

Seniors Marketplace: Addressing a New Consumer Base in an Unstable Medicare Climate

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The Medicare marketplace abounds with risks and opportunities, creating a sense of uncertainty and the prospect of significant market potential. While Medicare represents a strong growth market for the next two decades and is one of the few high-growth health insurance segments, health care executives face ambiguity on several fronts: reimbursements, regulation, and profitability.

Much of the future Medicare growth prospects are associated with the Baby Boomer generation, which reaches Medicare eligibility in 2011 and brings fundamentally different attitudes and greater expectations for their health and coverage. Combining this new consumer base with the uncertainty surrounding the regulatory and legislative environment, many health care executives continue to wrestle with the decision of whether to further invest in the Medicare market or harvest their current position. While reimbursement and structural risks exist, Oliver Wyman analysis suggests that insurers can mitigate these risks by carefully targeting market segments (i.e., geographies, products, consumers); building capabilities that drive long-term value; and diversifying their Medicare portfolio to hedge against federal program changes.

Medicare in 2009 and Beyond

To determine the right posture for your company to take toward Medicare, it is important to understand how the market dynamics align with your company's position and capabilities.

The Risks Are Real

The risks facing Medicare Advantage (MA) players include continued regulatory changes, the shifting role of the employer in sponsoring retiree benefits, and tougher competition.

Significant regulatory uncertainty. Given the U.S. financial turmoil and election, the likelihood of legislative action related to MA reimbursements and program structure increases. In particular, MA faces intense scrutiny because of the notable payment differential relative to Original Medicare rates. Private-fee-for-service (PFFS) has been under attack by Capitol Hill because of past marketing practices, high reimbursement levels, and unmeasured value-add. Unlike health maintenance organizations (HMOs), PFFS has operated with minimal regulatory requirements. Recent legislation is bringing changes to PFFS such as several new marketing requirements for MA and PDP in 2008/09; quality improvement programs by 2010; and network requirements by 2011. And additional disruptive regulatory risks may still be in store for PFFS.

Following the Medicare Improvements for Patient and Providers Act (MIPPA) guidance, plans are scrambling to reassess their current MA strategies while turning their attention to the Obama Administration, in order to assess pending changes, their magnitude, and timeframe.

Shifting employer role. As retiree health costs grow at nearly 13% per year, employers continue to decrease their retiree benefit offerings at the rate of 1-2% per year, resulting in a greater number of seniors spilling into the individual retiree market. Employers that choose to remain in the game are looking to group MA and other product options

for help with managing their retiree liabilities. Health plans will need to evaluate current employer offerings and understand employer preferences in order to design products that will ease group retirees' transition to Medicare. Exploring network-based MA offerings, developing individual transition products, and targeting areas with higher membership concentrations are other means for health plans to achieve scale and serve evolving employer needs.

Competition increases as new players vie for seniors business. MA membership has grown to account for 23% of national age 65+ Medicare enrollment in 2008. Despite over 100 new players entering the MA market since 2004, the national MA market is fairly concentrated, with the top seven players accounting for 53% market share (Exhibit 1). Nevertheless, many companies continue to place their bets in the MA space; some are focusing on early retirees (pre-65), while others build networks and explore new MA product offerings.

The Opportunities Are Also Significant

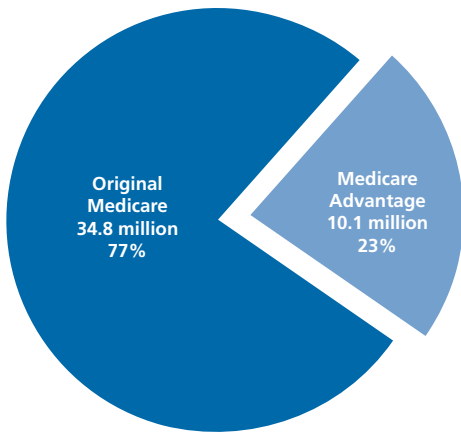
Simultaneously, MA represents an attractive growth market for health insurers and an area of strategic importance as it prepares health plans to compete in the approaching, largely retail marketplace.

Large growing market. The U.S. seniors population is poised to grow over 3% annually (three times the rate of overall population growth) for the next two decades and includes more than 43 million beneficiaries and \$460 billion in spending. This growth is driven by the 70+ million Baby Boomers, who begin to reach Medicare eligibility in 2011. By 2015, 34% of the U.S. population will be 50+ years old (Exhibit 2). Because this incoming generation of seniors is nearly twice as likely to select MA plans as their predecessors, we project migration from traditional FFS to MA will continue¹. This generational product preference creates ongoing growth opportunities for MA plans, particularly for players who best address seniors' needs and better manage health care costs for this higher-risk population.

