



BLUES POST MODEST TRENDS IN ADMINISTRATIVE COSTS IN 2007

Summary

Per member administrative cost growth declined from 6.1% in 2006 to 4.3% in 2007. Adjusted to eliminate the effect of a shift in Plans' product mixes, per member administrative expense growth declined from 6.5% in 2006 to 2.5% in 2007. Administrative expenses comprised 10.4% of premium equivalents in 2007.

The administrative expenses of Blue Cross Blue Shield Plans participating in our performance benchmarking study was \$25.36 per member per month (PMPM), but varied greatly by product. In 2007, the Commercial POS ASO/ASC administrative expenses were 7.6% of premium equivalents, the lowest such ratio, followed by Indemnity and PPO ASO/ASC at 8.0%. Medicare Advantage costs, with a median value of \$69.00 PMPM, had median expenses of 8.7% of premiums.

All values in this article exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. Dollar values, percents of premiums and percent change include pharmacy and mental health expenses and revenues. These results are excerpted from our 2008 *Sherlock Expense Evaluation Report*, comprising 2007 data.

Administrative Costs and Trends

For convenience, we group total administrative expenses into clusters, and standardize for size by expressing expenses on a per member basis. Values and rates of change for these clusters Blue Cross Blue Shield Plans and overall are shown in Figures 1 and 2. Appendix A provides values for all Plans participating in 2007, and comprises 2006 data.

Figure 1. Benchmark Summary
Blue Cross Blue Shield Costs by Functional Area Cluster, 2007 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	\$5.36	\$9.89	\$7.46	43.6%
Provider & Medical Mgmt.	2.08	3.87	3.12	39.7%
Account & Mem. Admin.	8.81	12.16	10.23	20.8%
Corporate Services	3.85	5.82	4.40	36.9%
Total	\$22.02	\$30.54	\$25.36	24.0%

Figure 2. Benchmark Summary

Blue Cross Blue Shield Percent Change in Costs by Functional Area Cluster

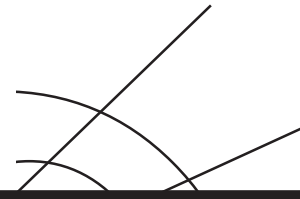
	2006 Data		2007 Data	
	% Chg.	Mix-Adjusted	% Chg.	Mix-Adjusted
Marketing	4.5%	9.1%	4.2%	4.9%
Provider & Medical Mgmt.	7.8%	7.7%	10.0%	2.2%
Account & Mem. Admin.	2.9%	5.1%	5.0%	3.9%
Corporate Services	5.2%	5.5%	0.2%	-6.2%
Total	6.1%	6.5%	4.3%	2.5%

Marketing expenses were \$7.46 PMPM, and grew by 4.2% PMPM. (All rates of change hold constant the universe of participants.) Broker Commissions was the fastest growing, high dollar value expense in that cluster of expenses. Rating and Underwriting grew fastest overall. Notably, Advertising and Promotion actually declined in 2007. The rate of Marketing cost growth was down from 4.5% in 2006. The 75th percentile value for this cluster was \$9.89 and the 25th percentile value was \$5.36 PMPM.

Marketing expense trends, along with those of other expense clusters, were affected by the growth of Medicare Advantage, discussed later. On a product mix adjusted basis, PMPM costs increased by only 4.9%, compared with 9.1% in 2006.

Medical and Provider Management grew by 10.0% to \$3.12 PMPM. Medical Management costs soared by 11.5% PMPM. Reflecting the increasing importance of Medicare Advantage, this cluster's cost increased by only 2.2% on a product mix adjusted basis, and the rate of increase in Medical Management costs was also sharply lower. The rate of Medical and Provider cost growth was up from 7.8% in 2006. The costs of Medical and Provider Management at the 25th percentile was \$2.08 PMPM and \$3.87 PMPM at the 75th percentile.

Account and Membership Administration cost increased to \$10.23 PMPM, up 5.0% from last year. The value at the 25th percentile for Account and Membership Administration was \$8.81, while the costs at the 75th percentile were \$12.16 PMPM. The rate of growth, on an as reported basis, was 2.9% in 2006, so that costs accelerated in this cluster in 2007. The fastest growing area was the small



Enrollment Membership and Billing area, followed by Information Systems expenses. Claim and Encounter Capture and Adjudication costs actually declined.

Adjusting for product mix changes between the years, the Account and Membership Adjudication cluster increased by only 3.9%, down from 5.1% in 2006. On this adjusted basis, each functional area's costs grew more slowly, except for Claim and Encounter Capture and Adjudication, which increased by 1.0%.

