



## MEDICARE-ORIENTED PLANS' ADMINISTRATIVE COST GROWTH INCREASES REMAIN MODEST IN 2007

### Summary

Per member administrative cost growth declined from 41.9% in 2006 to 3.3% in 2007. Because this universe is especially susceptible to volatility in the rates of increase due to product mix shifts, it is especially appropriate to look at trends that hold constant product mix. Adjusted to eliminate the effect of a shift in plans' product mixes, per member administrative expense growth increased from 0.9% in 2006 to 1.9% in 2007. Administrative expenses comprised 9.4% of premium equivalents in 2007.

The median administrative expenses of Medicare-Oriented plans participating in our performance benchmarking study was \$39.26, but varied greatly by product. Medicare Advantage costs, with a median value of \$73.92, had median expenses of 8.3% of premiums. The administrative expenses of the Medicare SNP products were \$105.21. In 2007, the Commercial ASO administrative expenses were 6.4% of premium equivalents, the lowest such ratio, followed by Medicare Special Needs Plans (SNP) at 7.2%.

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.

#### Calculation of Mix-Adjusted Rates of Expense Growth

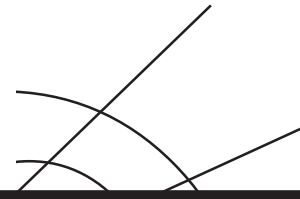
To make useful comparisons between administrative expenses, it is helpful to eliminate the effects of product mix differences. This is helpful both between organizations with different product mixes and also between periods.

Accordingly, in comparing expenses between periods, we make this adjustment by holding constant the product mix between the two years. To do this, since Medicare-Oriented 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.

The median proportion of premium equivalents represented by Medicare Advantage and Medicare SNP, used for rate of change calculations was 53.4% in 2007, up from 52.4% in 2006. On a weighted basis the proportion increased to 59.5% from 56.3%.

**Figure 1. Medicare Advantage Benchmark Summary**  
Medicare-Oriented Costs by Functional Area Cluster, 2007 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Marketing	\$9.36	\$13.50	\$10.49	94.9%
Provider & Medical Management	5.31	7.52	6.48	114.8%
Account & Mem. Administration	9.44	13.33	10.84	73.9%
Corporate Services	7.25	10.45	9.94	96.3%
Total	\$34.56	\$40.75	\$39.26	93.2%



## Administrative Costs and Trends

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

**Marketing** expenses were \$10.49 PMPM, and grew by 22.3%. (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, internal Sales and Marketing actually declined in 2007. The rate of Marketing cost growth was down from 59.1% in 2006. The 75<sup>th</sup> percentile value for this cluster was \$13.50 and the 25<sup>th</sup> percentile value was \$9.36 PMPM. On a product mix adjusted basis, PMPM costs increased by only 14.3%, compared with 27.5% in 2006.

**Medical and Provider Management** decreased by 12.1% to \$6.48 PMPM. Medical Management costs rose by 0.7%. This cluster's cost actually decreased by 16.7% on a product mix adjusted basis, and, on that basis, Medical Management costs actually decreased by 24.1%. The rate of Medical and Provider Management cost growth was down from positive 35.2% in 2006. The costs of Medical and Provider Management at the 25<sup>th</sup> percentile was \$5.31 PMPM and \$7.52 PMPM at the 75<sup>th</sup> percentile.

**Account and Membership Administration** cost increased to \$10.84 PMPM, up 1.8% from last year. The value at the 25<sup>th</sup> percentile for Account and Membership Administration was \$9.44 PMPM, while the costs at the 75<sup>th</sup> percentile were \$13.33 PMPM. The rate of growth, on an as reported basis, was 32.3% in 2006, so that growth declined in this cluster in 2007. The fastest growing area was the Enrollment/Membership/Billing area, followed by Customer Service expenses.

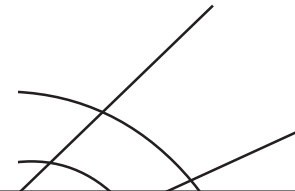
Adjusting for product mix changes in 2007, the Account and Membership Administration cluster increased by 5.6%, up from a decline of 7.7% in 2006. Information Systems was the biggest single source of expense growth and was up by 11.4%. On this adjusted basis, Enrollment/Membership/Billing functional area's costs grew more rapidly, while Customer Service expenses decreased by 13.6%.

