



## Provider-Sponsored Administrative Expenses Increase

This is a revision of a previous analysis published in August 2006. The principal reason for the revision is to exclude premium taxes for Medicaid product lines from revenues and expenses. These state taxes are unusual, and tend to distort all percent of revenue calculations and totals of per member per month costs. Please accept this in lieu of the previous version.

Provider-Sponsored health plans had a median total expense of the plans for all products in 2005 of \$24.67 per member per month (PMPM). Holding constant the universe, this represented a median rate of change in total expense of 4.9% over 2004's values.

The products offered had expenses which ranged from \$17.34 for Commercial ASO to a high of \$61.89 for Medicare Advantage. Expressed as a percent of premiums or equivalents, insured comprehensive products ranged from 7.2% for Medicare Cost to a high of 19.3% for Medicare Supplemental.

We also calculated the rate of growth holding constant the mix of products between each year. The universe as a whole had a median increase in costs of 13.0%. So adjusted, plans reporting membership growth had a cost increase of 6.9%, whereas plans reporting membership decreases had a cost increase of 19.0%.

This analysis is based on Sherlock Company's fourth annual benchmarks for Provider-Sponsored plans. The universe is composed of thirteen plans, of which 10 reported in both years.

### Expenses by Major Functional Category

**Marketing** includes the expenses of Rating and Underwriting, Product Development / Market Research, Sales and Marketing, Commissions and Advertising and Promotion. These expenses represented \$6.46 of the total administrative costs. At the 75th percentile, these costs were \$7.44, but only \$5.35 at the 25th percentile. The largest contributor to marketing is the commissions paid to brokers, which had a median cost of \$2.17.

**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 \$3.98. At the 75th percentile, these costs were \$5.24, but were \$2.76 at the 25th percentile. The expenses for Medical & Provider Management are sensitive to the mix of products that are offered. Managed care products such as HMOs tend to require a higher commitment to this function. Twelve of the thirteen plans in this universe offer commercial HMO.

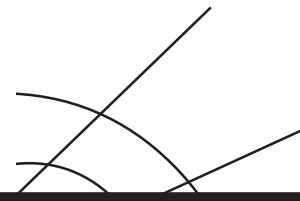
**Account & Membership Administration** represented \$7.75 per member per month of administrative expenses in 2005, the largest share of administrative costs. This category of expenses includes many of the core functions such as Enrollment (including Membership and Billing), Customer Services, Information Systems and Claims (including Encounter Capture and Adjudication). Plans reported \$10.68 at the 75th percentile and \$6.03 at the 25th 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 \$7.71 in administrative expenses. Fewer than 25 percent exceeded \$8.60 or were less than \$6.41. These expenses are more susceptible to economies of scale than other groups of functional expenses.

**Figure 1. Benchmarks for Provider-Sponsored Plans' Administrative Expenses: 2005**  
Cost Per Member Per Month - By Function, Comprehensive Products

	25th %	75th %	Median	s/Mean
Marketing	\$5.35	\$7.44	\$6.46	29.8%
Medical and Provider Mgmt.	\$2.76	\$5.24	\$3.98	40.1%
Account/Membership Admin.	\$6.03	\$10.68	\$7.75	33.6%
Corporate Services	\$6.41	\$8.60	\$7.71	36.1%
Total Expenses	\$19.80	\$30.16	\$24.67	28.5%



## Expenses by Product

Due to the varying resource requirements of the products, the costs of the products differed. For instance, Medicare Advantage products require a much more intensive commitment of administrative resources paralleling the greater health care needs of the senior population, and ASO products operate with lower overall costs than insured products.

Among insured products, Medicare Advantage had the highest costs at \$61.89. Commercial POS had the highest value for commercial insured products with \$31.36. HMO and Indemnity & PPO had median values of \$26.50 and \$30.92, respectively. Medicaid HMO and Medicare Supplemental plans typically cost \$20.93 and \$29.18, respectively to administer. Medicare Cost had a median value of \$43.49 per member per month. The commercial ASO product typically cost approximately \$10-15 less per member than the commercially insured products. The commercial ASO cost \$17.34 per member per month.

Expressed as a percent of premium or equivalent, administration also varied by product. (To facilitate comparability between firms that provide services internally and outsource those services, we excluded revenues and expenses services that are commonly capitated such as behavioral health and prescription drugs.)

Medicare Cost and Medicare Advantage had the lowest costs, at 7.2% and 7.9% of premium, with the high of 19.3% for Medicare Supplemental. A Medicaid HMO administration was 10.1% of premium equivalents.

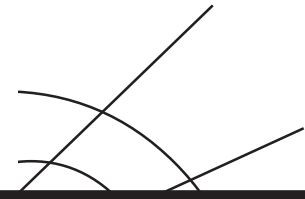
Among the commercial products, POS had the highest costs at 13.2% of premiums, followed by HMO at 11.9% of premium, and Indemnity & PPO at 11.5% of premium. Again, the ASO product comprised a lower percent of premium equivalents than its insured counterparts at 8.6% of premium equivalents.

