Plan Management Navigator
Analytics for Health Plan Administration July 2011

Blue Cross Blue Shield Plans' Administrative Costs Were 9.2% of Premiums in 2010

Summary

Blue Cross Blue Shield Plans' administrative expense growth declined once again in 2010. Administrative expenses were 9.2% of premiums in 2010 compared with 9.7% in 2009, 9.9% in 2008 and 10.4% in 2007. While raw per-member administrative cost trends decreased from 2.5% in 2009 to 1.0% in 2010, after eliminating the effect of product mix changes, the rate of cost growth decreased from 3.8% to 1.8%.

The median administrative expenses of comprehensive products of Blue Cross Blue Shield plans (Blue plans) participating in our performance benchmarking study in 2010 was $27.33 per member per month (PMPM), but varied greatly by product. In 2010, the FEP product, offered to federal employees, had administrative costs of $16.47 PMPM. Sharing low marketing costs with FEP, POS ASO/ASC had administrative expenses of $20.12 PMPM. Medicare Advantage was the highest administrative cost product, at $74.31 PMPM.

All values 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 and are allocated to the Account and Membership Administration cluster.

These results are excerpted from the Blue Cross Blue Shield edition of the 2011 *Sherlock Expense Evaluation Report (SEER)*. The results are based on our detailed surveys of 2010 operating parameters of 27 Blue Cross Blue Shield Plans, or approximately 70% of all Blue plans.

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. Cost values and rates of change are shown in Figures 1 and 2. Appendix A provides values for plans participating in the 2010 survey, and comprises 2009 data.

Sales and Marketing expenses were $7.15 PMPM and grew at an increasing rate, 1.5% in 2010 versus 0.5% growth in 2009. (All rates of change hold constant the universe of participants.) Eliminating the effect of product mix changes, the acceleration was even more evident as PMPM Sales and Marketing costs increased by 4.8% compared with 2.0% in 2009.

The higher constant-mix change, compared with as-reported, in part reflects a mix shift in favor of ASO/ASC and FEP products which have relatively low marketing costs. Both FEP and ASO/ASC products grew at the expense of insured products. Thus, on an as-reported basis PMPM broker Commissions declined, on a constant-mix basis broker Commissions were the single largest source of cost increase for the Marketing cluster.

Internal Sales and Marketing costs contributed heavily to the overall Sales and Marketing trend. Because of its rate of growth and size it was among the top 25 percent of functions in its contribution to growth on an as-reported or constant-mix basis. Product Development / Market Research grew at double digit rates on both an as-reported and constant-mix basis.

Staffing ratios sharply increased in Member and Group Communications and among Account Representatives.

Advertising and Promotion growth was higher in 2010 than in 2009 on both an as-reported and constant mix basis. The increase had only a modest impact on the overall growth, however. The small Rating and Underwriting function grew moderately on a constant-mix basis and actually declined on an as-reported basis.

The 75th percentile value for this cluster was $9.63 and the 25th percentile value was $4.98 PMPM.

Blue Cross Blue Shield plans in 2010 continued to reflect the economic turmoil of 2009. Year-over-year, for the 24 continuous plans, the median decrease in comprehensive product membership was 0.7%, and on average they grew by 1.5%. While commercial membership changes were at approximately those rates, insured membership declined by 6.0% on average as ASO/ASC grew by 9.9%. FEP membership grew by 4.9% on average. Of the thirteen continuous plans offering Medicare Advantage, the median decline in membership was 6.1%. Medicare Supplemental declined at a median rate of 4.0%.

Provider and Medical Management, in contrast with Sales and Marketing, posted a decline in growth, by 1.6% (compared with 3.3% last year) to $3.40 PMPM. On a constant-mix basis, per member cost growth fell from 5.4% to 2.1%. The mix of expenses changed dramatically. While Provider Network Management and Services declined, Medical Management increased. These contrasting trends were evident on both an as-reported and on a constant-mix basis.

That Medical Management continues to grow faster than most functions, either on a constant-mix or on an as-reported basis suggests that this function remains a relatively high priority for the plans.

Staffing ratios reflected this reallocation. The staffing ratios for Provider Network Management and Services declined especially if staff was committed to orientation, on-going education and in-services. While Medical Management staffing also declined, this was offset by a higher propensity to use non-labor support services in that function. Staffing in Medical Management nevertheless increased for Quality Components, Medical Informatics, retrospective reviews and peer reviews.