**Corporate Services** costs increased by 5.1%, and stayed level on a product mix adjusted basis. Corporate Executive and Governance and Association Dues both increased 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 44.5%, and on a product-mix adjusted basis they increased by just 1.2% in 2006. Total costs for this cluster were \$9.94 PMPM in 2007, while the 25<sup>th</sup> percentile value was \$7.25 PMPM and the value at the 75<sup>th</sup> percentile was \$10.45 PMPM.

**Figure 2. Medicare Advantage Benchmark Summary**  
Medicare-Oriented 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	59.1%	27.5%	22.3%	14.3%
Provider & Medical Management	35.2%	-11.0%	-12.1%	-16.7%
Account & Mem. Administration	32.3%	-7.7%	1.8%	5.6%
Corporate Services	44.5%	1.2%	5.1%	0.0%
Total	41.9%	0.9%	3.3%	1.9%





### Calculation of Premium Equivalents

Administrative services relationships, comprising almost 40% of commercial members for the plans in the Medicare-Oriented 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 which are 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 in a way that is most directly comparable with the insured business it is appropriate to add fees rather than administrative expenses to health care costs.

percentile was 10.8%. Comparing these results to those in Appendix B, administrative expenses were 0.9 percentage points lower as a percent of premium equivalents.

Marketing costs comprised 2.7% of premium equivalents, while the 25<sup>th</sup> percentile value was 2.3% and the value at the 75<sup>th</sup> percentile was 3.7%. The comparable median value in 2006 was the same as 2007, at 2.7%.

The value at the 25<sup>th</sup> percentile for Provider and Medical Management costs was 1.2% of premium equivalents and 1.8% at the 75<sup>th</sup> percentile. The median value, 1.3%, was 0.5 percentage points lower than the 1.8% posted last year.

The expenses associated with Account and Membership Administration were 2.8% of premium equivalents, 0.1 percentage point higher than last year. The value at the 25<sup>th</sup> percentile was 2.1% of premium equivalents and 3.2% of premium equivalents at the 75<sup>th</sup> percentile.

The median proportion of premium equivalents due to Corporate Services was 2.7%, 0.2 percentage points less than last year. Twenty five percent of plans had values below 1.3% of premium equivalents or above 2.9% of premium equivalents in 2007.

### 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 Medicare-Oriented plans. The 25<sup>th</sup> percentile value was 8.2% and the value at the 75<sup>th</sup>

### Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by forty-seven functional areas. Overall, the resources consumed in these products are reflected in varying administrative expenses that differ quite sharply between the various products. Our partici-

**Figure 3. Medicare Advantage Benchmark Summary**  
Medicare-Oriented 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	2.3%	3.7%	2.7%	39.0%
Provider & Medical Management	1.2%	1.8%	1.3%	45.2%
Account & Mem. Administration	2.1%	3.2%	2.8%	32.9%
Corporate Services	1.3%	2.9%	2.7%	42.7%
Total	8.2%	10.8%	9.4%	30.5%





**Figure 4. Medicare Advantage Benchmark Summary**

Medicare-Oriented Costs by Product, 2007 Data

Per Member Per Month

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
HMO	\$28.43	\$35.60	\$28.79	21.8%
POS	27.28	35.70	27.42	29.3%
Indemnity & PPO	31.87	35.25	34.14	13.7%
Total Comm. Ins.	\$30.44	\$35.60	\$30.79	12.7%
ASO	13.67	18.51	17.03	34.3%
Total Commercial	\$23.86	\$29.44	\$24.35	13.3%
Medicare Supplemental	\$30.54	\$30.54	\$30.54	NM
Medicare Advantage	63.80	109.73	73.92	48.2%
Medicare SNP	97.11	124.35	105.21	38.9%
Medicare Cost	NM	NM	NM	NM
Medicare Total	\$68.65	\$111.14	\$77.35	47.2%
Medicaid	\$21.31	\$29.33	\$24.65	31.5%
Comprehensive Total	\$34.56	\$40.75	\$39.26	93.2%
Medicare Part D	\$17.64	\$31.16	\$25.24	56.2%

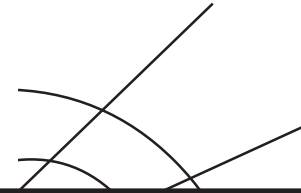
**Figure 5. Medicare Advantage Benchmark Summary**

