



*Transcript*

## Medicaid Administrative Costs: A Review of 2010 Results

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<Title Page>

I am Doug Sherlock. Welcome to our summary of the benchmarking study for Medicaid Plans. This is the fourth of a series of presentations on performance metrics for health benefit organizations. The results of the Independent / Provider - Sponsored and the Blue Cross Blue Shield Plans financial metrics were summarized in July; in September we hosted a similar web conference for TPAs. We expect to do a similar analysis on Medicare plans in the next few weeks.

Because some of those on the web conference are participants in our benchmarking studies, I want to thank them. A byproduct of their participation is the reports that are summarized today. This summary benefits Medicaid plans as a whole, and we are grateful for this.

Most health plans endeavor to closely manage their administrative costs. But several factors increase the urgency of this for Medicaid plans. The economic weakness is both reducing tax revenues to states while also increasing the need for the coverage that only Medicaid provides. Plus, health care reform is expected to increase eligibility for Medicaid, by 16 million Americans, according to the CBO.

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Today, I would like to touch upon our background, the levels of costs that the Medicaid plans incur and the sources of cost increase in 2010. 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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As you may know, we have been performing these benchmarking studies for many years. Sherlock Company is now completing its 14<sup>th</sup> consecutive annual survey of health plan operations and today's benchmarks are based on the cumulative experience of 514 health plan years. In all of our various universes this year, the 60 health benefit organizations serve nearly 50 million members. The Sherlock benchmarks' focus is on administrative expenses and related operational drivers, but they also include metrics of health care utilization.

Sherlock benchmarks are widely accepted. For instance, health plans serving well more than 60% of all people with private insurance are users of our 2011 edition benchmarks, even though we began publishing them only three months ago. 70% of all Blues participate, most AHIP board members are officers of plans using our benchmarks, most publicly traded companies are users and all or parts of five publicly traded companies with health plan operations have been participants within the year. Since our benchmarks are designed for plans' internal use, they have a high ratio of insight to effort.

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 appendix.

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The 11 plans that participated in our benchmarking study for Medicaid plans serve 5.7 million people under comprehensive health benefit plans, of which 4.3 million are Medicaid HMO members. On average, 73% of revenues of these plans stemmed from a comprehensive Medicaid product, though they also served commercial and Medicare Advantage as well. There was a mix of for-profit and non-profit organizations represented in our panel. The plan's we'll discuss here collectively serve 16.5% of all Medicaid MCO members.

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Here are the PMPM administrative cost levels for 2010, segmented by clusters of functions. The figure numbers on the slide refer to our free newsletter, *Plan Management Navigator*, which is available on our web site. Median core administrative costs for comprehensive products were \$21.56 per member per month and if you refer to Appendix A, you'll see that this is 3.8% less than the \$22.41 reported last year. This is an imperfect comparison since the plans in the annual universes differ, though it is noteworthy. The biggest difference is that Corporate Services costs are \$4.73 versus \$6.27 last year. The plans in this year's study are larger than last year, with an



average membership of 539,200 versus 393,931. This cluster of functions is where many of the scalable activities are found.

Total costs were \$23.74, 4.7% lower than last year's values of \$24.90. Marketing costs are 3.7% higher than the reported last year.

By the way, have a look at the Marketing cluster of functions' standard deviation divided by the mean. We use this calculation to express standard deviation, which would be expressed in dollars, in percent form. This ratio is also called the coefficient of variance. The coefficient of variance is double that of any of the other clusters. That reflects why we exclude these expenses from the core expenses: costs vary from state to state since the state laws governing marketing also vary from state to state.

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The more accurate way of understanding the trends in administrative expenses is to focus exclusively on the organizations that participated in our benchmarking studies for both 2011 and 2010. There were six such plans but the team doing the reporting for one organization changed so these changes are based on five organizations. This slide summarizes this.

Administrative cost for these plans increased in 2010. Looking at the core per member per month costs (that is, all expenses save marketing), the increase was 2.1%, a reversal from a decrease of 5.2% in 2009. To more accurately identify trend, we think that it is helpful to eliminate the effects of any changes in costs attributable to changes in a plan's product mix. We do this by reweighting last year's product costs by this year's product mix. So, holding mix constant, core administrative costs increased by 1.2% versus a decline of 5.8% in 2009.

Of the increases in core costs, Corporate Services grew fastest, by 5.9% as reported and 9.1% on a constant mix basis. Note also the slower growth for Provider & Medical Management on a constant mix basis compared to as-reported. This is due to the increasing importance of Medicare Advantage to these organizations.