Figure 1. Benchmark Summary
Blue Cross Blue Shield Costs by Functional Area Cluster, 2010 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Sales & Marketing	$4.98	$9.63	$7.15	45.1%
Provider & Medical Management	2.54	4.56	3.40	36.9%
Account & Mem. Adminstration	10.13	13.81	11.71	20.1%
Corporate Services	3.94	6.10	4.61	34.5%
Total	$24.23	$32.98	$27.33	24.6%

The costs of Provider and Medical Management at the 25th percentile was $2.54 PMPM and was $4.56 PMPM at the 75th percentile.

Figure 2. Benchmark Summary
Blue Cross Blue Shield Percent Change in Costs by Functional Area Cluster

	2009 Data		2010 Data	
	As Reported	Constant Mix	As Reported	Constant Mix
Sales & Marketing	0.5%	2.0%	1.5%	4.8%
Provider & Medical Management	3.3%	5.4%	1.6%	2.1%
Account & Mem. Administration	4.1%	4.2%	1.9%	2.2%
Corporate Services	5.5%	5.7%	-1.0%	-1.0%
Total	2.5%	3.8%	1.0%	1.8%

Account and Membership Administration costs increased to $11.71 PMPM, up 1.9% from last year. At the 25th percentile the cost of Account and Membership Administration was $10.13 PMPM, while the costs at the 75th percentile were $13.81 PMPM. In 2009, the rate of growth, on an as-reported basis, was 4.1% so cost growth sharply decreased in 2010. On a constant-mix basis, the decline in cost growth was similar, 2.2% as against 4.2% in 2009.

Information systems was far and away the most important reason for the increase that did occur. It grew faster than most functional areas, particularly so among functional areas in its own cluster. Because of its size, Information Systems had the greatest upward effect on overall costs.

Results are consistent with the possibility of increased Blue Cross Blue Shield plan automation of their activities. For instance, on a constant-mix basis each of the functions other than Information Systems (Enrollment / Membership / Billing, Customer Services and Claim and Encounter Capture and Adjudication) either had declines in PMPM costs or no increase. On an as-reported basis, only Claim and Encounter Capture and Adjudication PMPM increased, and that less than 1%.

Related to the possibility of increased automation were significant declines in staffing ratios, even adjusting for the effect of outsourcing. The staffing ratios for each Account and Membership Administration function declined.

Outsourcing increased for Information Systems but declined for all other functional areas in this cluster. Overall, outsourcing is relatively unusual among Blue Cross Blue Shield plans, equating to 10-11% of total FTEs, substantially unchanged from last year.

Corporate Services costs declined by 1.0%, on both a constant-mix and as-reported basis. These growth rates were sharply lower than last year when this cluster grew by 5.5%, as-reported and 5.7% constant-mix.

Central to this trend were declines in costs in a group of sub-functions containing Human Resources, Legal , Facilities, Audit, Purchasing, Printing and Mailroom. This is a large functional area and so affects overall trends. Other declining functions include Actuarial and Corporate Executive and Governance. Compensation levels for that latter function declined in 2010. By contrast Finance and Accounting costs increased.

Total costs for this cluster were $4.61 PMPM in 2010, while the 25th percentile value was $3.94 PMPM and the value at the 75th percentile was $6.10 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. Indeed, the insights thought to be available through the use of this metric is an underlying premise of the medical loss ratio provisions of the Patient Protection and Affordable Care Act.

As shown in Figure 3, administrative expenses were 9.2% of premium equivalents for comprehensive products sold by Blue Cross Blue Shield Plans. The 25th percentile value was 7.5% and the value at the 75th percentile was 10.2%.

Comparing these results to those in Appendix B, 2010 administrative expenses were 52 basis points lower relative to premium equivalents. Of the ten comprehensive products, only one ratio increased, the commercial HMO ASO/ASC. So, while the shift to low administrative cost ASO/ASC and FEP contributed to the overall decline, administrative cost declines relative to premiums in each product were also a factor. In order of importance to the overall decline were Sales and Marketing, Corporate Services, Account and Membership Administration and Provider and Medical Management.

Sales and Marketing costs comprised 2.3% of premium equivalents, with the 25th percentile value at 1.3% and the value at the 75th percentile was 3.3%. The comparable median percent in 2009 was 2.4% and the decline was 18 basis points in 2010.

The value at the 25th percentile for Provider and Medical Management was 0.9% of premium, while 1.3% of premium equivalents represented the 75th percentile. The median value, at 1.1%, was the same as posted last year.

The costs of Account and Membership Administration was 3.9% of premium equivalents compared with 4.0% last year, a modest decline. (Both 2010 and 2009 figures report the direct costs of Pharmacy and Mental Health administration within these clusters.) The value at the 25th percentile was 3.5% of premium equivalents and 4.3% of premium equivalents at the 75th percentile.

The median proportion of premium equivalents due to Corporate Services was 1.6%, 12 basis points lower than last year's value.

