

INDEPENDENT/PROVIDER-SPONSORED PLANS POST DECLINE IN ADMINISTRATIVE COST GROWTH RATE IN 2007

Summary

Per member administrative cost growth declined from 11.8% in 2006 to 4.9% in 2007. Adjusted to eliminate the effect of a shift in Plans' product mixes, per member administrative expense growth increased from 2.7% in 2006 to 3.0% in 2007. Administrative expenses comprised 9.4% of premium equivalents in 2007.

The administrative expenses of Independent/Provider-Sponsored plans participating in our performance benchmarking study was \$29.49, but varied greatly by product. In 2007, the Medicare Special Needs Plans (SNP) administrative expenses were 5.5% of premium equivalents, the lowest such ratio, followed by Commercial ASO at 6.4%. Medicare Advantage costs, with a median value of \$69.22, had median expenses of 7.8% of premiums.

All values in this article exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. 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 cluster and overall are shown in Figures 1 and 2. Appendix A provides values for all plans participating in 2007, and comprises 2006 data.

Marketing expenses were \$8.23, and grew by 10.3% 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, Sales and Marketing actually declined in 2007. The rate of Marketing cost growth was down from 22.6% in

2006. The 75th percentile value for this cluster was \$10.18 and the 25th percentile value was \$6.97 PMPM.

Marketing expense trends, along with those of other plans, were affected by the growth of Medicare Advantage, discussed later. On a product mix adjusted basis, PMPM costs increased by only 5.5%, compared with 16.9% in 2006.

Medical and Provider Management grew by 11.3% to \$4.39 PMPM. Medical Management costs rose by 9.5%. This cluster's cost actually decreased by 3.2% on a product mix adjusted basis, and the rate of increase in Medical Management costs was also lower. The rate of Medical and Provider cost growth was down from 15.3% in 2006. The costs of Medical and Provider Management at the 25th percentile was \$2.59 PMPM and \$5.86 PMPM at the 75th percentile.

Account and Membership Administration costs increased to \$9.30, up 4.8% from last year. The value at the 25th percentile for Account and Membership Administration was \$5.96 PMPM, while the costs at the 75th percentile were \$9.70 PMPM. The rate of growth, on an as reported basis, was 1.2% in 2006, so that costs accelerated in this cluster in 2007. The fastest growing area was Information Systems, followed by Enrollment, Membership and Billing.

Adjusting for product mix changes in 2007, the Account and Membership Administration cluster increased by 14.7%, up from a decline of 9.6% in 2006. On this adjusted basis, Information Systems and Enrollment, Membership and Billing functional area's costs each grew more rapidly.

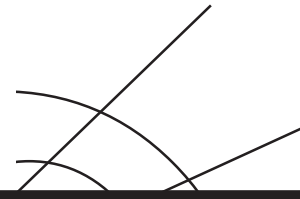
Corporate Services costs declined by 3.4%, and decreased by 8.7% on a product mix adjusted basis. Corporate Executive and Governance and Association Dues decreased, both on an as-reported and on a product mix adjusted basis. Growth in the costs for this functional area cluster was higher in 2006. On an as-reported basis costs grew by 11.4%, and on a product-mix adjusted basis they decreased by 6.9% in 2006. Total costs for this cluster were

Figure 1. Independent/Provider-Sponsored Benchmark Summary

Costs by Functional Area Cluster, 2007 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	\$6.97	\$10.18	\$8.23	34.9%
Provider & Medical Management	2.59	5.86	4.39	46.6%
Account & Mem. Administration	5.96	9.70	9.30	30.8%
Corporate Services	3.98	9.15	4.36	49.8%
Total	\$23.09	\$35.13	\$29.49	29.2%



\$4.36 PMPM in 2007, while the 25th percentile value was \$3.98 PMPM and the value at the 75th percentile was \$9.15 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 9.4% of premium equivalents for comprehensive products sold by Independent/Provider-Sponsored plans. The 25th percentile value was 7.6% and the value at the 75th percentile was 10.0%. Comparing these results to those in Appendix B, administrative expenses were 8 basis points lower as a percent of premium equivalents.