Medicare-Oriented Costs by Product, 2007 Data

Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
HMO	9.0%	11.8%	10.3%	19.7%
POS	8.8%	11.1%	8.9%	25.4%
Indemnity & PPO	12.3%	14.4%	13.7%	18.9%
Total Comm. Ins.	11.1%	11.8%	11.2%	14.3%
ASO	4.9%	8.5%	6.4%	33.6%
Total Commercial	9.7%	10.2%	9.9%	10.2%
Medicare Supplemental	10.3%	10.3%	10.3%	NM
Medicare Advantage	7.6%	12.0%	8.3%	41.2%
Medicare SNP	6.1%	9.0%	7.2%	50.1%
Medicare Cost	NM	NM	NM	NM
Medicare Total	7.1%	11.9%	7.8%	40.0%
Medicaid	7.0%	14.1%	9.0%	66.2%
Comprehensive Total	8.2%	10.8%	9.4%	30.5%
Medicare Part D	12.5%	27.5%	12.6%	77.0%





pants 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 Commercial 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 Medicare-Oriented plans is their Medicare SNP product, at \$105.21 PMPM, followed by Medicare Advantage, at \$73.92 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. Commercial ASO and Medicare SNP at 6.4% and 7.2%, respectively, are the lowest values. Notably, Medicare Advantage is only 8.3%.

## Other Universes

Because of the demands of our survey process, not all health plans are capable of submitting reliable information for this survey. Since so many of the health plans focused on Medicaid are relatively small, this necessarily leads to a relatively small universe. On the other hand, a number of Blue Cross Blue Shield Plans and Independent / Provider-Sponsored plans participating in other universes also offer Medicare Advantage. Medicare Advantage membership in these two universes were 659,059 members and 198,895 members, respectively, so that the combined universe of plans for which comparable data is available totals 936,943 members.

Recall that each of the universes segments its costs by product, as well as by functional area. We acknowledge that some differences between the universes, such as scale or the effect of differing products with which Medicare Advantage costs are shared, was not entirely eliminated. Notwithstanding, the results remain remarkably similar across universes. This suggests both the strength of the activity-based

**Figure 6. Medicare Advantage Benchmark Summary**  
Medicare-Oriented Characteristics by Universe, 2007 Data

	Medicare	Indep. / Prov. Sponsored	BCBS	Combined Universes*
<b>Administrative Expenses PMPM</b>				
25th PCTL	\$63.80	\$65.98	\$57.88	\$60.12
Median	73.92	69.22	69.00	71.32
75th PCTL	\$109.73	\$76.03	\$94.66	\$78.05
σ / Mean	48.2%	35.0%	31.6%	38.0%
<b>Administrative Expenses as a Percent of Premiums</b>				
25th PCTL	7.6%	7.0%	6.3%	6.8%
Median	8.3%	7.8%	8.7%	7.9%
75th PCTL	12.0%	8.7%	10.8%	10.4%
σ / Mean	41.2%	32.7%	40.6%	39.1%
<b>Plans Offering Medicare Advantage</b>	7	11	12	26
Medicare Adv. and SNP Revenues	\$2,768,818,718	\$2,574,177,750	\$6,987,476,844	\$10,961,386,928
Comprehensive Total Revenues	\$6,224,070,941	\$15,051,072,000	\$96,205,902,000	\$113,139,041,491

\* Four firms included in two universes, are excluded from combined figures.





accounting systems as the dearth of economies of scale.

## Background

Our participation includes 7 Medicare-Oriented plans, serving 1.2 million members with comprehensive products, of which 229,000 are Medicare Advantage or Medicare SNP members. Of the 7 plans, 4 were participants in 2007, contributing to a “practice effect” on the accuracy of data submitted by participants. This is our fifth 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 the universes. 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, Independent Provider-Sponsored Plans and Medicaid Plans. We have completed analyses of Blue Cross Blue Shield Plans Larger Health Plans, Independent Provider-Sponsored Plans and Medicaid Plans.

**Appendix A. Medicare Advantage Benchmark Summary**  
Medicare-Oriented Costs by Functional Area Cluster, 2006 Data  
*Per Member Per Month*

	25th PCTL	75th PCTL	Median	$\sigma$ / 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	8.11	27.73	9.70	81.8%
<b>Total</b>	<b>\$33.35</b>	<b>\$80.31</b>	<b>\$38.73</b>	<b>85.6%</b>

**Appendix B. Medicare Advantage Benchmark Summary**  
Medicare-Oriented Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2006 Data  
*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	$\sigma$ / Mean
Marketing	2.0%	3.4%	2.7%	40.2%
Provider & Medical Management	1.6%	2.5%	1.8%	50.5%
Account & Mem. Administration	2.5%	2.9%	2.7%	16.9%
Corporate Services	1.9%	3.3%	2.9%	46.5%
<b>Total</b>	<b>8.6%</b>	<b>13.4%</b>	<b>10.4%</b>	<b>32.8%</b>