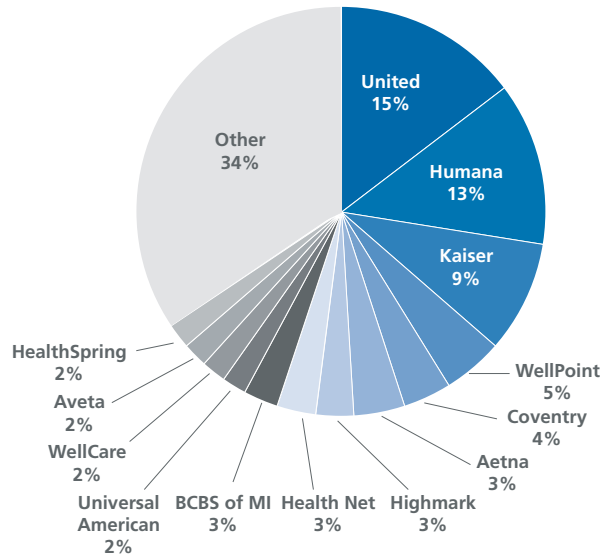
¹ Oliver Wyman seniors survey, December 2007

Exhibit 1 2008 national (65+) Medicare enrollment and competitive share

Medicare enrollment

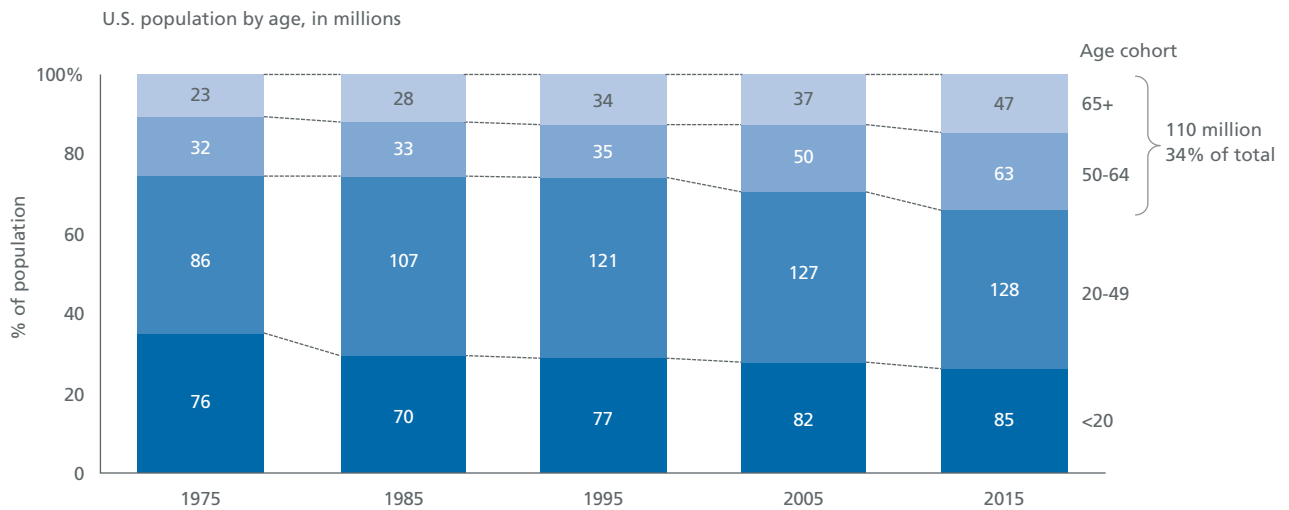


2008 National MA share



Source: CMS, September 2008; Oliver Wyman analysis

Exhibit 2 The composition of the U.S. population is aging, driving opportunity in the Medicare space



Source: U.S. Census, Oliver Wyman analysis

National market trends toward networked products. While the majority of historical MA growth occurred in PFFS plans, network-based products have gained greater market and plan interest—with Regional PPOs and Local PPOs experiencing 72% and 64% annual enrollment

growth, respectively, in 2008 (Exhibit 3). Further, the new network requirements for PFFS plans will cause managed care organizations (MCOs) to aggressively build network-based products for compliance and as a way to achieve market differentiation. Building a physician network

Exhibit 3 National MA market trends

National MA enrollment growth by product

	2007	2008	Growth
HMO	5,757,442	6,434,510	12%
PFFS	1,664,039	2,273,894	37%
Local PPO	402,423	659,601	64%
Regional PPO	167,483	288,816	72%
Cost	386,938	345,563	-11%
Other	305,223	39,606	-87%
Total	8,683,548	10,041,990	16%