Before I go any further, I need to quickly comment on a reporting quirk. Note that the core administrative expense growth runs slower than the component clusters of expenses. Also note that while cost trends are negative for Marketing, the total of Marketing and Core costs are greater than core costs alone. This results from using median rates of change for each of these clusters and overall. Medians, as the 50<sup>th</sup> percentile, mute the effect of extreme responses so we prefer them. But they can't be employed to perform calculations, occasionally giving rise to results like this.



As noted above, Marketing costs sharply decreased. Per member total costs declined by 6.4% on an as-reported basis and by 4.5% on a constant mix basis. The decline in marketing costs was less than that of last year, though the estimated cumulative effect is a per member decline of 36.5% over the past three years on a constant mix basis.

So, again because of the statistical quirk of median rates of change *total* per member costs grew by 6.1%, as-reported, compared with a decline of 5.4% last year. On a constant mix basis, total cost increased by 4.9% compared with a decline of 6.4% last year.

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This slide highlights the functional areas within each cluster that contributed to the changes in costs. We looked at both changes that were extremely dramatic as well as those changes in costs that were responsible for *most* of the change in the cluster of expenses. The later is the amount of change, weighted by the dollar cost. In most instances the functions that changed most dramatically also had the most impact on overall cost trend, on a weighted basis in 2010.

Corporate Services costs grew fastest in 2010, 5.9% PMPM on an as-reported basis. This cluster also grew in 2009. Corporate Executive and Governance was overwhelmingly responsible for this even though it is a relatively small function. This function includes activities related to corporate strategy: I imagine that consulting services related to adaptation to PPACA were an important part of this trend. This area also includes Lean and Six Sigma costs and we suspect that our participants may be especially aggressive here.

Finance and Accounting also increased in this cluster, perhaps also reflecting adaptations to the changing market.

Account and Membership Administration, had the second fastest growth at 5.4%. Enrollment/Membership/Billing and Claim and Encounter Capture and Adjudication declined while Customer Services grew slightly. Information Systems costs grew moderately and because of its size was the most important source of increase this cluster of costs on an as-reported basis.

Provider and Medical Management costs also grew, by 3.6% on an as-reported basis. This cluster of functions is comprised of Medical Management, like precertification and case management, and Provider Network Management and Services, tasked to respond to provider inquiries and to contract with providers.



Medical Management grew as Provider Network Management and Services declined. In fact, Medical Management grew so rapidly that its growth would explain all the cost increase for core functions on an as reported basis.

We exclude Marketing costs from core expenses since the values for each firm vary by the state laws under which it operates. Plans in some areas have very large internal sales forces while others do not.

Plans reported sharp declines in Sales and Marketing costs in 2010 of 6.4% on an as-reported basis. While most functions declined, Product Development / Market Research declined especially sharply while the cost-weighted decline in Advertising and Promotion was the chief source of the decline. Rating and Underwriting was unique in that it grew, on an as reported basis. This may be partly due to it being the repository for the HCC activities for these firms' Medicare products.

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This slide shows the mix shift in the continuously participating Medicaid plans. The plans grew at an average rate of 6.6%, notwithstanding a 3.0% decline in commercial business. By contrast, Medicaid HMO increased by 10.4% and Medicare increased by 36.5%. As discussed below, this appeared to have an impact on some of the cost trends.

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This slide is much like slide 7, highlighting the functional areas within each cluster that contributed to the changes in costs. Again, we looked at both changes that were extremely dramatic as well as those changes in costs that were responsible for *most* of the change in the cluster of expenses.

As on a constant mix basis, Corporate Services costs grew fastest in 2010, 9.1% PMPM compared with 5.0% last year. Corporate Executive and Governance was overwhelmingly responsible for this even though it is a relatively small function. I believe that the cost to adapt to the new environment were an important part of this trend. Actuarial also grew in 2010, for the second year in a row. This is unusual since the Actuarial function declined in each year from 2005 through 2008.

Account and Membership Administration, had the second fastest growth at 4.5%, compared with a median decline of 13.0% last year, on a constant mix basis. Information Systems increases



were central and explain, on this basis all of the increase in costs. Neither Enrollment/Membership/Billing, Claim and Encounter Capture and Adjudication nor Customer Services grew on a constant mix basis.

Provider and Medical Management costs also grew, by 2.6% on a constant mix basis, compared with a decline of 5.0% last year. Medical Management was, next to Corporate Executive and Governance, the most important source of cost increase on constant mix basis. By contrast, Provider Network Management and Services declined

Plans reported sharp declines in Sales and Marketing costs in 2010 of 4.5% on a constant mix basis as compared with a decline of 8.6% last year. While Product Development / Market Research declined especially sharply, the cost-weighted decline in the internal Sales and Marketing function was the chief source of the cluster's decline. Advertising and Promotion costs were also sharply off on this basis.

