



# Plan Management Navigator

Analytics for Health Plan Administration

Mid-July 2010

## INDEPENDENT / PROVIDER- SPONSORED PLANS' ADMINISTRATIVE COSTS WERE 8% OF PREMIUM IN 2009

### Summary

Administrative expenses grew at a sharply lower rate in 2009 among Independent / Provider-Sponsored (IPS) plans. As a result, they were 8.0% of premiums. This compared with 8.3% of premiums in 2008 and 9.4% in 2007. While raw per member administrative cost trends decreased from 11.1% in 2008 to 4.8% in 2009, after eliminating the effect of product mix differences, the rate of cost increase compressed even more dramatically, from 10.2% to 3.0%.

The weak economic environment and health care reform has made the management of administrative expenses an increasing priority for health plans. If not successfully managed, weak membership trends due to a difficult employment environment leads to negative operating leverage. Also, the minimum "medical loss ratios" introduced as part of health care reform exemplify the heightened scrutiny of administrative costs by federal and state regulators.

The administrative expenses of IPS plans participating in our performance benchmarking study in 2009 was \$28.35 per member per month (PMPM), but varied greatly by product. In 2009, the Commercial ASO/ASC administrative expense PMPM was \$17.40 PMPM and Medicare Advantage was \$73.80. Indemnity & PPO had the highest costs as a percent of premiums, at 12.5% and Commercial ASO / ASC was lowest at 5.4%.

All values in this article exclude investment and non-operating income and expense, income taxes and miscellaneous business taxes. Pharmacy and Mental Health costs are included in total administrative cost calculations but not in individual functional area clusters. These results are excerpted from the IPS edition of the 2010 *Sherlock Expense Evaluation Report*, comprising 2009 data.

### Administrative Costs and Trends

For convenience of analysis, we group various functional areas into clusters, and standardize for the size of the health plans by expressing expenses on a per member basis. Values and rates of change for these clusters and overall are shown in Figures 1 and 2. Appendix A provides values for all plans participating in 2009, and comprises 2008 data.

**Marketing** expenses were \$8.97 and sharply decelerated to 1.6% growth in 2009 from 14.3% in 2008. (All rates

of change hold constant the universe of participants.) Eliminating the effect of product mix differences, the decline in growth was even more dramatic, falling from 15.6% in 2008 to 1.0% in 2009.

All functional areas declined except internal Sales and Marketing and broker Commissions. While Product Development / Market Research and Advertising and Promotion plummeted, Sales and Marketing and broker Commissions grew at near double digit rates. This pattern was the same on both as-reported and constant mix basis.

Despite the modest growth for the cluster as a whole, broker Commissions were the greatest source of dollar increase among functional costs in all clusters. Advertising and Promotion, by contrast, was the greatest source of dollar decline.

The 75<sup>th</sup> percentile value for this cluster was \$9.81 and the 25<sup>th</sup> percentile value was \$7.87 PMPM.

Membership in the health plans participating in our IPS benchmarking study enjoyed growth in 2009. While commercial membership growth was barely up, both Medicare Advantage and Medicaid were up sharply. Overall, membership for plans in this universe was up by 2-3% in 2009.

**Provider and Medical Management** grew by 9.6% (compared with 22.7% last year) to \$4.86 PMPM. While well below last year's rate, this was by far the fastest growing cluster of costs, either as reported or constant-mix. On a constant-mix basis, this cluster's decline was even more precipitous, to 9.0% from 25.5% last year. While Provider Network Management and Services had the most rapid growth, the dollar impact was greater from the increase in Medical Management / Quality Assurance / Wellness.

