



Plan Management Navigator

Analytics for Health Plan Administration

Revised October 2007

MEDICARE ADVANTAGE PERFORMANCE BENCHMARKS RELEASED BY SHERLOCK COMPANY

The median costs of our universe of Medicare Advantage-focused health plans are \$37.30 Per Member Per Month (PMPM) for all comprehensive products in 2006 or 11.4% of premium equivalents, as reported in Sherlock Company's benchmarks. Medicare Advantage plans at the 25th percentile reported costs of \$32.36 PMPM (9.0% of premium equivalents), and at the 75th percentile, Medicare Advantage plans reported costs of \$78.04 PMPM (14.4% of premium equivalents). These costs exclude capital costs and taxes.

Medicare Advantage was \$92.27 with Coordinated Care Plans costing \$89.90 and SNPs costing \$109.81. Medicaid's reported costs were \$17.19. PMPM Commercial insured expenses were \$32.61. Reported PMPM expenses for Commercial ASO were \$15.67.

Health plans are increasingly focused on the aggressive management of their administrative costs and achieving best practices in operations management. Medicare Advantage plans are, like other plans, motivated by consumer demand (especially Congressional demand) and increasingly possess the technological ability to both lower costs and enhance the performance of their operations. In many cases this motivation is amplified by the tight fiscal constraints of their sponsoring provider systems.

Background on Medicare Advantage

While Medicare Advantage plans have been available to consumers for many years, in recent years, they have enjoyed such resurgence as to resemble a new industry.

After declining from a peak enrollment of 6.8 million in 2000, membership plateaued in the low five millions from 2002 through 2004. While membership grew by only 1.4% in 2004, in 2005 it accelerated to 7.8%. Growth in 2006 and 2007 was explosive at 25.7% and 19.2% respectively. As of September it appears that, 8.9 million of the 44 million beneficiaries (including 7 million younger disabled people), over 20%, are served by private health plans through 601 contracts.

According to the Kaiser Family Foundation eight states, Arizona, California, Colorado, Hawaii, Nevada, Oregon, Pennsylvania and Rhode Island, "have at least 30% of beneficiaries are in such plans."

Along with the membership resurgence, the number of plans has more than doubled from 292 to 601 since 2004. While 224 of the 309 increase are local Coordinated Care

Continued Next Column

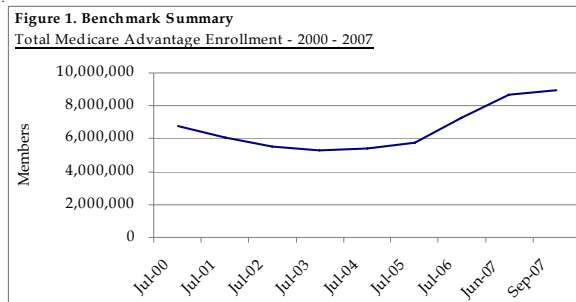
MEDICARE ADVANTAGE PANEL FORMING FOR 2008 BENCHMARKS

As noted elsewhere, Sherlock Company has recently completed its 2007 benchmarking study for Medicare Advantage plans. However, we have already received a number of inquiries concerning next year's study. Please contact us if we can answer any questions on the 2008 study.

The schedule is expected to unfold as follows. We will contact plans that have previously expressed interest in participating in our benchmarking studies in the next two months. In early January, we'll circulate draft survey forms for participant review and comment. Final survey instruments will be circulated in March, and returned to us in late May - early June. After data "scrubbing" and participant reviews of the drafts, we expect to publish the results to the participants in the summer of 2008.

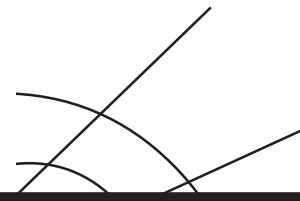
While we have not begun to develop our panel for 2008, three-quarters of plans participating in 2007 in our various studies also participated in 2006, so we believe we start with a credible universe. Please contact 215-628-2289 for additional information on participating in 2008.

Benchmarks Released: From Previous Column



Plans (CCPs), the 48 Private Fee For Service (PFFS) plans are a nearly 10-fold increase, based on Mathematica Policy Research figures. While enrollment increases in PFFS plans comprise 47.3% of the total, CCP enrollment comprised 43.2% of the total increase.