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While we prefer the PMPM metric for costs, there are some advantages to a percent of premium standard. It may provide a rough adjustment for cost of living, for example. If one does this, it is more intuitive to do so using premium equivalents for ASO relationships. Indeed, the rebate provisions of the PPACA are triggered by the MLR, a percent approach to health expenses.

This slide shows *core* administrative expenses as a percent of premium equivalents of 6.5%. Including Marketing costs, administrative expenses equal 7.8% of premium equivalents. Please note that it excludes taxes imposed by state governments as well as capital costs.

Note that the percent of premium equivalent of 6.5% is 50 basis points lower than last year's value of 7.0%, as shown in Appendix B. A precise comparison is impossible since medians don't sum and the universes differ. But note that Account and Membership Administration decreased by 40 basis points. Provider and Medical Management and Corporate Services increased however.

The decline in Sales and Marketing was 10 basis points to 0.9% of premiums or equivalents. Overall costs declined from 8.2% last year to 7.8% of premium equivalents this year.

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This slide shows the administrative expenses of each *product* offered by the Medicaid universe of plans. While the median Medicaid HMO mix was 81% of membership, the health care needs



of plan members vary quite a bit by product, and the associated administrative expenses do as well. I want to key on a few comparisons by way of illustration.

The ASO products had the lowest per member administrative expenses. The median costs for this product is \$15.02 PMPM. Similar commercial insured products average \$13.00 higher to administer PMPM. This largely reflects marketing but normally medical management costs are less in ASO products as well.

Medicare Advantage administrative costs are more than twice as high as comparable products for younger people, partly because of the high health care needs of seniors. Health care costs are normally entail costs of claims processing and customer service activities, which are reflected in the administrative expense levels. The effect of health care needs are especially evident when comparing the Medicare SNP product, at \$164.57 versus Medicare Advantage, at \$68.03.

Medicaid HMO have total costs of \$21.21, less than the insured commercial products offered by these plans. The people they serve are often younger and sometimes the plans spend little on marketing expenses. Some of the plans reported Medicaid expenses segmented by population, e.g., Low Income, Adult SSI and so forth. Note that the Adult SSI products costs considerably more PMPM than the Low Income.

Reporting was sparse for Child SSI and Medicaid Dual Eligible products this year. The one plan reported SSI costs are much higher than regular Medicaid.

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Note that on a percent of premium basis, the ranking of administrative expenses by product is different as shown on this slide.

While the lowest cost products are ASO (4.5 as a percent of premium equivalents), Medicare Advantage is also quite low, at 7.6%. The commercial products are higher, at 8.5% median. Medicaid HMO was 7.9%.

While marketing costs distort this a bit, the underlying reason for the lower costs of Medicare Advantage measured as a percent of premium is that these populations incur higher medical costs for their associated administrative support. Health care costs *per claim submitted* tends to be 20% higher for Medicare than for equivalent commercial members. Similarly, the health care need that prompts a customer service inquiry will tend to have a higher dollar value. Thus the percent of revenues tends to be less for these high health care cost product lines.

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Before I end my formal presentation, I would like to touch on Figure 6 of the October *Plan Management Navigator*. The Medicaid plans report median core administrative costs of \$20.04 PMPM, compared with \$21.68 for IPS plans and \$21.13 for the Blues. Measured as a percent of premiums, the Medicaid plans report core administrative costs of 6.7%, compared with 10.4% for IPS plans and 9.7% for the Blues.

When we looked at the components of this, were some generalizations were apparent. Information Systems costs were much lower, but they tended to be offset somewhat by higher Medical Management and Provider Services costs. IS costs were especially lower in Application Acquisition and Development costs. Enrollment costs also tended to be lower.

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This is the end of my formal presentation. Just to reiterate, core administrative expenses were 6.5%, down from 7.0% last year. Total administrative expenses were 7.8% of premiums compared with 8.2% last year.

Core PMPM administration increased by 2.1% versus a decline of 5.2% in 2009. However, holding product mix constant, core PMPM costs increased by 1.2% versus a decline of 5.8% last year.

These are trends one might expect under health care reform. Areas like IS, Corporate Executive and Governance, Finance and Accounting and Medical Management were mainly responsible for this.

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

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

### *Selected Questions*



If there are no further 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.

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

Thank you.