Transcript

Medicaid Administrative Costs: A Review of 2014 Results

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

<Title Page>

I am Doug Sherlock. Welcome to our summary of the benchmarking study for Medicaid plans. Thank you for participating. I also want to thank the participants in this year's benchmarking study, some of whom are on today's web conference. A by-product of their participation is the reports that are summarized today. This summary discussed today benefits Medicaid plans as a whole, and we are grateful for this.

This is the third of a series of presentations summarizing 2014 performance metrics for various peer groups of health plans. We expect to present on the last universe, of Medicare plans, in coming weeks.

<Slide 2, Figure 1>

Administrative expenses before Miscellaneous Business Taxes, after eliminating the effect of product mix changes, Core PMPM costs increased at a median rate of 6.3% PMPM. This is up from an increase of 1.6% in 2013 and is the second highest in the past five years. (Core expenses exclude Sales and Marketing.)

Account and Membership Administration was also above recent trend, increasing to 3.8% PMPM growth from 1.2% in the prior year. This rate was greater than three of the prior five years.

Total administrative costs PMPM increased by 3.3%, up from a decline of 1.4% last year. Not shown in this slide is that Miscellaneous Business Taxes amplified the increase in

cost trends. Continuously reporting plans posted median Miscellaneous Business Taxes of $6.09 in 2014 versus the equivalent of approximately $1.18 PMPM in 2013. Including the effect of a 617.7% increase in Miscellaneous Business Taxes, administrative costs overall increased by 15.1%.

As you know, Medicaid is central to health care reform because of its expansion's overall effect on the proportion of people who are uninsured. The ACA reforms "expanded Medicaid to nearly all adults under age 65 with income at or below 138%" of the Federal poverty level, if the states elect to implement this expansion. As of September 1, 2015, according to Kaiser Family Foundation, only 19 states had not implemented the expansion, down from 21 last year.

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These next two slides show the effect of Medicaid expansion on being uninsured for health care. The US Census Bureau reports this in the chart on this slide. Based on a September 2015 Census analysis, Medicaid growth was the second most important factor in the increased coverage, among forms of health coverage between 2013 and 2014, after direct purchase. Put a different way, the total number of uninsured declined by 8.8 million: The increase in Medicaid enrollment explains 76% of the reduction in uninsured.

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Gallup reports similar results. According to Gallup, the percent of people aged 18 and older who say that they are uninsured fell from 21.2% in the second quarter 2013 to 13.8% in the second quarter of 2015. The 2.7 percentage point increase was second only to Plan Fully Paid for by Self or Family Member, at 4.2%. If you consider that many of these had previously received coverage through their employer (which declined by 1 percentage point), the importance of Medicaid is even greater.

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Today I want to provide context for this analysis, and cover the topics listed on this page, including the long term trends, increases by cluster of expenses, the reasons for the increase and the actual cost values. I have included some supporting information in an appendix at the end of this presentation.

I've expressed gratitude for the participating plans so let me tell you a little about them. Kaiser Family Foundation reports that, as of March 2015, 39.3 million people were served with comprehensive services by Medicaid Managed Care Organizations. The 11 Medicaid health plans participating this year collectively served 6.9 million members with comprehensive products, including Medicaid. That product, collectively comprised 48.3% of plan revenue. Medicare SNP, which we believe to be about 80% dual eligible, was 9.4%. So, while Medicaid is typically the predominant product, it is not the only product offered by our participants.

While we believe that the combined Sherlock Benchmark plans serve a significant share of MCO members, we recognize that they are "self-selected." That is, they may operate at cost levels and trends that reflect that they measure their activities. On the grounds that "you manage what you measure," these selected plans may disproportionally include those with an interest in optimizing their costs.

The plans use the Benchmarks to learn whether they are world class organizations, to identify those organizations that are best-in-class and to prioritize targets for improvement. These last two are linked because the shortest way to emulate best practice is to achieve improvements in areas that represent the largest differences between you and the best in class. Our benchmarks are also used in many strategic initiatives from budgeting, to evaluation of outsourcing, to evaluating business combinations.

