

## BLUE CROSS BLUE SHIELD CHART BOOK NOW AVAILABLE

Sherlock Company has just published a summary of Blue Cross Blue Shield administrative costs and trends. It outlines sources of changes in administrative expenses by product and functional area clusters. It also contains a summary of regional trends and a succinct analysis of trends in information systems costs. Please call Sherlock Company for additional information

## NEW ADMINISTRATIVE EXPENSE BENCHMARKS FOR MEDICARE ADVANTAGE HEALTH PLANS

Sherlock Company recently published its third consecutive annual performance benchmarks for Medicare Advantage health plans. The universe serves over 974,000 members, in all product areas (including commercial), had median total administrative expense for all products in 2005 of \$29.96 per member per month (PMPM).

The Medicare Advantage product had the highest cost per member per month, with \$65.79 PMPM. Out of five the universes, this was the second highest Medicare Advantage product cost, Medicaid plans had the highest cost PMPM. Commercial products ranged from ASO with \$13.48 to POS with \$37.36. Medicaid HMO had PMPM costs of \$21.14.

Commercial HMO, POS, and Indemnity & PPO had costs as a percent of revenue of 13.2%, 16.0%, and 16.8%, respectively. In other products, the plans reported median costs ranging from 100.0% for Commercial ASO to 9.0% for Medicare Advantage.

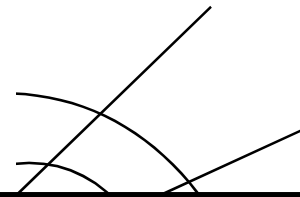
### *Background on Medicare Advantage*

The Medicare Advantage universe is one of five of the *Sherlock Expense Evaluation Report (SEER)*, a series of benchmarks of performance metrics for health plans. In-depth financial metrics for each universe are complemented with extensive operational metrics.

This universe is comprised of six plans, which together had revenues of \$3.7 billion. Medicare Advantage plans are unique in that firms exclusively focused on them are comparatively rare. This is in part a legacy of the old "50/50" rule under which Medicare Advantage was limited to 50% of total membership quality assurance purposes. Collectively, 58.4% of the revenues were from Medicare Advantage products, and the median proportion was 43.1%. Medicare Advantage members represented 20.9% of total membership, and the median proportion was 19.2%.

### *Expenses by Major Functional Category*

Administrative costs by principal area cluster for *all* of the products sold by Medicare Advantage Health Plans are displayed in Figure 1. (*SEER* itself segments costs *by product line* but also into many more functional areas.) The median total PMPM cost was \$29.96. The 75th percentile costs were \$31.93 and at the 25th percentile those costs were \$25.51.



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

	<u>25th %</u>	<u>75th %</u>	<u>Median</u>	<u>σ/Mean</u>
Marketing	\$5.63	\$8.50	\$7.13	99.8%
Medical and Provider Management	\$4.30	\$6.57	\$5.67	112.3%
Account and Membership Administration	\$7.23	\$9.67	\$8.78	63.0%
Corporate Services	<u>\$7.68</u>	<u>\$9.16</u>	<u>\$8.04</u>	<u>79.8%</u>
Total Expenses	\$25.51	\$31.93	\$29.96	87.1%

**Marketing** includes the expenses of Rating and Underwriting, Product Development / Market Research, Sales and Marketing, Commissions and Advertising and Promotion. At the 75th percentile, these costs were \$8.50, but only \$5.63 at the 25th percentile. These expenses represented \$7.13 of the total administrative costs.

**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 \$5.67. At the 75th percentile, these costs were \$6.57, but were as low as \$4.30 at the 25th percentile. The expenses for Medical & Provider Management are sensitive to the mix of products that are offered. Medicare Advantage members require significant commitment in medical management.

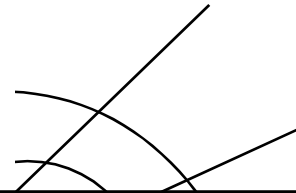
**Account & Membership Administration** represented \$8.78 per member per month of administrative expenses in 2005, the largest share of administrative costs. This category of expenses includes many of the core functions such as Enrollment (including Membership and Billing), Customer Services, Information Systems and Claims (including Encounter Capture and Adjudication). Expenses of \$9.67 was the 75th percentile value and \$7.23 was the value 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 \$8.04 in administrative expenses. Fewer than 25% of plans exceeded \$9.16 or were less than \$7.68. These expenses are more susceptible to economies of scale than other groups of functional expenses.

### *Expenses by Product*

Due to variation in resource requirements of the products, 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.

Medicare Advantage had the highest costs at \$65.79. The Commercial insured products had similar median values of \$27.53, \$37.36 and \$33.25 for HMO, POS, and Indemnity & PPO, respectively. Medicare HMO had a median value of \$21.14 per member per month. Commercial ASO cost \$13.48 per member per month. Commercial ASO products typically



**Figure 2. Benchmarks for Medicare Advantage Plans' Administrative Expenses: 2005**

Cost Per Member Per Month - By Product Line

	25th %	75th %	Median	$\sigma$ /Mean
Commercial Insured				
HMO	\$24.03	\$33.05	\$27.53	45.0%
POS	\$34.40	\$40.32	\$37.36	22.4%
Indemnity & PPO	\$33.04	\$35.58	\$33.25	8.1%
Commercial ASO	\$8.17	\$16.50	\$13.48	55.7%
Medicare				
Advantage	\$56.94	\$79.54	\$65.79	44.1%
Cost	NM	NM	NM	NM
Medicaid HMO	\$17.42	\$22.14	\$21.14	22.7%

cost approximately \$15-20 less per member than the commercially insured products.

