



*Transcript*

## Health Plan Administrative Costs: A Review of Medicare Results

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<Title Page>

Welcome to our review of the benchmarking study for Medicare Plans. Among the various benchmarking studies that we perform, this study has especially interesting application. Not only is this of interest to health plan managers, boards and others, this information is also of interest to policy people.

While most of you are responsible for achieving that optimal mix of costs and benefits that lead to superior long term performance for your plans, I would also like to welcome those of you who are in the legal and policy community as well.

I want to begin by thanking those of you who participated this year. Some of the plans that participated are small so that participation represents a considerable investment on their part.

By the way, all of you who are participating in our various studies should now have received Volumes I. Operational metrics have also been distributed to the Blues and Independent / Provider-Sponsored, Medicaid universes and will be delivered to the Medicaid universes shortly. Blues and Independent plans should have received health care utilization and medical management metrics and Medicare and Medicaid should be distributed in coming weeks.

As you may know, this is our eleventh consecutive year of performance benchmarking for health plans. Our various universes serve more than 36 million Americans, or one of every five insured, and health plans serving one in every three insured people are users



of our benchmarking studies. The seven plans participating in the Medicare study serve 1.2 million people. Medicare Advantage and Medicare SNP comprises only about 20% of all their members but the median share of revenues comprised by these products was 49% for this universe, enough in our judgment to be the focal point of their operations.

Plans participating in our benchmarking studies agree to complete our survey form in exchange for the resulting report. Administrative costs must be segmented by product as well as by functional area. Without belaboring the issue, we do have an array of very good checks to promote data quality.

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Today, I would like to touch upon trends in Medicare health plan administrative costs, their levels of costs, how their costs differ by product and how other universes compare with that of the Medicare universe. This will be a fairly brief presentation because much additional content is available in *Plan Management Navigator* for Late October. Then I'll try to answer any questions that you might have.

Before I begin, I would like to point out to our Medicare study participants that the numbers you see in these slides will differ slightly from what you have received. The reason for this is that we have included mental health and pharmacy costs and revenues in this presentation, which may be more readily understood by a broader audience.

Also, from time to time we will refer to values of expenses, which are normally the medians from our universes. We choose this as the best measure of central tendency. Accordingly, rates of change normally refer to rates of change in those median values and, you will note, on a raw basis modest product mix changes can make them volatile. Finally, some of the slides will refer to figure numbers. These correspond to those found in the Late-October *Plan Management Navigator*.

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In 2007, Medicare Plans posted modest growth in PMPM administration. Total costs increased by 3.3% PMPM versus 41.9% last year. Medicare plans increased their offerings of very costly Medicare products, which distorted upwards its real growth. For firms that participated in both 2006 and 2007, the weighted proportion of premiums and equivalents attributable to Medicare products increased to 59.5% from 56.3%. While



the increase was in low single digits, their costs are so high as to distort trend. Accordingly, after backing out the effect of this and other mix changes, Medicare PMPM costs increased by 1.9% rather than the 3.3% as reported. This was up from 0.9% on constant product mix basis in the prior year.

Marketing expense growth declined, from 59.1% to 22.3% on a product mix adjusted basis. While Rating and Underwriting grew fastest overall, broker Commissions were the fastest growing high dollar value of expenses. Internal Sales and Marketing actually declined in 2007. On a product mix adjusted basis, Marketing growth declined from 27.5% in 2006 to 14.3% in 2007.

The mix shift in favor of Medicare Advantage was especially evident in trends in Provider and Medical Management. The PMPM decline among Medicare plans was 12.1%, compared with a 35.2% increase last year. But, backing out the effect of mix changes, Medicare Provider and Medical Management declined even further, by 16.7%, compared with a decline of 11.0% last year. Medical management declined by 24.1% PMPM, on a constant product mix basis. I mentioned the increase in the Medicare share in 2007, I should add that on a weighted basis, Medicare products surged from 38.3% in 2005 to 50.0% in 2006.

Account and Membership Administration growth was affected by increases in both Enrollment / Membership / Billing and Customer Services costs. This cluster increased by 1.8% compared to an increase of 32.3% last year.

On a constant mix basis, expense growth increased, to 5.6% from a decline of 7.7% last year. Customer Services costs actually declined 13.6% PMPM on this basis, while Enrollment / Membership / Billing costs increased on this basis. The biggest single source of increase was Information Systems costs.

Corporate services cost growth has been trimmed dramatically in 2007. In 2007, PMPM expense growth increased by 5.1% compared to 44.5% in 2006. But on a product mix adjusted basis, costs were flat for the Medicare plans as compared with an increase of 1.2% last year among our respondents. Corporate Executive and Governance and Association Dues were responsible for the increases.



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This figure shows the distribution of administrative expenses of health plans focusing on Medicare. I am not going to belabor this since it is pretty self explanatory. But I do want to make a few casual observations.

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To put this distribution of expenses in some context, please see how the expenses of the clusters of operations compare between the universes.

Nationwide, according to Kaiser Family Foundation, Medicare managed care has grown from 7.6 million in 2006 to 10.1 million in July of 2008. These plans have also shown growth as I previously noted. Accordingly marketing costs are \$10.49 PMPM compared with \$8.23 for IPSs and \$7.46 for Blues. Marketing expenses are often minimal in Medicaid managed care plans, for that universe the median Marketing expenses are \$2.98. By the way, we sometimes call the Independent / Provider-Sponsored plans IPS plans since it is less of a mouthful.