There were three notable product mix changes in typical of plans participating in both year's benchmarking studies. ASO membership diminished relative to insured commercial, Medicare Advantage increased as did Medicaid. The increased commitment to Provider and Medical Management can be readily understood in this light. But it is especially interesting that the costs were high even backing out the effect of product mix, particularly Medicare. We suppose that IPS plans, recognizing the risks of high utilization as employer-based

**Figure 1. Benchmark Summary**

Independent / Provider-Sponsored Costs by Functional Area Cluster, 2009 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	\$7.87	\$9.81	\$8.97	31.7%
Provider & Medical Management	3.73	6.54	4.86	46.1%
Account & Mem. Administration	8.41	11.69	10.64	31.4%
Corporate Services	3.82	7.16	5.51	48.3%
Total	\$23.64	\$37.76	\$28.35	28.7%

\*Account & Membership Administration Includes Pharmacy & Mental Health



programs expired in the current recession, increased their emphasis on managing member costs.

The costs of Medical and Provider Management at the 25<sup>th</sup> percentile was \$3.73 PMPM and \$6.54 PMPM at the 75<sup>th</sup> percentile.

**Account and Membership Administration** cost increased to \$10.64, up 2.7% from last year. The value at the 25<sup>th</sup> percentile for Account and Membership Administration was \$8.41 PMPM, while the costs at the 75<sup>th</sup> percentile were \$11.69 PMPM. The rate of growth, on an as-reported basis, was 7.1% in 2008 so costs increased at a sharply lower rate this year.

Again, on a constant-mix basis, cost growth was much lower in 2009, 1.3% as against 10.0% in 2008. Recall that Medicare Advantage has much higher per-capita use of administrative

**Figure 2. Benchmark Summary**

**Independent / Provider-Sponsored Percent Change in Costs by Functional Area Cluster, 2009 Data**

	2008 Percent Change		2009 Percent Change	
	As Reported	Constant Mix	As Reported	Constant Mix
Marketing	14.3%	15.6%	1.6%	1.0%
Provider & Medical Management	22.7%	25.5%	9.6%	9.0%
Account & Mem. Administration	7.1%	10.0%	2.7%	1.3%
Corporate Services	6.1%	1.3%	2.0%	-4.1%
Total	11.1%	10.2%	4.8%	3.0%

*\*Account & Membership Administration Includes Pharmacy & Mental Health*

resources, explaining the sharp difference between as reported and lower constant mix-rates of change.

Enrollment / Membership / Billing and Customer Services PMPM costs were lower than last year, at mid-single digits, both on an as reported and constant mix basis. Both Claim and Encounter Capture and Adjudication and Total IS Expenditures edged upwards but their larger dollar values overwhelmed the declines in the other functional areas of this cluster.

**We have not performed an in-depth analysis comparing staffing between periods but at first blush it appears that each of Enrollment / Membership / Billing, Customer Services Claim and Encounter Capture and Adjudication and Total IS Expenditures had lower ratios than in 2008. Our staffing ratios include outsourced employee equivalents.**

**Corporate Services** costs grew by 2.0%, but declined by 4.1% on a constant mix basis. These growth rates were both lower than for 2008 when costs for this cluster increased by 6.1% on an as-reported basis and by 1.3% on a constant mix basis. Each of Finance and Accounting, Actuarial, Corporate Services and Corporate Executive / Governance declined on a constant mix basis. All of these but Actuarial declined on an as-reported basis as well. Only Association Dues and License / Filing Fees increased in both comparisons. Corporate Executive / Governance had the steepest declines, at near double digit rates.

Total costs for this cluster were \$5.51 PMPM in 2009, while the 25<sup>th</sup> percentile value was \$3.82 PMPM and the value at the 75<sup>th</sup> percentile was \$7.16 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, administrative expenses were 8.0% of premium equivalents for comprehensive products sold by IPS plans. The 25<sup>th</sup> percentile value was 7.2% and the value at the 75<sup>th</sup> percentile was 9.0%. Comparing these results to those in Appendix B, administrative expenses were 30 basis points lower as a percent of premium equivalents. This decline is partly attributable to the heavier mix of Medicare, which has lower costs relative to premium, but also evidently from more aggressive cost management.

## Calculation of Premium Equivalents

Administrative services relationships, comprising 19% of all IPS commercial members, play havoc with the intuition that administrative costs, when expressed as a percent, are a proportion of the premium dollar. That is because, under ASO relationships, employers are only billed for the administrative services that health plans provide rather than for the cost of care, which is borne by the self-insured groups. In other words, under GAAP accounting, if expressed as a percent of revenues, administrative expenses under ASO arrangements will have a denominator that is a small fraction of the premium dollar, dashing the intuitive appeal of the administrative expense ratio. This is a common problem that became increasingly visible during health care reform discussions.