**Figure 2. Benchmarks for Provider-Sponsored Plans' Administrative Expenses: 2005**

Cost Per Member Per Month - By Product Line				
	25th %	75th %	Median	s/Mean
Commercial Insured				
HMO	\$24.44	\$34.81	\$26.50	32.3%
POS	\$25.65	\$34.39	\$31.36	29.3%
Indemnity & PPO	\$20.48	\$35.91	\$30.92	42.2%
Commercial ASO	\$11.32	\$20.54	\$17.34	36.7%
Medicare Supplemental	\$19.96	\$42.86	\$29.18	160.4%
Medicare				
Advantage	\$56.30	\$75.24	\$61.89	23.3%
Cost	\$30.35	\$46.16	\$43.49	46.4%
Medicaid HMO	\$18.90	\$23.19	\$20.93	26.5%

**Figure 3. Benchmarks for Provider-Sponsored Plans' Administrative Expenses: 2005**

Costs as a Percent of Premium or Equivalents - By Product Line				
	25th %	75th %	Median	? / Mean
Commercial Insured				
HMO	10.4%	13.9%	11.9%	29.6%
POS	10.4%	14.2%	13.2%	28.4%
Indemnity & PPO	10.1%	17.1%	11.5%	41.9%
Commercial ASO	6.1%	10.3%	8.6%	101.0%
Medicare Supplemental	12.9%	27.0%	19.3%	188.2%
Medicare				
Advantage	7.8%	10.1%	7.9%	23.9%
Cost	6.7%	10.6%	7.2%	46.2%
Medicaid HMO	7.7%	10.8%	10.1%	40.9%



## Rapid Increase in PMPM Costs

The results this year are substantially different from last year, notably because the median cost is \$24.67, 18.5% higher than we reported last year. This also diminishes a historic favorable relationship between this universe and Blue Cross Blue Shield Plans in that last year Provider-Sponsored Plans costs were approximately 19.8% lower, and are only 7.1% lower this year.

We have given this shift a great deal of thought. First, it is clear that the increase was *not* due to low cost plans leaving since, in general, those plans had costs that were slightly *higher* than the continuing plans. We lost eight plans from our Provider-Sponsored panel, which were replaced by three. No fewer than half of the plans that left the panel have been, or are being, acquired.

Not entirely surprisingly, the three new firms had costs that were relatively high. These three firms had a median cost 46.0% higher than the median cost of continuing plans.

But what is especially remarkable is the 17.8% increase in median *values*, to \$23.98 PMPM, for plans that participated in both years. Simply put, this increase is the statistical result of high cost plans reporting greater increases in costs than lower cost plans. By the same token, the median *rate* of expense growth is only 4.9%.

One could imagine a scenario in which high cost plans exhibited lower growth in expenses, but that was not the case this year. There were six plans, with costs over \$20.00 PMPM. The six high cost plans that participated last year had a cost increase of 18.0% PMPM. The four plans reporting the lowest cost last year had cost increases of 2.2% PMPM. The difference in median costs between the low and high cost plans expanded from \$6.12 PMPM in 2004 to \$12.12 PMPM in 2005.

## Growth versus Decline

The short-term effects of scale may have affected cost trends. Accordingly we reanalyzed the data dividing the group into health plans that gained membership and those that lost membership. In summary, expenses were weighted by the median product mix in each year had a cost increase of 6.9% for the five plans that increased in membership in 2005. The plans that experienced a decrease in membership had a cost increase of 19.0%. In addition, for the declining plans, a shift in favor of relatively high cost products such as Medicare Advantage may have been responsible for up to a third of the overall increase.

## Universe as a Whole

As noted above, the ten plans that participated in 2004 and in 2005, as a group posted a 13.0% increase holding constant the mix of products. Marketing posted a 15.5% increase and Medical & Provider had a 13.8% increase. Account & Membership had the largest increase with 22.6%. Corporate Services had a slight increase of 0.9%.

There were wide variations in the median cost increases by product mix in each year. For commercial HMO insured plans, there was a 25.5% increase, while commercial POS insured experienced less of an increase with 9.8%. Indemnity & PPO insured experienced a 15.9% decrease in cost in 2005. Commercial ASO had an increase of 2.6% in its cost in 2005. Medicare Supplemental had a decrease in cost of 11.6%, while Medicare Advantage jumped up 14.5%. Medicare Cost experienced a growth of 12.0% and the Medicaid HMO expense rose 4.0%.

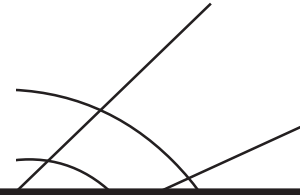
## Plans with Decline in Membership

Plans with a decrease in membership in 2005 had cost increase of 19.0% increase, holding constant the mix of products between the plans. Marketing experienced a 37.0% increase while Medical & Provider Management posted a 14.6% increase in costs. Account & Membership increased costs on a PMPM basis by 20.0% and Corporate Services also jumped up 6.4%, respectively.