Accordingly, the average size of a Medicare Advantage contract is now 14,841, a decline of 19.4% since 2004. More dramatically, the size of the average CCP has declined by



40.3% to 15,631. Of the PFFS plans, 48% have been licensed since July 2006.

Besides the PFFS results included in the above figures, according to Medicare Payment Advisory Commission (MedPAC)'s June 2007 report, "in 2007, the number of SNPs has again risen, to 476, from 276 in 2006 and 125 in 2005. SNP enrollment as of March 2007 was about 843,000, compared to 532,000 enrollees in July 2006." According to Mathematica, as of August, special needs plans enrollees totaled 989,112, of which 72% were Dual-eligibles.

Thus, it is more common for plans to be new, both in longevity but also in product mix. Both SNPs and PFFS plans are new products and while they contribute greatly to overall growth, more traditional CCPs have also enjoyed a healthy resurgence.

According to MedPAC, "Congress has looked to private plans to provide a source of efficiency in the program." MedPAC goes on to note that "Recent analysis of efficiency in MA shows that some types of plans are efficient while others are not." For instance, it estimates that HMO plans under their new payment methodology bid at 97% of the Medicare Part A and Part B fee-for-service expenditures, other models operate at 103 to 109% of that benchmark. (Including the effect of rebates in part used to finance extra benefits, MedPAC believes that payments are approximately 112% of the amounts paid under the fee-for-service Medicare.)

While MedPAC's interest in efficiency is focused on the costs Medicare pays, health plans' ability to fulfill Congress's expectation of efficiency is achieved through management policies. In the case of some functional areas, achievement of efficiency represents a balancing of various kinds of costs, say in the case of health care costs versus medical management. In other areas they can be attacked by the ones as essentially self-contained functional areas.

At Sherlock Company, we believe that the management of all costs is essential to the achievement of Congress's efficiency objectives. While our efforts include

benchmarking of health care utilization, they are primarily directed at administrative costs. With so many new health contracts, performance benchmarks appear to be especially valuable.

Background on the Medicare Edition of SEER

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.

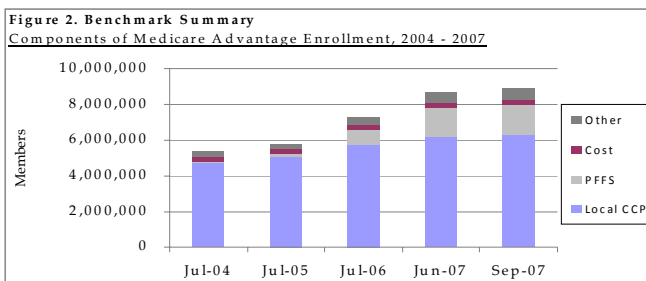
Compiling data for benchmarks for plans focused on Medicare Advantage presents unique challenges. For inclusion in our universe, we sought plans that had Medicare as a central focus of their operations, were interested in managing costs and had information systems and expertise necessary to participate in the benchmarking studies.

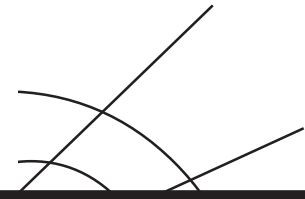
The first problem we faced is that, as noted above, Medicare Advantage members are frequently served through small contracts. This means that health plans serving the Medicare Advantage market, if they are exclusively focused on Medicare Advantage, are typically very small. Indeed, that average contract size ratio likely overstates the size of the plans since some have multiple contracts. According to KFF, UnitedHealth, Humana and Kaiser, for instance, serve 39% of all Medicare Advantage members through numerous contracts.

Thus very few health plans have adequate "band width" of financial reporting capability to participate in our benchmarking studies. As a result, our universe of participants likely self-selects in favor of firms with a strong commitment to the aggressive management of their administrative costs, along with superior systems to measure their performance. They tend to be larger organizations compared with other Medicare Advantage plans. One benefit of having larger than average plans is that we also minimize the effect of start-up costs that are difficult to interpret in benchmarking studies.