Corporate Services costs grew by 0.2% PMPM, and declined by 6.2% on a product mix adjusted basis. Finance and Accounting, Actuarial and Corporate Executive and Governance decreased, both on an as-reported and on a product-mix adjusted basis. Growth in the costs for this functional area cluster was higher in 2006. On an as-reported basis costs grew by 5.2%, and on a product-mix adjusted basis they grew by 5.5% in 2006. Total costs for this cluster were \$4.40 PMPM in 2007, while the 25th percentile value was \$3.85 PMPM and the value at the 75th percentile was \$5.82 PMPM.

Accounting for 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, overall, administrative expenses were 10.4% of premium equivalents for comprehensive products sold by Blue Cross Blue Shield Plans. The 25th percentile value was 8.3% and the value at the 75th percentile was 12.4%. Comparing these results to those in Appendix B, administrative expenses were 20 basis points higher as a percent of premium equivalents, but please note that the universes were slightly different.

Marketing costs comprised 3.0% of premium equivalents, with the 25th percentile value 1.9% and the value at the 75th percentile 4.0%. The comparable median percent in 2006 was 2.8% or 20 basis points lower than for 2007.

The value at the 25th percentile for Medical and Provider Services costs was 0.8% of premium, while the 1.4% of premium equivalents represented the 75th percentile. The median value, 1.1%, was 10 basis points lower than the 1.2% posted last year.

The expenses associated with Account and Membership Administration were 3.8% of premium equivalents, substantially identical to last year. The value at the 25th percentile was 3.5% of premium equivalents and 5.2% of premium equivalents at the 75th percentile.

The median proportion of premium equivalents due to Corporate Services was 1.9%, substantially the same as last year. Twenty-five percent of plans had values below 1.4% of premium equivalents or above 2.3% of premium equivalents in 2007.

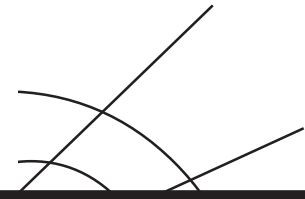
Calculation of Premium Equivalents

Administrative services relationships, comprising nearly one-half of all Blue Cross Blue Shield commercial members, play havoc with the intuitive notion that administrative expenses expressed as a percent is a proportion of the premium dollar. That is because fees for such ASO relationships are billed to employers only for the administrative services that they provide, rather than for the cost of care which is borne by the self-insured groups. Since each of the Plans submits the health care expenses for the self-insured groups (which they know since they process 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/ASC clients reflect a profit assumption. Therefore to estimate premium equivalents it is appropriate to add the fees rather than the administrative expenses to estimate premium equivalents that are most directly comparable with the insured business.

Figure 3. Benchmark Summary
Blue Cross Blue Shield Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2007 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ / Mean
Marketing	1.9%	4.0%	3.0%	44.3%
Provider & Medical Mgmt.	0.8%	1.4%	1.1%	45.2%
Account & Mem. Admin.	3.5%	5.2%	3.8%	24.7%
Corporate Services	1.4%	2.3%	1.9%	36.4%
Total	8.3%	12.4%	10.4%	25.9%



Calculation of Mix Adjusted Rates of Expense Growth

To make useful comparisons between administrative expenses, it is helpful to eliminate the effects of product mix differences. This is helpful both between organizations with different product mixes and also for organizations or groups of organizations reporting in multiple periods.

Accordingly, in comparing expenses between periods, we make this adjustment by holding constant the product mix between the two years. This is especially important since Medicare Advantage has increased in the product portfolios of Blue Cross Blue Shield Plans and this product consumes far more resources per member than its comparable products for people under 65 years of age

To do this, since Blue Cross Blue Shield Plans report to us by product, we reweight their expenses so that the product mix in the prior period is the same as in the recent period. For consistency, we apply the same weighting to the current period cost values. We then recalculate the rates of change based on the reweighted estimated expenses.

Administrative Expenses by Product

While we have long viewed understanding administrative expenses by product to be central to understanding overall administrative expenses and trends, as discussed elsewhere, segmentation by product makes a major difference in 2007 with the growth of Medicare Advantage products.

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, members in Medicare Advantage products submit 2.4 times as many claims as members in insured HMO products so their costs per member are accordingly higher. More directly, ASO products have lower overall costs than their insured counterparts since ASO arrangements are normally sought by larger groups that tend to be less costly to market to.

The most expensive product offered by Blue Cross Blue Shield Plans is their Medicare Advantage products, at \$69.00 PMPM, followed by Indemnity and PPO Insured. The

least expensive comprehensive product was POS, sold on an ASO basis, at \$19.07 PMPM. This is shown in Figure 4.

As shown in Figure 5, on a percent of premium basis, the ranking of administrative expenses is quite different. ASO forms of POS and Indemnity / PPO at 7.6% and 8.0%, respectively, are the lowest values. Notably Medicare Advantage is only 8.7% which is especially remarkable considering expenses needed to achieve the rapid growth that it has achieved.