In the context of *Plan Management Navigator*, our solution to mitigating this potential misunderstanding is to express expenses as a percent of premium equivalents. Since each of the plans submits the health care expenses for the self-insured groups (which they know since they process their 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. Since revenues less expenses equal profits, to estimate premium equivalents it is appropriate to add the fees rather than the administrative expenses to directly compare costs with the insured business.

**Figure 3. Benchmark Summary**

Independent / Provider-Sponsored Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2009 Data  
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	2.0%	3.1%	2.3%	29.4%
Provider & Medical Management	1.0%	1.7%	1.3%	34.6%
Account & Mem. Administration	2.7%	3.1%	2.8%	22.5%
Corporate Services	1.2%	1.8%	1.4%	39.4%
Total	7.2%	9.0%	8.0%	17.9%

\*Account & Membership Administration Includes Pharmacy & Mental Health

## Calculation of Constant Mix Rates of Expense Growth

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

Accordingly, in comparing expenses between periods, we hold constant the product mix between the two years. This is especially important since Medicare Advantage has increased in the product portfolios of some IPS plans and this product consumes far more resources per member than comparable products for people under 65 years of age.

To do this, since IPS 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 one. We then recalculate the rates of change based on these reweighted estimates.

Marketing costs comprised 2.3% of premium equivalents, with the 25<sup>th</sup> percentile value at 2.0% and the value at the 75<sup>th</sup> percentile of 3.1%. The comparable median percent in 2008 was 2.4% or 10 basis points higher than for 2009.

The value at the 25<sup>th</sup> percentile for Provider and Medical Management was 1.0% of premium, while the 1.7% of premium

equivalents represented the 75<sup>th</sup> percentile. The median value, at 1.3% was 20 basis points lower than the 1.5% posted last year.

The sharpest decline in the proportion of the premium dollar going towards administration was in the percent of premiums attributable to Account and Membership Administration. The costs of Account and Membership Administration were 2.8% of premium equivalents compared with 3.1% last year, a 30 basis point decline. (Both 2009 and 2008 figures reflect our new reporting of the direct costs of Pharmacy and Mental Health administration within these clusters.) The value at the 25<sup>th</sup> percentile was 2.7% of premium equivalents and 3.1% of premium equivalents at the 75<sup>th</sup> percentile.

The median proportion of premium equivalents due to Corporate Services was 1.4%, unchanged from last year's value. Twenty-five percent of plans had values below 1.2% of premium equivalents or above 1.8% of premium equivalents in 2009.

## Administrative Expenses by Product

All participants in our benchmarking studies segment their costs by product as well as by over forty functional areas. Our participants normally have quite robust activity-based costing systems to facilitate this. For example, members in Medicare Advantage products submit far more claims per commercial members so their costs per member may be adjusted on that basis. Because of lower Marketing costs, ASO PMPM costs are usually well less than for comparable insured products.

These differences are manifest in their overall cost differences. The most expensive product offered by IPS plans is their Medicare Advantage product, at \$73.80 PMPM, followed by

Indemnity & PPO products at \$37.77 PMPM. The least expensive comprehensive product was Commercial ASO at \$17.40 PMPM. This is shown in Figure 4.

As shown in Figure 5, on a percent of premium equivalent basis, the ranking of administrative expenses is different. As with the PMPM costs, the lowest

**Figure 4. Benchmark Summary**

Independent / Provider-Sponsored Costs by Product, 2009 Data  
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Commercial Insured				
HMO	\$23.40	\$38.94	\$26.59	34.5%
POS	\$23.49	\$40.02	\$31.51	34.2%
Indemnity & PPO	\$31.06	\$43.05	\$37.77	21.6%
Commercial ASO	\$14.54	\$23.50	\$17.40	33.9%
Medicare Supplemental	\$20.21	\$41.66	\$28.16	40.6%
Medicare Advantage	\$63.53	\$79.00	\$73.80	25.3%
Medicaid	\$17.11	\$25.41	\$19.04	23.5%
Comprehensive Total	\$23.64	\$37.76	\$28.35	28.7%
Medicare Part D	\$7.77	\$15.73	\$11.14	45.9%

median percent of premium equivalents was Commercial ASO at 5.4%. But Medicare Advantage is the next lowest at 7.9%. Indemnity & PPO, at 12.5%, has the highest ratio of administration to premiums.

