



## MEDICARE ADVANTAGE ADMINISTRATIVE EXPENSE COSTS

News concerning Medicare is abundant these days. Since the passage of the Medicare Prescription Drug, Improvement and Modernization Act of 2003, private plan enrollment has begun to grow. Total Medicare Advantage membership has seen its first increase since 2000, and currently stands at approximately 6.1 million beneficiaries.<sup>1</sup> The Medicare prescription drug program now covers more than 27 million beneficiaries and continues to grow.<sup>2</sup> The number of Medicare contracts issued has also begun to increase for the first time in years, signaling the rise of new entrants. In addition to receiving higher payment rates, health plans are using Part D coverage to create more attractive and accessible plans for consumers. Such plans are sometimes envisioned as “gateway” products to Medicare Advantage.

Publicly-traded Medicare companies have also been performing well. PacifiCare Health Systems, Inc. had a greater than 40% stock price increase during 2005 before it was acquired by UnitedHealth Group. Humana, Inc. had even better performance with a price gain of more than 80% during 2005. By contrast, the Medicaid plans lost 18% of their value during 2005, while the S&P 500 only gained 3%.

Because of the heightened visibility of this product and because of recent inquiries, Sherlock Company recently analyzed data from Medicare-oriented plans that participated in our 2005 *SEER* survey. For the Medicare Advantage product, the median per member per month (PMPM) costs were \$42.73. Plans reported median PMPM costs of \$23.71 for all products. Expressed as a percent of premiums or equivalents, Medicare Advantage administration was 6.74%. Overall the products offered by these plans had administrative expenses equal to 8.99% of premiums or equivalents.

Included in our study were six selected Medicare-Oriented plans. These firms included plans from the Publicly-traded and Provider-Sponsored universes. We estimate that these plans comprised approximately 18% of all Medicare Advantage members during 2004.<sup>3</sup> The plans’ commitment to Medicare Advantage ranged from 10% to 23% as measured in

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## DASHBOARD SUMMARY FOR JANUARY

Next month will mark the beginning of the third year for the Sherlock Company *Health Plan Dashboard*. This is a useful tool for management, consultants, and researchers to receive the latest data concerning the operational and financial performance of health plans. Data is collected each month from a pool of Blue Cross Blue Shield and Provider-Sponsored plans.

For the trailing three months ended January 31, 2006, the eleven health plans in our *Health Plan Dashboard* reported revenue growth of 4.4%, with ASO/ ASC growth of 16.7%, while managed care revenue decreased by 0.8%. Membership declined by 9.2% for managed care but increased by 26.2% in the indemnity business. Managed care and ASO had price increases of 9.6% and 16.2%, respectively, while indemnity posted an increase of 8.0%.

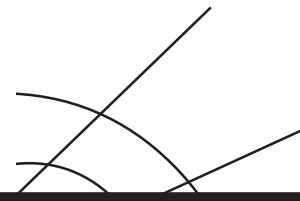
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## 2006 PERFORMANCE BENCHMARKS UNDERWAY

With the distribution of the financial and operational metrics survey forms to participants last month, we began the process of the 2006 *SEER* benchmarks. This year brings many improvements, including the use of survey forms that are common to all universes and more than 200 pages of definitions and examples. As with prior editions, we support participant requests for clarification through our online forum. This will allow us more flexibility to customize *SEER* to meet our clients’ needs, such as editions tailored to geographic regions. We have also added new metrics that participants have requested and further refined their definitions.

This year we have 19 Blue Cross and Blue Shield Plan participants, representing half of all licensees. Our Provider-Sponsored universe contains 15 health plans and our Medicaid-Oriented edition has 11 participants. Health plans participating in *SEER* cover approximately one-fifth of all insured Americans.

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members, while the percent of revenues from Medicare Advantage in this universe ranged from 29% to 59%. Note that health plans exclusively serving the Medicare Advantage universe are exceedingly rare. These reporting firms have an average Medicare HMO membership of 141,000. Comprehensive total average membership for these plans is approximately 671,000.

*EXPENSES BY MAJOR FUNCTIONAL CATEGORY*

Figure 1 shows administrative costs by principal functional group for *all* of the products sold by Medicare-oriented health plans. (*SEER* itself segments costs *by product line* but also into many more functional areas.) The total median PMPM cost was \$23.71.

expenses in 2004. This category of expenses includes many of the core functions of health plans such as Enrollment (including Membership and Billing), Customer Services, Information Systems and Claims (including Encounter Capture and Adjudication). Plans reported \$10.17 at the 75<sup>th</sup> percentile and \$6.19 at the 25<sup>th</sup> percentile.

