	\$23,525,517,386	\$99,079,419,395	\$133,171,709,388

*Excludes six firms included in two universes.

Corporate Services: Medicare Focused plans are higher than either IPS or Blue plans. Corporate Executive / Governance and Finance and Accounting are notably higher as is the Corporate services function. Facilities are notably high with the Corporate Services function.

In summary, versus the IPS plans, the greatest difference is in Corporate Services. These activities are often scalable. Versus Blue plans, the Corporate Services differences are also evident, but the much lower marketing costs are balanced by higher Account and Membership Administration costs. These Medicare focused plans are performing as one would expect – they are incurring the costs associated with their growth.

Background on This Universe and SEER

The peer group universe in this analysis consisted of eleven Medicare plans, which together served 2.9 million members. On average 67.4% of the premiums and fees of these plans came from Medicare Advantage products. The median membership in this universe was 227,000 members.

Costs comparisons are based on the results for plans that participated in each of the comparison years. PMPM and percent values are for all plans

that reported this year. We employed median values throughout this process as the best measure of central tendency.

Overall, our benchmarks in 2010 (containing 2009 data) comprise the experience of approximately 454 health plan years. We also have universes of Independent / Provider-Sponsored Plans, TPAs, Larger Health Plans, Blue Cross Blue Shield Plans and Medicaid Plans. We have completed our reporting on the results of the Independent / Provider-Sponsored Plans, TPAs and Blue Cross Blue Shield Plans and the results of these may be found on our web site.

Appendix B. Medicare Advantage Benchmark Summary
 Medicare-Oriented Costs by Functional Area Cluster,
 as a Percent Premiums or Equivalents, 2008 Data

Percent of Premium Equivalents

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Sales and Marketing	2.8%	5.0%	3.5%	45.0%
Provider & Medical Mgmt.	1.3%	2.0%	1.7%	43.1%
Account & Mem. Admin.	2.5%	3.5%	2.8%	26.5%
Corporate Services	1.9%	2.8%	2.4%	45.7%
Total	8.0%	13.0%	10.2%	33.3%

Appendix A. Medicare Advantage Benchmark Summary
 Medicare-Oriented Costs by Functional Area Cluster, 2008 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Sales and Marketing	\$10.64	\$38.64	\$17.77	77.7%
Provider & Medical Mgmt.	5.44	13.08	7.25	83.0%
Account & Mem. Admin.	10.19	24.76	14.12	63.1%
Corporate Services	7.15	17.83	10.96	75.1%
Total	\$34.97	\$90.38	\$46.46	70.5%