Marketing costs comprised 2.6% of premium equivalents, with the 25th percentile value 2.1% and the value at the 75th percentile of 3.0%. The comparable median percent in 2006 was 2.4% or 23 basis points lower than for 2007.

The value at the 25th percentile for Medical and Provider Services costs was 1.0% of premium, while the 1.8% of premium equivalents represented the 75th percentile. The median value, 1.3%, was 31 basis points lower than the 1.6% posted last year.

The expenses associated with Account and Membership Administration were 2.8% of premium equivalents, 7 basis points higher than last year. The value at the 25th percentile

was 2.4% of premium equivalents and 3.4% of premium equivalents at the 75th percentile.

The median proportion of premium equivalents due to Corporate Services was 1.7%, 81 basis points less than last year. Twenty five percent of plans had values below 1.3% of premium equivalents or above 2.7% of premium equivalents in 2007.

Calculation of Premium Equivalents

Administrative services relationships, comprising nearly one-quarter of commercial members for the plans in the Independent/Provider-Sponsored universe, play havoc with the intuitive notion that administrative expenses expressed as a percent is a proportion of the premium dollar. That is because such ASO relationships are billed to employers only for the administrative services that they provide, rather than for the cost of care 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.

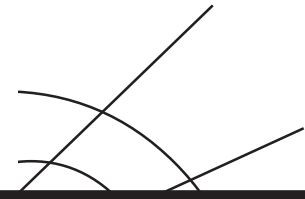
Note that, as with premiums, fees charged to ASO clients reflect a profit assumption. Therefore to estimate premium equivalents it is appropriate to add the fees rather than the administrative expenses to estimate premium equivalents in a way that is most directly comparable with the insured business.

Figure 2. Independent/Provider-Sponsored Benchmark Summary
Percent Change in Costs by Functional Area Cluster

	2006 Data		2007 Data	
	Percent Change	Percent Change Mix-Adjusted	Percent Change	Percent Change, Mix-Adjusted
Marketing	22.6%	16.9%	10.3%	5.5%
Provider & Medical Management	15.3%	20.5%	11.3%	-3.2%
Account & Mem. Administration	1.2%	-9.6%	4.8%	14.7%
Corporate Services	11.4%	-6.9%	-3.4%	-8.7%
Total	11.8%	2.7%	4.9%	3.0%

Figure 3. Independent/Provider-Sponsored Benchmark Summary
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	2.1%	3.0%	2.6%	33.4%
Provider & Medical Management	1.0%	1.8%	1.3%	37.5%
Account & Mem. Administration	2.4%	3.4%	2.8%	26.8%
Corporate Services	1.3%	2.7%	1.7%	41.0%
Total	7.6%	10.0%	9.4%	20.1%



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 between 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 the median increase in the number of Medicare Advantage members of Independent/Provider-Sponsored plans was 10.3%, and this product consumes far more resources per member than its comparable products for people under 65 years of age.

To do this, since Independent/Provider-Sponsored plans report to us by product, we reweight their expenses so that the product mix existing in the prior period is the same as in the current. We then recalculate the rates of change based on these reweighted estimates.

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, this has made 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 thirty-six 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 tend to submit more claims than 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 Independent/Provider-Sponsored plans is their Medicare SNP product, at \$78.05 PMPM, followed by Medicare Advantage, at \$69.22 PMPM. The least expensive comprehensive product Commercial ASO at \$17.03 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. Medicare SNP and Commercial ASO at 5.5% and 6.4%, respectively, are the lowest values. Notably Medicare Advantage is only 7.8% which is especially remarkable considering expenses needed to achieve the growth that it has achieved.

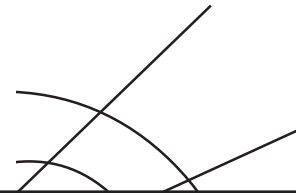
The Increasing Importance of Medicare Advantage

As noted previously, Independent/Provider-Sponsored plans appeared to sharply increase their participation in Medicare Advantage products in 2007. As stated previously, the median membership growth was 10.3%, and the number of plans in our universe offering these products increased from 7 in 2006 to 11 in 2007. (We have excluded from both years the plans that had too few members to have useful metrics.)