## Background

The peer group universe in this analysis consisted of seventeen Independent / Provider-Sponsored plans, which collectively served 6.0 million members. Twelve of this year's participants participated in the previous year and 70.0% of this year's participants have three or more years of experience participating in SEER.

Approximately 1.3 million of the commercial members were served under some form of self-insurance arrangement, comprising approximately 19% of the total members. Medicare Advantage, offered by 15 plans, on average comprised 8% of their total membership. Perhaps more significantly from a cost perspective, Medicare Advantage comprised 21% of the typical IPS plans' revenues. Medicaid HMO, offered by eight plans, comprised 9% of the plans' membership, and Medicare Supplemental, offered by seven plans, comprised very little of the total membership.

Costs comparisons are based on the results for plans that participated in each of the comparison years. PMPM values are actual for all plans in the universes. We employed median values throughout this analysis as the measure of central tendency because it minimized the effects of outlying responses.

There were modest changes in the values for 2008 data between how they were originally reported and how they are reported in this year's edition. Besides minor late corrections, we incorporated the direct administrative costs of mental health and pharmacy administration into Account and Membership Administration.

**Figure 5. Benchmark Summary**

Independent / Provider-Sponsored Costs by Product, 2009 Data

*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	σ/ Mean
<b>Commercial Insured</b>				
HMO	7.9%	10.5%	9.1%	26.3%
POS	6.7%	9.5%	8.8%	29.4%
Indemnity & PPO	9.7%	15.4%	12.5%	26.8%
<b>Commercial ASO</b>	4.9%	6.7%	5.4%	24.6%
Medicare Supplemental	8.4%	18.7%	10.9%	51.6%
Medicare Advantage	6.8%	9.3%	7.9%	22.6%
Medicaid	7.8%	12.3%	8.6%	30.4%
<b>Comprehensive Total</b>	7.2%	9.0%	8.0%	17.9%
Medicare Part D	6.3%	9.2%	7.9%	56.6%

tion. Also, rates of change are calculated medians while last year they were calculated as rates of changes in median values.

Overall, our benchmarks in 2010 will comprise the experience of approximately 450 health plan years. We also have universes of Blue Cross Blue Shield Plans, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. We will be reporting on those results in the next three months.

**Appendix A. Benchmark Summary**

Independent / Provider-Sponsored Costs by Functional Area Cluster, 2008 Data

*Per Member Per Month*

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	\$7.73	\$9.53	\$8.66	35.4%
Provider & Medical Management	4.03	5.62	5.08	40.9%
Account & Mem. Administration	8.58	12.80	10.38	29.8%
Corporate Services	4.14	7.10	4.80	45.3%
<b>Total</b>	<b>\$25.41</b>	<b>\$34.98</b>	<b>\$30.35</b>	<b>29.1%</b>

*\*Account & Membership Includes Pharmacy & Mental Health*

**Appendix B. Benchmark Summary**

Independent / Provider-Sponsored Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2008 Data

*Percent of Premium Equivalents*

	25th PCTL	75th PCTL	Median	σ/ Mean
Marketing	2.0%	3.1%	2.4%	31.0%
Provider & Medical Management	1.1%	1.7%	1.5%	33.4%
Account & Mem. Administration	2.7%	3.5%	3.1%	23.6%
Corporate Services	1.2%	2.1%	1.4%	37.3%
<b>Total</b>	<b>7.5%</b>	<b>10.1%</b>	<b>8.3%</b>	<b>21.8%</b>

*\*Account & Membership Administration Includes Pharmacy & Mental Health*