Note also that the \$6.48 in Provider and Medical Management is pretty high. The comparable numbers for Independent / Provider-Sponsored plans and Blue Cross Blue Shield Plans are \$4.39 and \$3.12, respectively. The Medicaid universe has costs of \$6.19. These Medicare plans both have a greater population of people who require greater health services, and they also invest in care management. Our early October, September and July *Navigators* contain the comparable data for these other universes.

Medicare plans have Account and Membership administration that is higher than that of the larger Independent / Provider-Sponsored plans and Blue Cross Blue Shield Plans. But because these plans are typically smaller than the ones in other universes, it is notable that these costs have a median value of only \$0.61 PMPM higher than the Blue Cross Blue Shield plans. They are substantially higher than the highly specialized Medicaid plans with costs of \$7.72 and less so than \$9.30 for the IPS's.

If economies of scale are found anywhere, they are found in Corporate Services. Median PMPM costs for Medicare Plans, with 170,000 members, is \$9.94. For Medicaid Plans,



with 210,000 members is \$5.00. For IPS plans, with 250,000 members on average, PMPM costs are \$4.36. Blue Cross Blue Shield Plans, with 750,000 members have median corporate services costs of \$4.40.

As we'll discuss later, regardless of the universe, it is expensive to offer Medicare managed care products. Accordingly, the total costs PMPM are considerably higher at \$39.26 versus \$24.30 for Medicaid, \$25.36 for Blues and \$29.49 for IPS plans.

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This slide shows the distribution of costs expressed as a percent of premium equivalents. In terms of order of expenses, it tells much the same story as the PMPM data. Account and Membership Administration is the largest piece of administrative expenses, but Marketing and Corporate Services expenses come closely behind. Provider and Medical Management is by far the smallest.

I do have to add that the proportions are affected by the nature of the Medicare population that is served. The denominator for these ratios is premiums and the numerator is the relevant administrative expense. The premium is developed, based on health care costs which are considerably higher and administrative costs which are higher but less so, than is found for commercial products.

Let me offer a concrete example. It turns out that among Blue Cross Blue Shield Plans, health care costs are three times higher for Medicare versus commercial. But the number of claims is roughly 2.5 times. Therefore the health care cost per claim is approximately 20% higher. Accordingly the administrative costs as a percent of revenues is less.

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This slide shows administrative expenses expressed as a percent of premium equivalents, for Medicare plans and the other three universes. The scale effect is evident for Corporate Services for this universe as its expenses are high relative to premiums when compared with other universes.



Account and Member Administration are actually lower than most of the other universes because of the focus on Medicare, as previously discussed. The focus on care management is also clear in the Provider and Medical Management numbers, which are lower only than the Medicaid universe. Marketing expenses are high and only exceeded by Blue Cross Blue Shield Plans.

Overall, the focus on Medicare managed care offsets the scale disadvantages of this universe so that as a percent of premiums, this universe administration that is equal to or lower than most of the others.

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The difference in the costs of various products is shown in this slide. Medicare plans collectively offered nine different products although, as previously noted, they were focused on Medicare managed care. While Medicare Advantage had total costs of \$73.92, and the median costs of Medicare SNP products offered by this universe were \$105.21, they offered numerous products with much lower costs. Insured commercial products were \$30.79, and its ASO counterpart was \$17.03. Med Sup and Medicaid were \$30.54 and \$24.65, respectively. It is the high weighting of the expensive Medicare products that gives rise to the high relative costs as shown in Figure 5.

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This slide also shows the differences in the costs of the various products, but expressed as a percent of premium equivalents. I would like to point out, however, that the order of expenses differs. For instance, note that SNP and Medicare Advantage are the high cost products on a PMPM basis, but they are among the lowest costs on a percent of revenue basis.

As I previously mentioned, it is helpful to conceptualize this counter-intuitive difference by recalling that the cost per claim submitted is higher in the Medicare population. This is helpful with respect to policy discussions in that it underscores why it is inappropriate to compare the percent of premiums devoted to administration in commercial lines with the regular Medicare program.

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Finally, I would like to end with a comparison that we touched on earlier. This slide shows a comparison between the various universes for their Medicare products. Focusing on the PMPM expenses for the core products, these plans had costs that were slightly higher than those of IPS and BCBS plans. On a percent of premium basis, they were lower than that of the Blue Cross Blue Shield Plans but higher than IPS plans. Conventional wisdom reflects that there are economies of scale in many industries so that it is not intuitively obvious that the Medicare plans should even be competitive. After all these plans have roughly 170,000 members on average, compared with 210,000 members for Medicaid plans, 750,000 for Blue Plans and 250,000 for IPS plans. Yet relatively small size is not prevent them from being competitive.

<Figure 11>

Again, many thanks for joining us in this conference call. I'll now to answer any questions that you might have.

If those are all the questions for today, let me close by inviting you to contact me about any additional questions that surface. We do intend to post a transcript of the formal part of this presentation, along with the slides on our website.

*<Appendix slide follows. It describes the functional areas found in the each of the functional area clusters discussed in this presentation.>*