Commercial HMO Insured products had a growth of 24.1%, while Commercial POS Insured had the only decrease at 3.8%. Indemnity & PPO Insured also increased as did Commercial ASO by 4.6% and 42.8%, respectively. Medicare Supplemental was not a factor in 2004, but became one in 2005; therefore a proper comparison could not be made. Medicare Advantage had an increase of 16.7% in expenses. In 2005, none of the five declining plans had Medicare Cost, which made comparison unnecessary. Medicaid HMO had an increase in expenses of 22.9%.

The total rate of increase is in part a result of any changes in the mix of membership by product of the plans. For instance, a shift in favor of Medicare Advantage, with its very high costs, can create an apparent increase where none truly exists. In this case, the median Medicare Advantage mix increased to 4.9% from 4.0% of members and Medicaid HMO decreased from 11.4% to 11.1%.

There are, we believe, three reasons for the sharp cost increases. First, some costs are relatively fixed in the



short term. With the decrease in membership for these plans, it is expected that these costs will have to be absorbed by fewer members, increasing total PMPM expenses. Second is the apparent desire to invest in growth to regain sales reflecting in higher marketing costs. Third, plans with declining membership seemed to have invested in Medical & Provider Management in order to drive total costs lower, including health benefits.

## Universe of Plans with Membership Growth

The plans that gained membership in 2005 had a rate of increase PMPM expense, holding constant the product mix between the plans in each year, of 6.9%. Marketing had the greatest increase in costs at 11.8% while Medical & Provider had an increase in cost of 3.9%. Account & Membership also increased by 8.1% and Corporate Services rose by 2.5%, respectively.

Commercial HMO Insured costs increased by 27.7%, in 2005. Commercial POS Insured costs had a 13.0% growth, while the expenses for Indemnity & PPO Insured decreased 22.9%. A decrease of 0.4% was seen in the commercial ASO line of products. Medicare Supplemental saw a sharp decrease in expenses, by 11.6%, while Medicare Advantage experienced an increase of 13.3%. Medicare Cost and Medicaid HMO decreased by 2.4% and 13.3%, respectively.

The largest increase, by functional area, for the plans with increased membership in 2005 was Marketing with 11.8%. In one case, Advertising and Promotion contributed 48.2% to the growth of its Marketing costs. Commissions were the second biggest contributor with 37.6%.

Medical & Provider Management and Account & Membership increased by 3.9% and 8.1%, respectively. Anecdotally, the increase in Medical Management / Quality Assurance / Wellness was the main contributor to the increase in the Medical & Provider Management expense, with costs that increased 78.4%. Total Information System Expenditures was the biggest contributor to the increase cost in Account and Membership Administration with an increase of 71.4%.

## Background on SEER

Volume I (Financial Metrics) of *SEER* for Provider-Sponsored Plans contains an extensive amount of analyses of eight principle product areas and more than thirty functional areas. Separate analyses include

outsourced functions such as mental health, pharmacy and COB / Subrogation. Products include Commercial HMO, Commercial Point-of-Service, Commercial Indemnity and PPO, Medicare Advantage, Medicare Cost, and Medicaid HMO.

The Volume I financial metrics volume of the Provider-Sponsored Plans Edition is second of several Sherlock Company benchmarks for the management of health plan performance. Other universes include Medicaid Plans, Blue Cross Blue Shield Plans and Larger Plans. The 13 Plans included in this study serve over 4.0 million members in Provider-Sponsored Plans.

In addition to the financial metrics, other performance metrics are included in a companion volume of operational metrics. These metrics include factors affecting costs such as member use of the function, employee productivity, unit cost and staffing ratios. This volume also analyses various drivers of those metrics such as the extent to which these functions are performed electronically, quality measures and other function-specific measures.

*SEER* reports are the definitive benchmarks for health plan administration. They are critical tools to enhance operational performance and support strategic initiatives ranging from management of the product portfolio, vendor negotiations, outsourcing and business combinations. Health plans participating in Sherlock Company's benchmarking studies include Larger Plans, Blue Cross Blue Shield, Provider-Sponsored, Medicaid-Oriented plans and Medicare Advantage plans.

Sherlock Company ([www.sherlockco.com](http://www.sherlockco.com)), based in Gwynedd, Pennsylvania, provides informed solutions for health plan financial management. Since its founding in 1987, Sherlock Company has been known for its impartiality and technical competence in service to its clients.

Additional information concerning the 2006 *Sherlock Expense Evaluation Reports* is available by contacting Sherlock Company.

Contact:  
Douglas B. Sherlock, CFA  
Sherlock Company  
215-628-2289  
[sherlock@sherlockco.com](mailto:sherlock@sherlockco.com)