Second, while the ideal participant is one that is exclusively committed to Medicare Advantage products, this is unusual, especially among the more established larger health plans. Recall that UnitedHealth, Humana and Kaiser all serve mainly members who are *not* Medicare Advantage members. The larger, more established plans operated under the old "50/50" rule under which Medicare Advantage was limited to 50% of total membership for quality assurance purposes.

We adapted to these systemic limitations in the available universe in two ways; we included only those plans that





were heavily (though not exclusively) committed to Medicare Advantage, and we required that health plans submit expenses segmented by product.

As a result, collectively, 47.9% of the revenues were from Medicare Advantage products, and the median proportion was 45.1%. Medicare Advantage members represented 25.0% of total membership, and the median proportion was 22.1%.

Overall, our benchmarking study of Medicare Advantage plans favored a few plans with highly reliable data over numerous plans that had much weaker data. The resulting universe is comprised of six plans, which together had revenues of \$4.2 billion. We believe that there are few PFFS members in this study. Data is from 2006.

The financial metrics summarized here are complemented by extensive operational metrics in companion volumes, analyzed into factors of user demand, employee productivity, unit cost, staffing ratios and cost per employee. For instance, Customer Service reports on "manual" inquiries per member, productivity of customer service representatives, cost per inquiry and per-employee costs of customer service. Numerous drivers of costs and quality are also provided. In the Customer Service area, for example, these include average speed of answer, abandonment rate and inquiry resolution time.

Expenses by Functional Area Cluster

In the Medicare Advantage edition of *Sherlock Expense Evaluation Report*, administrative expenses for each product are segmented into nearly forty different functional areas. For the purpose of the *Plan Management Navigator*, we have summarized these functional areas into "clusters" of Marketing, Medical and Provider Management, Account and Membership Administration and Corporate Services. The expenses reported here are highly sensitive to product mix, as described later.

Marketing expenses represented \$10.36 PMPM (2.9% of premium equivalents) of the total

administrative costs. At the 75th percentile, these costs were \$17.66 PMPM but only \$8.48 PMPM at the 25th percentile. Commissions paid to brokers comprised \$2.58 PMPM, a significant share of these expenses. This is notable since only 25% of members are served through insurance brokers. Other expenses in this cluster include Rating and Underwriting, Product Development / Market Research, Sales and Marketing and Advertising and Promotion.

Medical & Provider Management is the cluster of Provider Network Management and Services and Medical Management. Provider contracting, provider service, case and disease management and precertification are among the activities provided by functions in this cluster. These expenses had a median value of \$7.50 PMPM (2.0% of premium equivalents). At the 75th percentile, these costs were \$15.81 PMPM, but were as low as \$5.80 PMPM at the 25th percentile.

Expenses for Medical & Provider Management are highly sensitive to the mix of products offered: Managed care products are emphasized by Medicare Advantage plans, and they tend to display a higher commitment to this function.

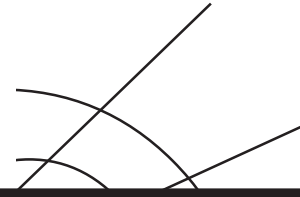
Account & Membership Administration represented \$10.77 per member per month of administrative expenses (2.9% of premium equivalents) the largest share of administrative costs. This cluster of expenses includes many of health plans' core functions such as Enrollment (including Membership and Billing), Customer Services, Information Systems and Claims (including Encounter Capture and Adjudication). Plans reported \$17.80 at the 75th percentile and \$9.32 at the 25th percentile.

Figure 3. Benchmark Summary
Medicare Advantage Plan Costs by Functional Area Cluster
Per Member Per Month

	25th Pctl	75th Pctl	Median	σ /Mean
Marketing	\$8.48	\$17.66	\$10.36	95.6%
Provider & Medical Management	5.80	15.81	7.50	110.0%
Account & Mem. Administration	9.32	17.80	10.77	60.0%
Corporate Services	8.02	27.44	8.93	85.5%
Total	\$32.36	\$78.04	\$37.30	84.9%

Figure 4. Benchmark Summary
Medicare Advantage Plan Costs by Functional Area Cluster
Percent of Premium Equivalents