**Corporate Services** represented the final category. It included investments in HIPAA compliance as well as Finance and Accounting, Actuarial, Corporate Services (including Human Resources, Facilities, Legal and Regulatory, Corporate / Executive and Association Dues and Miscellaneous Business Taxes). These expenses collectively represented \$5.91 in administrative expenses. Fewer than 25% exceeded \$7.63 or were less than \$5.34. These expenses are more susceptible to economies of scale than other groups of functional expenses, in our view.

<b>Figure 1. Benchmarks for Medicare Plans' Administrative Expenses: 2005</b>				
<i>Cost Per Member Per Month - By Function, Comprehensive Products</i>				
	25th Percentile	75th Percentile	Median	$\sigma$ /Mean
Marketing	\$4.51	\$7.15	\$5.76	42.25%
Medical and Provider Management	\$4.03	\$4.47	\$4.14	7.61%
Account and Membership	\$6.19	\$10.17	\$7.40	33.12%
Corporate Services	\$5.34	\$7.63	\$5.91	35.45%
Total Expenses	\$20.13	\$28.03	\$23.71	29.96%

**Marketing** expenses included Rating and Underwriting, Product Development / Market Research, Sales and Marketing, Commissions and Advertising and Promotion. These expenses represented \$5.76 of the total administrative costs. At the 75th percentile, these costs were \$7.15, and \$4.51 at the 25th percentile.

**Medical & Provider Management** was composed of Provider Network Management and Services and Medical Management (including Quality Assurance and Wellness Programs). These expenses had a median value of \$4.14. At the 75th percentile, these costs were \$4.47, and were \$4.03 at the 25<sup>th</sup> percentile. By contrast, the Blue and Provider-Sponsored universes reported median costs of \$2.83 PMPM and \$3.31, PMPM, respectively.

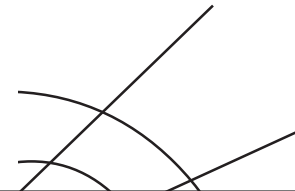
**Account & Membership Administration** represented \$7.40 per member per month of administrative

*EXPENSES BY PRODUCT*

Among the products offered by the plans in our study, the Medicare Advantage product had the highest PMPM cost to administer at \$42.73, with 25% of the respondents reporting costs of \$33.35 or less, or \$52.84 or more. This was followed by the Medicare Supplemental product, with median costs of \$35.03. Expressed as a percent of revenue, however, Medicare Advantage operated at 6.74% of premiums, which was the lowest of all of the products. Medicaid HMO cost \$19.64 PMPM to administer, which was 9.70% of premiums. This is shown in Figures 2 and 3.

Among the commercial products, Indemnity & PPO insured had the highest costs PMPM at \$31.96. Commercial HMO insured had median costs of \$20.92, while commercial POS insured had costs of

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**Figure 2. Benchmarks for Medicare Plans' Administrative Expenses: 2005**  
Cost Per Member Per Month - By Product Line

	25th Percentile	75th Percentile	Median	$\sigma$ /Mean
Commercial HMO				
Insured	\$20.22	\$25.17	\$20.92	16.93%
ASO / ASC	NM	NM	NM	NM
Commercial POS				
Insured	\$21.67	\$28.82	\$25.61	28.49%
ASO / ASC	NM	NM	NM	NM
Indemnity & PPO				
Insured	\$30.77	\$35.21	\$31.96	13.80%
ASO / ASC	NM	NM	NM	NM
Medicare Advantage	\$33.35	\$52.84	\$42.73	42.70%
Medicaid HMO	\$12.87	\$23.35	\$19.64	40.04%
Medicare Supplemental	\$35.03	\$35.03	\$35.03	NM
Stand-alone Dental	\$2.52	\$2.52	\$2.52	NM

**Figure 3. Benchmarks for Medicare Plans' Administrative Expenses: 2005**  
Costs as a Percent of Premium or Equivalents - By Product Line

	25th Percentile	75th Percentile	Median	$\sigma$ /Mean
Commercial HMO				
Insured	10.23%	12.62%	11.73%	18.72%
ASO / ASC	NM	NM	NM	NM
Commercial POS				
Insured	10.38%	14.52%	12.35%	33.15%
ASO / ASC	NM	NM	NM	NM
Indemnity & PPO				
Insured	13.21%	16.59%	15.95%	24.70%
ASO / ASC	NM	NM	NM	NM
Medicare Advantage	5.17%	7.72%	6.74%	40.69%
Medicaid HMO	9.11%	12.29%	9.70%	23.73%
Medicare Supplemental	30.23%	30.23%	30.23%	NM
Stand-alone Dental	18.09%	18.09%	18.09%	NM

\$25.61. As a percent of revenue, Indemnity & PPO also had the second highest costs, at 15.95%. Medicare Supplemental had the highest cost at 30.23% of premiums. Commercial POS had costs as a percent of premiums of 12.35% and commercial HMO had costs of 11.73%.