Figure 3. Benchmark Summary
Blue Cross Blue Shield Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2010 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Sales & Marketing	1.3%	3.3%	2.3%	47.4%
Provider & Medical Management	0.9%	1.3%	1.1%	32.1%
Account & Mem. Administration	3.5%	4.3%	3.9%	18.6%
Corporate Services	1.2%	2.0%	1.6%	27.8%
Total	7.5%	10.2%	9.2%	21.9%

Calculation of Premium Equivalents

Administrative services relationships, comprising just over 54% of all Blue Cross Blue Shield 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/ASC 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/ASC 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 recurring problem that became increasingly visible during health care reform debates.

Our solution to mitigating this potential misinterpretation 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 groups' self-insured claims), by adding this amount to the administrative service fees actually billed, we are able to estimate what the premiums would have been if the groups has been insured. These are called premium equivalents.

Note that, as with premiums, fees charged to ASO/ASC 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.

Twenty-five percent of plans had values below 1.2% of premium equivalents or above 2.0% of premium equivalents in 2010.

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 than commercial members so total claims processing costs may be allocated by claims as opposed to members. Because of lower Sales and Marketing costs, ASO/ASC PMPM costs are usually much less than for comparable insured products.

These differences are manifest in their overall cost differences. The most expensive product offered by Blue Cross Blue Shield Plans is their Medicare Advantage product, at $74.31 PMPM, followed by Commercial HMO Insured products at $36.60 PMPM and Commercial Indemnity and PPO Insured Product at $34.35. Excluding FEP, the least expensive comprehensive product was Commercial POS ASO/ASC at $20.12 PMPM. The FEP product cost $16.47 PMPM to administer. Product cost shown in Figure 4.

As shown in Figure 5, on a percent of premium equivalent basis, the product ranking of administrative expenses is different. The lowest median percent of premium equivalents was commercial POS ASO/ASC at 6.2%. The centrally important commercial Indemnity and PPO ASO/ASC was 7.2%. (FEP, a unique product, was 5.2%.) The highest cost product, measured by the percent of premiums attributable to administration, was Medicare Supplemental at 16.0%. Medicare Advantage, the high cost plan on a PMPM basis, is lower than average measured as a percent of the premium dollar, at 8.4%.

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 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 and ASO/ASC products have increased in the product portfolios of Blue Cross Blue Shield Plans. Medicare Advantage consumes far more resources per member than comparable products for people under 65 years of age, and marketing costs are sharply lower for ASO/ASC products versus their insured counterparts.

To calculate cost trends while excluding mix changes, we take advantage of the fact that Blue Cross Blue Shield plans report to us by product. We can then reweight their prior year expenses to match the product mix in the current period. We then calculate the rates of change in costs based on these reweighted estimates.

Background on Sherlock Benchmarks

The universe in this analysis consisted of twenty-seven Blue Cross Blue Shield Plans, which collectively serve 38.3 million members. These plans are also twenty-seven primary licensees, or 69.2%, of the thirty-nine primary licensees of the Blue Cross Blue Shield system. Twenty-four of this year's participants participated in the previous year and 81% of this year's participants have five or more years of experience participating in *SEER*.

Approximately 16.9 million of the commercial members were served under some form of self-insurance arrangement,

Figure 4. Benchmark Summary
Blue Cross Blue Shield Costs by Product, 2010 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Commercial HMO				
Insured	$31.97	$40.33	$36.60	25.0%
ASO / ASC	$18.52	$27.30	$23.84	24.1%
Commercial POS				
Insured	$23.93	$37.73	$29.91	42.0%
ASO / ASC	$16.49	$29.01	$20.12	30.2%
Indemnity & PPO				
Insured	$29.05	$42.11	$34.35	27.1%
ASO / ASC	$18.67	$22.10	$20.46	25.1%
FEP	$14.65	$21.47	$16.47	31.5%
Medicare Advantage	$67.21	$84.29	$74.31	18.0%
Medicaid	$19.64	$25.23	$23.13	27.8%
Medicare Supplemental	$20.77	$35.96	$28.70	43.1%
Comprehensive Total	$24.23	$32.98	$27.33	24.6%
Stand Alone Dental	$2.34	$3.36	$2.71	84.9%
Medicare Part D	$15.00	$20.11	$16.79	40.5%