	25th Pctl	75th Pctl	Median	σ /Mean
Marketing	2.0%	3.8%	2.9%	39.0%
Provider & Medical Management	1.7%	2.8%	2.0%	48.4%
Account & Mem. Administration	2.7%	3.2%	2.9%	16.4%
Corporate Services	1.8%	3.5%	2.9%	48.9%
Total	9.0%	14.4%	11.4%	31.5%



Corporate Services represented the final cluster of expenses. It included expenditures for 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 \$8.93 PMPM (2.9% of premium equivalents) in administrative expenses. Fewer than 25% exceeded \$27.44 PMPM or were less than \$8.02 PMPM. These expenses are more susceptible to economies of scale than other groups of functional expenses, based on Sherlock Company's economies of scale studies.

Expenses by Product

In the Medicare Advantage edition of *Sherlock Expense Evaluation Report*, results for seven different products were reported. Due to variation in resource requirements of the various products, costs of the various 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, SNP products are even more costly and ASO products operate with lower overall costs than insured products.

SNP costs were the highest at \$109.81 PMPM, 22.3% higher than Medicare Advantage (our term for CCPs), which was \$89.80. The Commercial insured products had median values of \$33.47, \$25.00 and \$25.52 for HMO, POS, and Indemnity & PPO, respectively. Commercial ASO cost \$15.67 per member per month. Commercial ASO products typically cost less per member than the commercially insured products chiefly due to lower marketing costs.

Medicare Advantage was 12.6% of premium equivalents. SNP costs were 12.2% of premiums. Expressed as a percent of premium equivalents, administrative costs also varied by product. Medicaid HMO had the lowest cost, at 8.2% of premium equivalents. Among the Commercial products, Commercial

HMO had the highest percent of premium equivalents with 14.3, followed by Indemnity & PPO with 12.8%, and POS with 9.5% of premium equivalents, respectively. Commercial ASO comprised a lower percent of premium equivalents than their insured counterparts at 7.4%.


One half of the plans, three of them, in our universe had Special Needs Plans. As noted above, these costs were 22.3% more than CCPs. In parsing the PMPM differences, the median proportions of the difference that is attributable to Marketing and Medical and Provider were 0.0% and 50.2%, respectively. The Account and Membership expense comprised 40.8 percent of the difference as Corporate Service represented 37.6% of the difference. 

Figure 5. Benchmark Summary
Medicare Advantage Plan Costs by Product
Per Member Per Month

	25th Pctl	75th Pctl	Median	σ /Mean
HMO	\$25.18	\$42.32	\$33.47	31.4%
POS	\$24.51	\$34.99	\$25.00	37.8%
Indemnity & PPO	\$19.32	\$31.73	\$25.52	68.8%
Total Comm. Ins.	\$24.37	\$40.69	\$32.61	30.3%
ASO	\$13.69	\$17.64	\$15.67	25.2%
Total Commercial	\$22.52	\$29.83	\$24.29	32.4%
Medicare Advantage	\$71.11	\$115.65	\$89.80	40.3%
Medicare SNP	\$101.28	\$141.34	\$109.81	33.7%
Medicare Total	\$72.16	\$115.78	\$92.17	40.6%
Medicaid	\$16.74	\$17.65	\$17.19	7.5%
Comprehensive Total	\$32.36	\$78.04	\$37.30	84.9%

Figure 6. Benchmark Summary
Medicare Advantage Plan Costs by Product
Percent of Premium Equivalents

	25th Pctl	75th Pctl	Median	σ /Mean
HMO	2.6%	15.8%	14.3%	21.8%
POS	9.4%	13.9%	9.5%	41.5%
Indemnity & PPO	9.5%	16.1%	12.8%	73.0%
Total Comm. Ins.	10.9%	16.1%	13.2%	29.2%
ASO	6.4%	8.2%	7.4%	24.9%
Total Commercial	10.1%	12.8%	11.1%	20.8%
Medicare Advantage	9.4%	15.9%	12.6%	37.6%
Medicare SNP	8.1%	13.1%	12.2%	52.6%
Medicare Total	7.8%	15.2%	12.0%	37.5%
Medicaid	7.2%	9.2%	8.2%	34.7%
Comprehensive Total	9.0%	14.4%	11.4%	31.5%