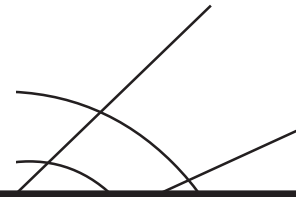
Medicare-oriented plans had median costs of \$42.73, or 6.74% of revenue. Provider-Sponsored plans had a median cost of \$48.54, or 7.77% of revenue. Medicaid-oriented plans had the highest Medicare Advantage costs at \$58.76, or 8.47% of revenue. This is shown in Figure 4.

### MEDICARE PLANS' MEDICARE ADMINISTRATIVE EXPENSES COMPARED TO OTHER UNIVERSES

The Medicare-oriented plans exhibited lower median Medicare Advantage administrative costs than Blue Cross Blue Shield Plans. The latter had median costs of \$47.60, or 7.31% of revenue, while the universe of

These lower costs were seen despite the fact that Blue Cross Blue Shield Plans are typically much larger than Medicare-oriented plans. They are closer in size to the Provider-Sponsored plans and the Medicaid plans, yet still had lower costs. Specialization may play a role in enabling these Medicare plans to administer the product for less. Plans with a higher concentration in one product lessen the complexity associated with support of multiple products.

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**Figure 4. Benchmarks for Medicare Plans' Administrative Expenses: 2005**  
 Cost Per Member Per Month - By Universe, Medicare Advantage

	25th Percentile	75th Percentile	Median	$\sigma$ /Mean
Medicare-oriented	\$33.35	\$52.84	\$42.73	42.70%
Blue Cross Blue Shield	\$38.32	\$58.53	\$47.60	48.21%
Provider Sponsored	\$39.52	\$55.14	\$48.54	30.86%
Medicaid-oriented	\$57.04	\$60.49	\$58.76	8.31%

Employees may be more knowledgeable about Medicare processes, which contributes to lower administrative costs.

**Dashboard Summary:** *Continued from Page 1*

Health benefits ratios overall declined by 2.3 percentage points, but increased by 2.8 and 0.4 percentage points for indemnity and managed care lines, respectively. The number of scripts per person increased by 0.1 to 9.1 on an annualized basis. E/R visits per decreased by 25.3 to an annual rate of 248.6 per thousand and hospital days per thousand increased by 1.4 days to 298.5 days per thousand.

Administrative expense to premium increased by 1.1 percentage points to 9.8%. Claims volumes increased to 13.9 per member per year while inquiries per member decreased to 1.9 per member per year. Staffing ratios increased by 0.93 FTEs to 17.0.

Information in our health plan dashboard is segmented by product and is presented on a monthly as well as a trailing-three months basis. It is intended to complement the *Sherlock Expense Evaluation Report* in its brevity and timeliness. Please contact us regarding ordering or participation information.

*We are in the process of expanding the Health Plan Dashboard in two principle respects. First, we are actively seeking new participants. You, and perhaps others in your organization, will soon receive information regarding how to participate in our Dashboard. We'll note the costs, data requirements and so forth, and our objective to keep the time required to submit the data to thirty minutes.*

*Second, we are aggressively seeking new metrics for inclusion. The criteria are the data submission time and the utility of the metrics. Please contact us directly if your organization would like to jump start its participation in the Dashboard.*

**2006 SEER Benchmarks:** *Continued from Page 1*

We will be receiving completed survey forms for all universes during May and early June. We expect to begin publishing the first reports in Mid-June, continuing through August for the rest of our universes and volumes. *Please contact us if you would like more information concerning either purchasing or participating in SEER.*

Notes Regarding Medicare

<sup>1</sup>Total Medicare Advantage includes Coordinated Care Plans (CCPs), PPO Demos, Private Fee-for-Service, Cost, and Other. This is found in the Kaiser Family Foundation's *March, 2006 Monthly Medicare Tracking Report*.

<sup>2</sup>Centers for Medicare and Medicaid Services.

<sup>3</sup>For comparability with SEER, Medicare Advantage enrollment includes only CCPs. The number of enrollees was taken from the Kaiser Family Foundation's *December, 2004 Monthly Medicare Tracking Report*.