



*Transcript*

## Medicare Administrative Costs: A Review of 2008 Results

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<Title Page>

I am Doug Sherlock. Welcome to our summary of the benchmarking study for Medicare Plans. This is the third of a series of presentations on health plan performance metrics. Independent / Provider - Sponsored financial metrics were summarized in July, Blue Cross Blue Shield Plans in August and we expect to host a similar web conference for Medicaid plans in two weeks.

I'll share who *we* are in just a moment but you may be interested in knowing who *you* are. There are now 41 people registered to participate in this web conference of which 85% were with health plans and 15% were consultants or affiliated with business process outsourcing firms.

Some of the health plans who are on the call are participants in our benchmarking studies. A byproduct of their participation are the reports that are summarized today. This summary benefits the health plan industry as a whole, and we are grateful for this.

Most health plans endeavor to closely manage their administrative costs. But with the economic conditions and the proposed cuts in Medicare, this management takes on additional urgency.

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Today, I would like to touch upon our background, the levels of costs that the Medicare plans incur and the sources of cost increase in 2008. Then I would like to speak to the

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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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To briefly summarize the key points of this presentation, costs increased in 2008. Looking at the per member per month costs, the increase was 8.3%, up from 3.3% in 2007. Some of this represented a shift in the product mixes of the participating plans. Holding mix constant, costs increased by 10.2% versus 1.9% in 2007. Of the cost increases, Marketing costs sharply increased and comprised the majority of the increase, offsetting flat to down Corporate Services costs. Note that these plans had very sharp growth 33.5% as against 10.1% for all plans.

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As you may know, we have been performing these benchmarking studies for many years. Sherlock Company is now completing its 12<sup>th</sup> annual survey of health plan operations and our benchmarks are based on 396 health plan years of experience. In all of our universes this year, the plans serve 39 million members. Our focus is administrative expenses and related operational drivers, but also include metrics of health care utilization.

These benchmarks are widely accepted by health plans and others, and plans serving more than one in every 2.7 insured people used our 2008 metrics. Most Blues and most plans whose officers serve on the board of AHIP are users or participants. Health plans serving 20-25% of all Medicare private plan membership are participants in our benchmarks, either through this or other universes. Our benchmarks benefit from cross fertilization across universes. Since this is designed for plans' internal use, it has 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 Medicare plans serve 3.0 million people under comprehensive health benefit plans, of which 1.1 million are Medicare private health plan beneficiaries. On average, 53.8% of members and 67.1% of revenues were served under a comprehensive Medicare product. 25.8% revenues were commercial and 7.1% of revenues Medicaid.

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Here are the results for 2008. Median administrative costs for comprehensive products were \$46.46 per member per month and if you refer to Appendix A, you'll see that this can be compared with \$39.26 last year. 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; we think that medians are often a better measure of central tendency. Comparing this slide with Appendix A is an imperfect comparison since the plans in the annual universes differ. Despite this, it is notable that Marketing costs increased by \$7.29 to \$17.77, and Account and Membership Administration increased by \$2.59 to \$13.43. Account and Membership Administration includes all of the core activities of health plans - Customer Services, Claims Adjudication, Enrollment and Information Systems. Corporate Services costs increased more modestly. By the way, the figure numbers on the slide refer to our free newsletter, *Plan Management Navigator*, which is available on our web site, along with this presentation.

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If you look at the two right columns labeled "2008 Data", you'll see more appropriate comparisons but they tell a similar tale. In this slide, we have made all comparisons reflect the same plans in both years. Focusing on the bottom row and the left columns for each year, PMPM costs increased by 8.3% in 2008 versus an increase of 3.3% in 2007. Obviously, this year reflects a high rate of increase.

That high increase difference grows if you hold constant the product mix. Again, I am referring to the bottom row, but in this instance, the right columns. (Incidentally, we control for mix by weighting the 2007 expenses by the 2008 product mix. Remember, plans report to us expenses by functional area and also by product.) Adjusting for this, expense growth is 10.2% higher than 1.9% last year.



Note particularly the sharp increase in Marketing costs. They were up 18.0% before backing out the effect of product mix differences, and 29.1% holding constant that mix. This is a faster rate of growth than for 2007 when holding constant the mix. It is plain that Medicare plans sharply increased their commitments to this cluster of functions.

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I previously mentioned the greater importance of certain product areas and this slide loosely quantifies this. Membership for Medicare SNP increased very sharply at 91.1%, while Medicare Advantage increased at 29.8%. Indemnity & PPO insured also had a relatively large increase at 25.6%. For all products, membership increased by 9.4%.

The revenue mix for Medicare SNP and Medicare Advantage increased by 0.5 and 0.2 percentage points, respectively. The revenue mix for Indemnity & PPO increased by 4.2 percentage points.

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This slide highlights the functional areas within each cluster that contributed to the increase in costs. We looked at both *fast* growing cost areas as well as costs that were responsible for *most* of the increase in the cluster of expenses.

Marketing costs comprised two-thirds of the dollar increase in PMPM costs in 2008. Marketing costs increased by 18.0% in this universe, lower than the 22.3% increase last year. External broker Commissions cost growth was relatively high. Broker Commissions, because of its high relative size, was responsible for the highest proportion of this year's cost increase for this cluster, by far.

Medical and Provider Management, at a 13.6% growth rate, was the second fastest growing cluster. While Provider Network Management and Services grew modestly, Medical Management / Quality Assurance / Wellness grew at a rapid rate and was responsible for nearly 90% of the total increase for that cluster.