This product shift has entailed significant changes in the operating characteristics of plans offering Medicare Advantage. Total expenses for Medicare Advantage are approximately 20% larger than those of Medicare Supple-

Figure 4. Independent/Provider-Sponsored Benchmark Summary
Costs by Product, 2007 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
HMO	\$20.86	\$30.91	\$28.61	31.4%
POS	25.93	32.79	27.28	24.3%
Indemnity & PPO	30.10	38.09	34.64	17.3%
Total Comm. Ins.	20.88	33.03	30.44	25.9%
ASO	14.70	20.77	17.03	34.7%
Total Commercial	20.82	29.44	24.35	25.9%
Medicare Supplemental	46.29	66.29	56.30	38.0%
Medicare Advantage	65.98	76.03	69.22	35.0%
Medicare SNP	70.07	87.62	78.05	24.6%
Medicare Cost	25.21	41.30	33.25	68.4%
Medicare Total	55.21	76.67	68.66	43.5%
Medicaid	22.10	26.95	24.65	33.6%
Comprehensive Total	\$23.09	\$35.13	\$29.49	29.2%
Medicare Part D	\$21.37	\$31.16	\$25.24	37.0%



mental, but medical management costs are almost 2.5 times larger.

Background

Our participation includes 13 Independent/Provider-Sponsored plans, serving 4.0 million members with comprehensive products. Of the 13 plans, 10 were participants in 2007 and 9, or 69.2%, have three 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 sixth consecutive annual edition.

Costs comparisons are based on the results for plans that participated in each of the comparison years. PMPM values are actual for all

plans. We employed median values throughout this process 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 Blue Cross Blue Shield Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. We have completed an analysis of Blue Cross Blue Shield Plans and will be reporting on the Medicare and Medicaid results in the next month.

Figure 5. Independent/Provider-Sponsored Benchmark Summary
Costs by Product, 2007 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ / Mean
HMO	7.9%	11.1%	10.1%	26.9%
POS	8.8%	11.0%	9.6%	23.8%
Indemnity & PPO	11.5%	16.1%	14.2%	23.0%
Total Comm. Ins.	9.4%	11.2%	10.9%	23.2%
ASO	5.9%	8.6%	6.4%	34.5%
Total Commercial	8.1%	10.0%	9.7%	20.8%
Medicare Supplemental	19.2%	43.9%	31.4%	60.5%
Medicare Advantage	7.0%	8.7%	7.8%	32.7%
Medicare SNP	4.1%	7.0%	5.5%	34.2%
Medicare Cost	8.0%	9.8%	8.9%	28.8%
Medicare Total	7.1%	8.6%	7.8%	31.5%
Medicaid	6.9%	11.2%	9.0%	51.6%
Comprehensive Total	7.6%	10.0%	9.4%	20.1%
Medicare Part D	15.4%	30.3%	18.3%	64.7%

Appendix A. Independent/Provider-Sponsored Benchmark Summary
Costs by Functional Area Cluster, 2006 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ / Mean
Marketing	\$6.43	\$10.24	\$7.93	30.4%
Provider & Medical Management	3.21	5.99	4.74	41.5%
Account & Mem. Administration	6.07	10.43	8.45	30.6%
Corporate Services	4.34	9.63	8.57	47.5%
Total	\$25.31	\$34.42	\$28.79	30.4%

Appendix B. Independent/Provider-Sponsored Benchmark Summary
Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2006 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ / Mean
Marketing	2.1%	3.2%	2.4%	31.3%
Provider & Medical Management	1.0%	1.7%	1.6%	32.3%
Account & Mem. Administration	2.5%	3.3%	2.8%	26.1%
Corporate Services	1.6%	2.9%	2.6%	40.6%
Total	8.3%	10.9%	9.5%	22.3%

Reprinted from August, 2008 Edition of PULSE.