Expressed as a percent of revenue, administrative costs also varied by product. Medicare Advantage had the lowest cost, at 9.0% of revenue. Among the Commercial products, Indemnity & PPO had the highest percent of revenue with 16.8%, followed by POS with 16.0%, and HMO with 13.2% of revenue, respectively. Commercial ASO comprised a higher percent of revenue than their insured counterparts at 100.0%. Medicaid HMO had the highest percent of revenue with 142.1%.

**Figure 3. Benchmarks for Medicare Advantage Plans' Administrative Expenses: 2005**

Cost as a Percent of Revenue - By Product Line

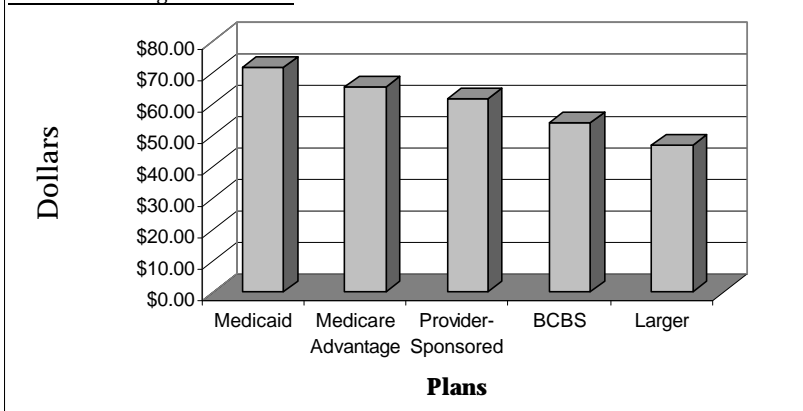
	25th %	75th %	Median	$\sigma$ /Mean
Commercial Insured				
HMO	10.5%	16.4%	13.2%	37.9%
POS	16.0%	17.9%	16.0%	34.5%
Indemnity & PPO	14.1%	18.4%	16.8%	26.8%
Commercial ASO	96.0%	101.5%	100.0%	55.3%
Medicare				
Advantage	7.8%	10.9%	9.0%	31.4%
Cost	NM	NM	NM	NM
Medicaid HMO	8.6%	20.6%	142.1%	45.7%

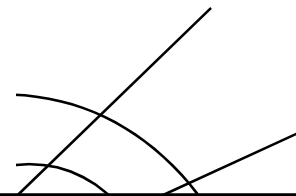
## Medicare Advantage Costs Compared to Other Universes

Out of the five SEER universes, the Medicare Advantage universe had the second highest cost for its Medicare Advantage product with \$65.79. We believe that one reason for this is the presence members with high health care needs. This cost was 40.6% greater than the Larger Plans, with the lowest cost of the five universes with \$46.79. The Blue Cross Blue Shield and the Provider-Sponsored edition had costs of \$54.21 and \$61.89, respectively. Medicaid-Oriented plans had the highest Medicare Advantage cost with \$71.77. The median of Medicare Advantage cost was \$61.89.

**Figure 4. Benchmarks for Medicare Advantage Plans' Administrative Expenses: 2005**

Medicare Advantage Costs PMPM





## *Plans with Special Needs*

There were two plans in our Medicare Advantage universe that offer what can be called Special Needs Plans, (SNP). Such plans serve people who have chronic or disabling conditions, are dual-eligible for Medicare and Medicaid or are institutional or require care that is equivalent to that found in institutional settings. There are 276 such plans at present. The growth in the plans has been remarkable. Approvals to participate in the program, have gone from 11 in 2004, 125 in 2005, and 150 in 2006. Apparently, only ten plans have withdrawn from the program. They currently serve 602,881 members.

The plans had a median total administrative expense for SNP of \$147.92 PMPM. Marketing and Medical and Provider represented \$34.29 and \$32.92 PMPM of the total administrative costs. The Account and Membership expense was \$34.86 PMPM. Customer Service was the highest cost at \$45.85 PMPM. This data is separately calculated and is not reflected in the figures. Notably, if they were included medians would remain the same but high values would decline.

Because this is a relatively new program, many health plans do not segment costs between regular Medicare Advantage and Special Needs Plans. Accordingly, in one case, we assisted the plans in segment costs.

## *Background on Performance Benchmarks*

Volume I (Financial Metrics) of *SEER* for Medicare Advantage Plans contains an extensive amount of analyses of nine principle product areas and twenty-eight functional

areas. Separate analyses include outsourced functions such as mental health, pharmacy and COB / Subrogation. Products include HMO, Point-of-Service, Indemnity and PPO, Commercial ASO, Medicare Advantage, Medicaid HMO, Child Buy-in and Family Buy-in.

The Volume I financial metrics of the Medicare Advantage Plans Edition provides standardized PMPM cost as a percent of revenue for the management of health plan performance. Other performance metrics are included in a companion, Volume II, of operational metrics. These metrics include factors affecting costs such as member use of the function, employee productivity, unit cost and staffing ratios.

Collectively, *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. Other health plans participating in Sherlock Company's benchmarking studies include Larger Plans, Blue Cross Blue Shield, Provider-Sponsored, and Medicaid-Oriented Plans.

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

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