Growth in the cluster of Account and Membership Administration was more modest at 6.0% in 2008. Enrollment costs grew faster than the cluster while Claim and Encounter Capture and Adjudication grew more slowly but the fastest growing area was Customer Services costs by nearly 10.0%. The largest increase, with respect to the total



dollars, was Information Systems. Increases in IS expenses were equal to the additional dollars in the next two functions combined.

Corporate Services costs increased by only 1.8% on a PMPM basis in 2008. Three of the five functions within the cluster actually declined. The tiny Association Dues and License / Filing Fees costs was the fastest growing area and had a meaningless effect on the total increase. The functional area of Corporate Services posted a decline in per member costs and was the major contributor to the fact that the cluster of Corporate Services to had a modest growth.

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This slide reflects the contribution to expense growth of various functions *holding constant the product mix*. Again, the overwhelming reason for the cost increase stemmed from marketing cost growth. Marketing expenses grew by 29.1%, from 18.0% reported without this adjustment. It was higher than the 14.3% rate of last year. Internal Sales and Marketing costs were primarily responsible for the increase in this cluster. Notably, Rating and Underwriting grew the fastest at 45.3%, PMPM, in 2008. Broker commissions grew rapidly as well, and were the second most important contributor to growth. The high expense growth here may well be related to the very rapid growth enjoyed by these plans.

While the rate of growth, at 11.2%, in Medical and Provider Management was lower than the as-reported rate of 13.6%, it was still quite high. It compares with an adjusted rate of -16.7% last year. Provider Network Management and Services costs did not grow at all on a PMPM basis, while spending for Medical Management / Quality Assurance / Wellness grew by nearly one-third! It was, accordingly, entirely responsible for the increase in this cluster of expenses.

The expenses committed to Account and Membership Administration increased from 6.0% on an as reported basis to 13.6% on a constant mix basis. This is higher than the 5.6% adjusted rate for 2007. Claim and Encounter Capture and Adjudication had the greatest increase while Enrollment represented most of the increase, measured in dollars. Information Systems costs grew slower than last year on a mix adjusted basis, and was the second largest contributor to cost growth in 2008.



On a mix-adjusted basis Corporate Services costs *decreased* by 10.1%, compared with an increase of 1.8% on an as-reported basis, and stable on an adjusted basis for 2007.

Actuarial costs represented the highest decrease on a per member per month basis, while Corporate Executive and Governance was most responsible for the decrease in the cluster of expenses. Corporate Services comprised the second most important factor in this decline in this cluster of expenses.

So, just to reiterate, cost growth was relatively high for participating Medicare plans, compared with recent trends. But regardless of how product mix changes are treated, increases in Internal Sales and Marketing and Medical Management were central factors in the growth that did occur. Together these functions comprised more than 80% of the PMPM increase in total costs.

The modest growth in the Corporate Services cluster and its decline on a mix adjusted basis is notable and, arguably related to the increase in Marketing costs. While very few administrative functions are scalable, many of them are found here. The sharp growth for these plans may stem from the “investment” in marketing, resulting in some operating leverage.

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This slide shows administrative expenses as a percent of premium equivalents of 10.2%. Please note that it excludes taxes imposed by state governments as well as capital costs. Our calculations of premium equivalents is discussed in the October edition of *Plan Management Navigator*.

Note that the percent of premium equivalent of 10.2% is 80 basis points higher than last year’s value of 9.4%, as shown in Appendix B. A precise comparison is impossible since medians don’t sum and the universes differ. But note that Marketing increased by 70 basis points, while corporate services declined by 30 basis points. Again, there is the possibility of interaction between marketing, growth and corporate services costs.

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This slide shows the administrative expenses of each product offered by the Medicare universe of plans. The health care needs of plan members vary quite a bit by product as



do the associated administrative expenses. I want to key on a few comparisons by way of illustration.

The ASO products had the lowest per member administrative expenses. It runs approximately \$17.73 PMPM. Medicare Advantage administrative costs are more than three times as high as comparable products for younger people, partly because of the high health care needs of seniors, but this year was also affected by the high marketing expenses associated with this product. The most expensive product offered by Medicare plans is their Medicare SNP product at \$175.67 PMPM, followed by Medicare Advantage and PFFS. But on a percent of premium basis, the ranking of administrative expenses by product is different as shown on the next slide.

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Percent rankings are different than PMPMs. The lowest cost products tend to be Medicare, with MA and PFFS at less than 10%. The commercial products are higher, typically 10.5%. While marketing costs distort this a bit, the underlying reason for the difference is that seniors incur higher medical costs for their associated administrative support. For instance, health care costs per dollar of claim submitted tends to be 20% higher. Also, 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 as well.

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This is the end of my formal presentation. Just to reiterate, PMPM administration increased by 8.3% versus 3.3% in 2007. However, holding product mix constant, PMPM costs increased by 10.2% versus 1.9% last year. This increase in costs was more than 67.3% attributable to growth in Marketing costs.

I have attached to the end of this presentation some appendices in support of this presentation. They include our publication schedule for our benchmarks, 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 Medicare 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.

I want to add that we'll be having one more web conference in this series. In two weeks, we'll perform some comparisons for the Medicaid Universe. Late in the fall, we'll resume our series on operational drivers of functional administrative costs, with Erin Sawchuk. We'll follow up in coming weeks with a schedule and hope that you will consider participating again in these web conferences.

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.