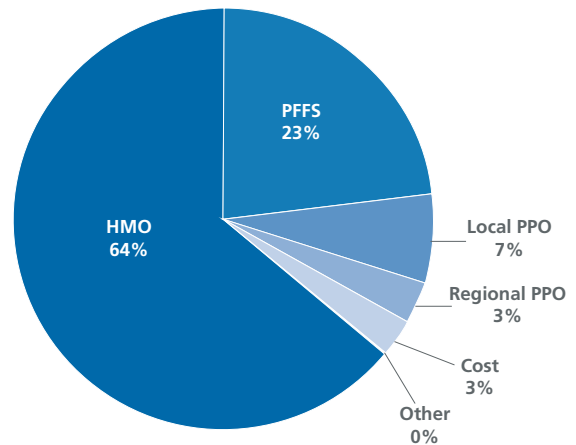
Source: CMS, July 07 - July 08; Oliver Wyman analysis

with experience in geriatric care will enable more coordinated and proactive health management, and can help health plans actualize a more comprehensive approach to addressing the unique needs of the senior population.

Baby Boomers are likely to change the game.

Future generations of seniors have greater expectations for health care coverage and consumption given their distinct generational attitudes toward personal health, health care, wealth, insurance, and retirement. Given that the first wave of Boomers turned age 60 in 2006, players with capabilities to serve the pre-65 seniors population may gain a competitive advantage by establishing relationships with this group prior to Medicare eligibility. Boomers bring enough clout to drive health care industry transformation, and the players who focus on younger seniors' unique needs and attitudes are likely to realize long-term wins in the Medicare market. One of the trends driven primarily by Boomer interest is the notion of a health and wealth convergence. With 95% of Americans worried about finances in retirement and health care costs being seniors' second-greatest retirement fear (28%), the market is starting to consider both financial and health needs in retirement—as is evidenced by the rapid

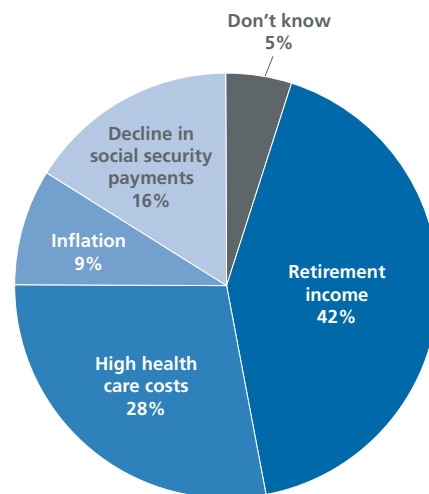
National MA-only enrollment breakout by product



Source: CMS, September 2008; Oliver Wyman analysis

movement of financial service companies entering the health care space to address this confluence of market needs (Exhibit 4). There has been much speculation about how health plans might partner with the financial services industry to provide holistic retirement solutions. While in its infancy, the health and wealth convergence has forced the market to rethink the capabilities required to effectively serve working, retired, well, and frail seniors.

Exhibit 4 Health care costs are the second greatest fear seniors have about retirement



Source: National Association for Variable Annuities, Retirement Fears Survey

Despite the risks and uncertainty surrounding Medicare, the seniors market is still a highly attractive business opportunity for players equipped to compete for the long term. By building the right capabilities and focusing on the unique needs of the seniors population, health plans will position themselves to profitably capture their share of this growing market.

A Strategic Approach to Medicare

In order to capture the Medicare opportunity, health plans must make investments to address market preferences and competitive pressures while preparing for market shifts. The right approach for each company will vary based on that company's current market position, growth goals, and risk tolerance; yet three positioning options allow plans to balance the opportunities and risks present in the Medicare market: selective market development, long-term value creation, and business model diversification.

Selective Market Development

Health plans perform better when they allocate disproportionate capital, with the goal of offering the highest-fit products, to targeted customer segments in attractive geographies. Each component of a health plan's strategic approach should enable it to carefully target the segments, geographies, and product areas that best align with the company's position and capabilities. As a health plan looks to develop its Medicare business, it should select markets based on underlying attractiveness and the target consumer segments it can successfully serve, given its organizational strengths. In addition, the health plan must direct its attention to developing products, services, and capabilities to fit the needs of its target segments.

By identifying and targeting distinct attitudinal seniors segments, health plans can begin to build infrastructure and capabilities to directly address the needs of its highest-fit consumers. For

example, in order to reach a subset of the incoming generation with lower health care costs today but still address concerns about future health care expenditures, health plans may consider offering a Medicare Savings Account (MSA) given Boomers' familiarity with high-deductible products in the commercial market. As the industry shifts to a retail market, consumer segmentation will become increasingly critical to the success of major market development initiatives. Oliver Wyman work in this space has revealed the existence of discrete, market-specific seniors segments with varying attitudes and needs—enabling health plans to tailor products, services, channels, messaging, and approach to each target segment. In addition, health plan leadership should vary their level of MA aggressiveness and investment by geography based on the attractiveness of that market relative to the health plan's strengths and objectives. Each organization has a unique set of capabilities. As such, there is no single formula by which every MCO can assess market attractiveness. By marrying segmentation with a market attractiveness assessment, successful players in the MA market have aligned their products to the specific needs of target seniors segments in their most attractive markets.