The Increasing Importance of Medicare Advantage

As noted previously, Blue Cross Blue Shield Plans sharply increased their participation in Medicare Advantage products in 2007. The median membership growth was 16.5%, and the number of plans in our universe offering these products increased from 8 in 2006 to 12 in 2007. (We have excluded from both years the plans that had too few members to have useful cost metrics.) This is a significant development for Blue Cross Blue Shield Plans: In aggregate, the premiums of Medicare Advantage sold by the 12 plans with this product exceed that of the Medicare Supplemental products offered by all 23.

This product shift has entailed significant changes in the operating characteristics of plans offering Medicare Advantage. Total administrative expenses for Medicare Advantage are approximately twice as large as Medicare Supplemental, but medical management costs are approximately eleven times larger. For the Plans as a whole,

Figure 4. Benchmark Summary

Blue Cross Blue Shield Costs by Product, 2007 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
<i>Commercial HMO</i>				
Insured	\$28.03	\$32.42	\$30.12	31.9%
ASO / ASC	\$17.55	\$25.48	\$22.19	26.3%
<i>Commercial POS</i>				
Insured	\$25.03	\$32.01	\$28.15	27.5%
ASO / ASC	\$14.89	\$23.11	\$19.07	41.1%
<i>Indemnity & PPO</i>				
Insured	\$26.58	\$36.59	\$30.43	29.6%
ASO / ASC	\$16.22	\$23.93	\$20.66	26.9%
Medicare Advantage	\$57.88	\$94.66	\$69.00	31.6%
Medicaid	\$19.45	\$23.68	\$19.94	20.9%
Medicare Supplemental	\$22.13	\$38.91	\$27.43	36.0%
Comprehensive Total	\$22.02	\$30.54	\$25.36	24.0%
Stand Alone Dental	\$2.37	\$3.44	\$3.17	67.5%
Medicare Part D	\$15.00	\$24.39	\$17.89	40.3%

medical management costs in this product exceed those of insured HMO and POS products by more than 40%.

Background

Our benchmarking participation includes 23 Blue Cross Blue Shield Plans, serving 30.8 million members with comprehensive products. Twenty two of the plans are primary licensees, comprising most of the 39 primary licensees of the Blue Cross Blue Shield Association.

Of the 23 plans, 21 were participants in 2007 and 18, or 78.3%, have five or more years of participation in Sherlock Company benchmarks, contributing to a “practice effect” on the accuracy of data submitted by participants. This is our eleventh consecutive annual edition of benchmarks.

Longitudinal cost comparisons are based on the results for plans that participated in each of the comparison years. However, PMPM values are actual for all Plans the universes at that time, so that they are not precisely comparable. We employed median values throughout this analysis as the best measure of central tendency.

Overall, our benchmarks in 2008 will comprise the experience of approximately 340 health plan years. We also have universes of Independent/Provider-Sponsored Health Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. We will be reporting on those results in the next two months.

Figure 5. Benchmark Summary

Blue Cross Blue Shield Costs by Product, 2007 Data

Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ / Mean
<i>Commercial HMO</i>				
Insured	9.4%	13.7%	12.0%	26.1%
ASO / ASC	6.0%	10.7%	9.5%	37.3%
<i>Commercial POS</i>				
Insured	9.8%	12.2%	10.4%	24.5%
ASO / ASC	5.8%	10.8%	7.6%	146.0%
<i>Indemnity & PPO</i>				
Insured	9.3%	13.7%	11.8%	31.1%
ASO / ASC	6.9%	9.3%	8.0%	79.2%
Medicare Advantage	6.3%	10.8%	8.7%	40.6%
Medicaid	8.7%	11.3%	9.3%	24.1%
Medicare Supplemental	14.2%	22.5%	16.4%	35.0%
Comprehensive Total	8.3%	12.4%	10.4%	25.9%
Stand Alone Dental	13.0%	18.4%	15.7%	70.1%
Medicare Part D	15.9%	9.6%	16.7%	38.5%

Appendix A. Benchmark Summary

Blue Cross Blue Shield Costs by Functional Area Cluster, 2006 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Marketing	\$5.60	\$9.34	\$7.46	39.3%
Provider & Medical Mgmt.	2.06	3.55	2.96	32.8%
Account & Mem. Admin.	9.16	11.53	9.94	20.8%
Corporate Services	4.15	5.70	4.82	25.7%
Total	\$21.74	\$30.22	\$25.99	22.0%

Appendix B. Benchmark Summary

Blue Cross Blue Shield Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2006 Data

Percent of Premium Equivalents

	25th PC	75th PC	Median	σ / Mean
Marketing	2.1%	4.1%	2.8%	40.4%
Provider & Medical Mgmt.	1.0%	1.4%	1.2%	28.1%
Account & Mem. Admin.	3.6%	5.1%	3.8%	23.8%
Corporate Services	1.7%	2.2%	1.9%	26.3%
Total	8.7%	12.1%	10.2%	22.6%

