Transcript

Independent / Provider-Sponsored Administrative Costs: A Review of 2009 Results

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Douglas B. Sherlock, CFA
sherlock@sherlockco.com
(215) 628-2289

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Welcome to our summary of the benchmarking study for Independent / Provider – Sponsored Plans. I believe that most of you are health plan managers. Accordingly, you have responsibility to achieve that optimal mix of costs and benefits that lead to superior long-term performance for your customers, your owners and the public at large.

We appreciate the complexity of this task. This is obviously a challenging environment. First, you have to manage administrative costs in a weak economic environment. Revenues are compressed by soft enrollment, pricing pressure and in some cases a migration of customers to ASO arrangements. Health care reform compounds this challenge in that, for commercial insured and for Medicare Advantage, so-called "medical loss ratio" regulations heighten the visibility of administrative expenses. Hopefully, this presentation will prove helpful in your cost management endeavors.

Before I proceed, I do want to thank all of you who are participants in our various benchmarking studies. While participating plans realize a return on their investment in the benchmarking process, it is nevertheless the case that the summary benchmarks that result benefit other firms as well.

As you may know, we have been performing these benchmarking studies for a number of years. They are widely accepted among health plan managers and other users. Plans participating in our benchmarking studies agree to complete our survey form in exchange for the resulting report. Costs must be segmented by product as well as by functional area: that segmentation is shown in the appendix slides. Our quality assurance procedures are also summarized in the appendices.

This is the first of a series of presentations on health plan performance metrics. Blue Cross Blue Shield financial metrics will be summarized in about three weeks and we expect to host similar web conferences for Medicare and Medicaid plans in September.

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Today, I would like to touch upon a little bit of background on us, the levels of costs that the Independent / Provider-Sponsored plans report and the sources of cost increase in 2009. Then I would like to speak to the costs by product reported by these plans. For the sake of brevity, I have included some supporting information only in appendix form.

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Sherlock Company is now completing its 13th consecutive annual survey of health plan operations and our benchmarks will reflect approximately 450 health plan years of experience. In all of our universes this year, we estimate the plans collectively serve 42.3 million members. Our benchmarks' focus is administrative expenses and related operational drivers, but they also include many metrics of health care utilization.

Sherlock Company benchmarks are in widespread use by health plans, and health plans serving most insured Americans are users of our 2009 metrics. Most Blues and a plurality of other health plan association members are users of, or participants in, our benchmarks. Since the benchmarks are designed for plans' internal use, we have designed it to provide a high ratio of insight to effort, though I acknowledge that the efforts are considerable. Because we have multiple peer groups, and each of them has their strong suits, our benchmarks benefit from cross-fertilization across universes.

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Today I would like to discuss the results for our first reporting peer group, the Independent / Provider-Sponsored plans. These 17 plans are house-hold name companies often associated with prominent hospital systems. At 350,000 members on average, they are substantial organizations, usually with more than one billion dollars in annual revenues and are in markets "from sea to shining sea." Their market power is often especially strong locally since they have either ownership links with a health system or at least a vestigial relationship with one. This is especially important because they are disproportionately committed to managed care products such as HMO, Medicaid or Medicare Advantage.

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Here is a summary of the results for the 2010 benchmarking study, reflecting 2009 calendar year results. (All of the costs are expressed in PMPM values.) Median costs were $28.35 PMPM and if you refer to Appendix A, you'll see that this compares with $30.35 last year. This does not mean costs fell. The mix of plans and the mix of products served by those plans participating in both years changed. Just to anticipate a question, yes it is possible, though we cannot know for certain, that our benchmarks are of plans that are lower cost than average. After all, you manage what you measure.

Each plan segments its costs by function, and there are more than 40 of them for this universe. However, for this presentation, we think it is helpful to group expenses into clusters. Appendix C describes how we summarize these functions into the clusters reported on here.

Account and Membership Administration is the dominant source of costs for health plans at $10.64. This is followed by Marketing expenses at $8.97. Provider and Medical Management, at $4.86, and Corporate Services, at $5.51, are relatively small clusters of expenses. The figure numbers refer to our free research publication, *Plan Management Navigator*, which is available on our web site, along with this presentation.

By the way, the median costs, expressed PMPM or as a percent of revenues, will be the way that we'll refer to cost metrics. Because medians are the 50th percentile value, the clusters won't necessarily sum to the median for total expenses.

Another calculation note is that when we make comparisons we try to be as careful as possible make them "apples-to-apples." So where this slide pertains to all 17 health plans that participated in the benchmarking study, the slides showing cost changes will reflect only the 12 that participated in both 2009 and 2010 surveys.