Figure 5. Benchmark Summary
Blue Cross Blue Shield Costs by Product, 2010 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Commercial HMO				
Insured	9.4%	11.6%	10.4%	20.0%
ASO / ASC	5.8%	9.2%	8.2%	28.2%
Commercial POS				
Insured	7.5%	12.4%	9.2%	37.4%
ASO / ASC	6.1%	10.0%	6.2%	34.1%
Indemnity & PPO				
Insured	8.4%	13.1%	11.0%	29.2%
ASO / ASC	6.0%	8.1%	7.2%	28.4%
FEP	4.3%	6.0%	5.2%	40.2%
Medicare Advantage	6.8%	10.0%	8.4%	24.7%
Medicaid	8.9%	11.6%	10.4%	20.3%
Medicare Supplemental	12.5%	20.7%	16.0%	33.4%
Comprehensive Total	7.5%	10.2%	9.2%	21.9%
Stand Alone Dental	13.4%	24.2%	16.8%	42.9%
Medicare Part D	11.0%	18.7%	15.4%	45.8%

comprising approximately 54% of their total commercial members. Medicare Advantage, offered by 15 plans, comprised 2.5% of their total comprehensive membership. In four of the plans, Medicare Advantage comprised more than 20% of their total revenues, and in 11 cases, their Medicare Advantage revenues exceeded their historically important Medicare Supplemental revenues. Combining all of this universe's revenues, those from Medicare Advantage are twice that of Medicare Supplemental.

Rates of change in costs are calculated for plans that participated in both of the comparison years. By contrast, PMPM values are actual for all plans in the universe. We employed median values throughout this analysis as the measure of central tendency because it minimized the effects of any outlier responses.

Including all of our benchmarks, those published in 2011 will comprise the experience of more than 510 health plan years. We also have universes of Independent / Provider-Sponsored Plans, TPAs, Larger Health Plans, Medicare Advantage Plans and Medicaid Plans. Later this month, we will publish results on the Independent / Provider-Sponsored Plans and we will be reporting on the rest of the results in the months that follow.

Why Administrative Costs Matter Now

The Affordable Care Act and the weak economic environment has increased the impetus to manage health plan administrative costs.

According to the Bureau of Labor Statistics, seasonally-adjusted employment declined from a peak of 146.6 million in November 2007 to 139.8 million in May 2011. 13.9 million people were unemployed and 6.2 million had been unemployed for six months or more. A June 2011 report by the Kaiser Commission on Medicaid and the Uninsured found that 57% of adults who were unemployed and looking for work were uninsured. For health plans, the weak economy contributes to a loss of membership and a commensurate need to reduce administrative costs.

Health care reform leads to additional pressures on health plan administrative expenses. The Affordable Care Act, signed into law on March 2010, does this in two notable ways: Premium rate increases will be subject to more intense oversight and medical loss ratios (MLRs) will be subject to strict minimums. In fact, the MLR rule is explicitly intended to encourage efficiency: "The rebate provisions of section 2718 are designed not just to provide value to policyholders, but also *to create incentives for issuers to become more efficient in their operations*." (Italics added.) In short, health care reform limits managerial latitude in many strategic decisions leaving chiefly administrative cost management as the principal avenue of managerial discretion.

Government-sponsored programs are similarly subject to administrative cost pressures. Under the Affordable Care Act, Medicare Advantage will be subject to medical loss ratio rules beginning in 2014. The pressures on Medicaid are important but more indirect. High unemployment has increased the number of people eligible for Medicaid. Also, under the Affordable Care Act, one-half of all newly insured people will be new enrollees in state Medicaid programs. So, while membership growth can be anticipated for Medicaid plans, state Medicaid programs are under financial stress as 44 states and the District of Columbia are projecting 2012 budget shortfalls. Thus, as with commercial plans, close attention to the management of administrative expenses is today will be central to maintaining viability for Medicaid and Medicare plans, now and in the future.

Appendix A. Benchmark Summary
Blue Cross Blue Shield Costs by Functional Area Cluster, 2009 Data
Per Member Per Month

	25th PCTL	75th PCTL	Median	σ/ Mean
Sales & Marketing	$5.96	$10.17	$7.49	39.9%
Provider & Medical Management	2.27	4.52	3.41	41.4%
Account & Mem. Administration	10.82	13.51	12.21	20.0%
Corporate Services	4.06	5.83	4.96	31.4%
Total	$24.60	$32.73	$28.02	22.4%

Appendix B. Benchmark Summary
Blue Cross Blue Shield Costs by Functional Area Cluster, as a Percent Premiums or Equivalents, 2009 Data
Percent of Premium Equivalents

	25th PCTL	75th PCTL	Median	σ/ Mean
Sales & Marketing	1.9%	3.4%	2.4%	43.2%
Provider & Medical Management	0.8%	1.4%	1.1%	34.8%
Account & Mem. Administration	3.6%	4.4%	4.0%	21.2%
Corporate Services	1.4%	2.0%	1.7%	26.4%
Total	7.9%	10.2%	9.7%	21.2%