Long-Term Value Creation

The evolution of MA and the resulting increased competition for seniors' business will continue to cause market shifts requiring health plans to invest in value-creation capabilities. While it is important to not lose sight of administrative costs, focusing on cost-structure improvements alone will not position players for long-term market leadership. To win in the Medicare market in the coming years, health plans will need to bring innovative solutions that change the competitive nexus from administrative costs to total value.

Today's Medicare program design has caused MA plans to shift from a business model focused on attracting the healthy to one that creates market value by embracing those who have been historically underserved—frail and rural seniors.

While PFFS plans were introduced with minimal CMS requirements to ease their introduction to the market, health plans and the government have come to realize that effectively serving the elderly requires a stable Medicare-specific provider network with experience in delivering and managing the care of the senior population. With the recent MIPPA regulatory guidance, the message is clear: Value-based investments will be required to play in tomorrow’s Medicare marketplace.

Furthermore, various research on life maturity regards ages 50 to 59 as the “change” years—with an individual’s life circumstances beginning to shift significantly during his or her early to mid-50s. While Medicare alone represents a large market opportunity, utilizing a broader definition of seniors to include pre-Medicare eligibles will allow MCOs to meet seniors’ needs today and position organizations for the future. By reaching out to the broader seniors (age 50+) market—which is characterized by a mix of age, life circumstances, and work status—organizations can better understand the needs of their senior population and develop the mechanisms required to capture seniors as long-term customers. MCOs should seek to identify opportunities to establish relationships with and better serve younger seniors (age 50-64) and leverage investments historically targeted at Medicare beneficiaries (age 65+).

Organizations willing to make the shift will be required to invest in capabilities that directly address the market risks associated with serving the seniors population, like provider networks and care coordination, in order to remain competitive and achieve long-term gains in Medicare (Exhibit 5).

While the rules, structure, and product names in Medicare are likely to change, there will be ongoing opportunity for health plans willing to invest in capabilities that drive value by delivering better care, controlling costs, and improving benefits for seniors and their families.

Business Model Diversification

While selective market development and long-term value creation are keys to Medicare success, plans must also consider whether to diversify their investments in Medicare in order to hedge against program changes in select areas. While the uncertainty around this highly regulated federal program is not a new phenomenon, the potential impact of modifications to Medicare has some health care executives reluctant to invest further in this market. Others continue to invest but lack adequate contingency plans to account for likely marketplace changes. Health plans frozen in a state of indecision or making undiversified investments face the risk of financial losses as legislative shifts occur and more responsive, market-savvy

Exhibit 5 Investing in capabilities to address market risks

Market risk	Value-creation capability
New regulatory requirements	Adequate provider networks, chronic care improvement programs
High utilization due to declining health	Health management, care coordination services, geriatric-focused provider network
Adverse selection	Wellness programs, prevention incentives, and Medicare Savings Accounts
High utilization due to inappropriate use of care	Seniors advocacy services or other form of health care system navigation service
Uncontrolled chronic conditions	Enhanced drugs coverage, coordination of care across the continuum, medication therapy management
Increased competition	Outreach to seniors prior to Medicare eligibility, consumer segmentation
Shift in employer’s role	Group and individual retiree solutions
Fixed-income consumers	Affordable plans with predictable expenses

Source: Oliver Wyman analysis

competitors vie for their Medicare market share. MCOs should assess their commitment and approach to the Medicare market as they would evaluate any other moderately risky investment—with a deliberate level of commitment, a focus on long-term success, and a diversified investment strategy. This diversification could include investments across a variety of products, geographies, channels, and consumer segments.

Health plans could offer a balanced product portfolio that addresses varying senior and consumer needs, possible competitor actions, and the need for a contingency plan in the event of a significant legislative change. Plans that continue to offer limited products through traditional channels or in few geographies without consideration for distinct segment needs will face higher levels of market risk. By establishing a footprint across different products, segments, channels, and geographic areas, health plans

can hedge against the risks surrounding the Medicare market and ease transitions as program changes occur.

Moving From Uncertainty to Strategy

While the Medicare market risks are real, seniors market opportunities are also significant for health plans that invest carefully. Concern about the uncertainty surrounding Medicare is widespread. Many players are reevaluating their place in the Medicare market to determine their investment strategy over the next three to five years. To position their organizations for long-term success, health plans must carefully assess their exposure to market threats, invest in core capabilities that are highly aligned with seniors' needs, and develop a diversified, market-driven portfolio of solutions that mitigates the legislative risks. ❖

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