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This slide shows a remarkable trend of a sharp decline in growth in expenses. On an as-reported basis, IPS plans had per member expense growth that declined from 11.1% in 2008 to 4.8% in 2009. (All of the percent comparisons are *changes* in per member per month.) Reweighting each plans' costs to eliminate the effect of changes in their product mix change, total expense growth is only 3.0%, down from 10.2% in 2008.

Marketing cost declines were especially steep. As-reported, growth declined from 14.3% to 1.6%. They were steeper still on a constant-mix basis, declining from 15.6% in 2008 to 1.0% in 2009.

Account and Membership Administration also had a notable decline. Growth fell from 7.1% in 2008 to 2.7%, as-reported, and from 10.0% to 1.3% on a constant-mix basis.

The much smaller Corporate Services cluster had a similar decline in its growth rate. On an as-reported basis, cost growth fell from 6.1% in 2008 to 2.0% in 2009. On a constant-mix basis, costs declined from 1.3% to *minus* 4.1%.

Provider and Medical Management costs grew less than last year but its growth rates greatly exceeded that of the other clusters. Growth declined from 22.7% to 9.6% on an as-reported basis and from 25.5% to 9.0% on a constant-mix basis. That last number is important. It is saying that these IPS plans increased their commitments to this cluster of functions *even when you eliminate the effect of product mix changes.* I can only speculate that perhaps employment weakness may have played a role in that decision.

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This slide highlights the functional areas within each cluster that contributed to the changes in costs, on an as-reported basis. Recall that overall costs increased by 4.8% PMPM. In this slide, the arrows and comments are referring to changes in costs not changes in growth. So a down arrow means that PMPM costs actually fell in 2009.

The modest growth in Marketing was attributable to a sharp decline in costs of Advertising and Promotion and in Product Development / Market Research, with the former sliding at the fastest rate and the latter declining with the greatest magnitude. Despite these declines, the high dollar areas of Sales and Marketing and Commissions grew rapidly, keeping the trend positive. It should be remembered that broker

Commissions are often calculated as a percent of the premium dollar which means that it can nearly pace health care inflation. Despite this, marketing cost trend is the lowest in at least the past five years.

Declines in PMPM costs for Enrollment / Membership / Billing and Customer Services compressed trends in Account and Membership Administration. While *increasing* at a *slower* rate than those other areas *decreased*, Information Systems and Claims adjudication forced overall cluster costs up in 2009. Information Systems trends have a disproportionate effect on this cluster and total costs since it is the largest function in this cluster.

The very sharp decline in Corporate Executive / Governance was the single greatest factor in the slow growth in Corporate services. This function also declined most rapidly. But most other functions also declined. Only Association Dues and Filing Fees had an important upward effect on trend in the Corporate Service cluster of expenses.

Provider and Medical Management was our fastest growing cluster. Provider Network Management and Services was the fastest *growing* function while the much larger Medical Management function had the *greater weighted* effect on trend.

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I have mentioned the changes in the product mix, and this slide details them. Note how Medicare and Medicaid have grown – these products are relatively heavy users of medical management by health plans. By contrast note the modest growth in commercial business. Perhaps Marketing cost growth is low because, well, why market if the market isn't there.

<Side 9>

This slide reflects the contribution of various functions to cost growth after we hold constant the product mix. Corporate Services *declined* PMPM by 4.1%, largely due to the speed and magnitude of the decline in Corporate Executive / Governance expense. While nearly all functional areas within this cluster declined, the Corporate Services *function* also declined. This *function* consists of HR, Legal, Facilities and the like.

The modest Marketing expense growth occurred only because high dollar areas of Sales and Marketing and Commissions grew rapidly. By contrast Product Development / Market Research and Advertising and Promotion were both way down.

On a constant-mix basis, Enrollment / Membership / Billing and Customer Services declined. Notwithstanding Claims adjudication costs were up. Information systems costs was also up slightly.

We are still sorting through the staffing ratios since they will be published in the Volume II.A Operational metrics in the next few weeks. But when I looked at the raw results, for the entire peer groups in 2010 and 2009, the staffing ratios for this cluster of functions all declined. In fact they declined in each of Enrollment / Membership / Billing, Customer Services, Claims and Information Systems.

As on an as-reported basis Provider and Medical Management costs had the highest growth rate for Independent / Provider-Sponsored plans. Provider Network Management and Services grew most rapidly but heavier-weighted Medical Management had the greatest effect on the cost trend. Again, because this is after mix-adjustment, this is plainly not the result of higher exposure to Medicare or Medicaid. Rather, this seems to have been a strategic decision by the IPS plans. As an aside, I think this trend also illustrates the robustness of our definitions. While some health plans are electing to report medical management as health benefits for MLR calculations, this result provides evidence that, regardless of health plans' other reporting, it is not occurring in our benchmarks.

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We are not great fans of expressing administrative expenses as a percent of premium since (a) it isn't actionable, (b) it confounds cost performance with factors of revenue yield, (c) it varies quite a bit by product and (d) if one uses GAAP accounting for the revenue denominator, and that revenue is in part ASO fees, then the actual ratio conflicts with normal intuitions about it.

We cannot solve all of these problems but we address a few of them in this presentation. Most importantly, we employ premium equivalents for ASO products. Essentially, this means that we incorporate health benefits into the ASO's top line. Our calculations of premium equivalents is discussed in detail in *Plan Management Navigator*.

This slide shows administrative expenses as a percent of premium equivalents. At 8.0%, it is probably lower than consensus estimates for health plan administration. It compares with the 8.3% last year and 9.4% for 2007 data. Account and Membership administration, at 2.8% of premium comprises a third of administrative expenses, followed by Marketing at over one-fourth at 2.3%. Provider and Medical Management costs and Corporate Services costs were 1.3% and 1.4% respectively.

Again, the 8.0% of premium figure is probably contrary to conventional wisdom. While a precise comparison is impossible since medians don't sum and the universes differ, on a percent basis, Account and Membership Administration declines seem to be the largest factor in the 30 basis point improvement from last year.

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Costs vary quite a bit by product which is why we and our participants segment costs in this way. Because of their low marketing costs, ASO products are the lowest cost comprehensive product offered by Independent / Provider-Sponsored plans. Medicare Advantage is the high cost plan: seniors have greater health needs, so submit more claims and have more customer service interactions as well.

At a per member per month cost for comprehensive products of $28.35, these plans' emphasis on commercial HMO is evident. At $26.59, this is the lowest cost of the commercial insured products. IPS plans are also often leaders in Medicaid products which, at $19.04, is also a low cost product.

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This slide shows the administrative expenses of each product offered by the Independent / Provider-Sponsored universe of plans, expressed as a percent of the premium equivalent. Here again, the commercial ASO business is the lowest cost plan, at 5.4% of premium. Broker commissions tend to be small and uncommon for this product. Medicaid is also a relatively low cost plan at 8.6% of premium, as it was in the PMPM calculations.

But note how, expressed as a percent of premium, Medicare Advantage becomes the second lowest cost plan, at 7.9% of premiums. Medicare has low administrative costs relative to premium in part because the administrative activities tend to be less per dollar of health benefits. Put a different way, health costs per claim is 20% higher than for commercial lines. Since Medicare Advantage comprises 19% of the revenues of these organizations these low values reduce overall percents.

Indemnity and PPO products have comparatively high administrative costs relative to premium. This is a minor product for these plans, and I suspect that these two facts are related.

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This is the end of my formal presentation. The headline conclusion is that, for Independent / Provider-Sponsored Plans, administrative expenses are only 8% of premium. Perhaps more importantly from an operational perspective, administrative expense growth sharply decreased, especially when changes in product mix are eliminated.

While marketing cost growth declined to its slowest rate in at least the past five years, we think that the main factor reducing cost growth was modest growth in Account and Membership Administration. Corporate Services actually declined PMPM on a constant-mix basis.

Provider and Medical, while growing less than in 2008, grew the fastest among the functional area clusters. That this is occurring once you back out the effect of the relatively rapid growth in these plans' Medicare and Medicaid businesses suggests to us that this is the result of a deliberate policy of these plans.

I have attached to the end of this presentation some appendices in support of this presentation. They include last year's costs, the functions found in the clusters we have been speaking of and some notes on our quality assurance and our business model.

Now I would like to open this for questions about the results of the benchmarking study.

Questions

I want to again thank you for your participation in this web conference. More in depth and actionable information is available in the benchmarking study itself, which anyone can license. Please contact me directly if you are considering licensing these materials.

On August 5, we will have a similar web conference on the results of the Blue Cross Blue Shield plans. There are 24 participating plans in this universe, comprising 60% of the primary licensees of the Blue Cross Blue Shield Association. We hope that you will consider participating in this web conference as well.

I want to close by once again thanking all of you who participated in this study for your efforts. Your participation not only enhances your own firm's performance but also raise the bar for all other plans.

This is Doug Sherlock of Sherlock Company.