About Sherlock Company. As you may know, we have been performing annual surveys of health plan operations over the last 18 years so our benchmarks are based on the cumulative experience of nearly 700 health plan years. In all of our various universes this year, the 40 health plans serve 41.5 million members. In addition, many plans license our materials: health plans serving 140 million insured people use the 2014 Sherlock Benchmarks.

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Now I want to touch on trends in administrative costs. This is not for all plans but only for those that participated in both years. The columns to the right for each years hold

constant the product mix between the plans. This gives us true apples-to-apples comparisons.

The line, "Subtotal: Core Expenses" ties to my earlier comment that Core PMPM costs increased at a median rate of 6.3% PMPM. (Core expenses exclude Sales and Marketing.) This is up from an increase of 1.6% in 2013. Total expenses declined at a median rate of 1.4% in 2013 but increased at a median rate of 3.3% in 2014.

Account and Membership Administration growth was slower than the other core clusters but accelerated over last year. Growth increased from last year's trend of 1.2% to 3.8%. This was the highest rate of growth since 2011. While Information Systems declined on a PMPM basis, Enrollment and Customer Services increased at a double digit rate. Also, Claims increased at a near double digit rate.

Note however that the cost increases for Account and Membership Administration in 2014 ran higher for Constant Mix versus As Reported. That likely results from the fact that Medicaid products cost less to administer than other products and grew faster in 2014. Put a different way, the shift to low cost Medicaid among continuing plans had the effect of reducing ostensible growth in PMPM costs. Once the effect of that mix shift is eliminated, the higher cost increases become apparent.

The Medical and Provider cluster's cost growth increased to the highest level since at least 2011. Medical and Provider Management costs grew at a median rate 5.6% versus an increase of 0.2% last year.

There are two functions in this cluster, Medical Management / Quality Assurance / Wellness, and Provider Network Management and Services. Both were substantially higher than in the previous year and the last time that similar increases occurred was in 2011. While Medical Management is a much larger function, Provider Network Management and Services grew faster.

The costs in the cluster of Corporate Services increased by 5.5% PMPM, a sharp increase compared with the 0.6% decline in the prior year. Actuarial posted the sharpest increase to near double digit growth. However the growth was somewhat lower than the prior year. Finance and Accounting and Corporate Executive and Governance both accelerated, actually switching from declines to growth. If a plan incurred management consulting that affected the enterprise as a whole the costs would likely have fallen in

these functions. (That convention is our intent.) Corporate Services *function* growth was essentially flat. Association Dues and License / Filing Fees grew faster than most of the other functions in this cluster.

The functions that comprise Core Expenses include all of the administrative activities of Medicaid focused health plans, except those of Sales and Marketing. Rules for Sales and Marketing for Medicaid vary from state to state so we treat this cluster a little differently.

The Sales and Marketing cluster's costs declined at a median rate 4.2% versus a decline of 1.0% last year. The median rates of increase for most functions in this cluster declined. The sole exceptions were Commissions and Sales which increased. Since Sales and Marketing expenses are very small for Medicaid products (broker Commissions are non-existent), the rates of growth in this cluster largely pertain to other products offered by these Medicaid focused plans.

This slide also shows the growth in total administrative costs over the past two years. Total cost growth increased from the prior year: 3.3% versus a decline of 1.4% in the prior year.

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This slide highlights the functional areas within each cluster that contributed to the changes in costs. Here, 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 latter is the amount of change weighted by the dollar cost. I think this is the closest to the true change in costs because it reweights costs to reflect the current product mix of the participants.

The Core constant-mix change was 6.3%, up from 1.6% in the prior year. The Total change was an increase of 3.3% compared with a decline of 1.4% last year.

The biggest change in core costs Corporate Services cluster costs. They increased by 5.5% compared with a decrease of 0.6% PMPM last year. Finance and Accounting, Actuarial and Corporate Executive and Governance had significant increases. Actuarial was the fastest growing area and the larger Finance and Accounting area was responsible for the greatest contribution to the increase.

The second biggest change in core costs was in Provider and Medical Management. Costs grew far faster, by 5.6% on a constant mix basis compared with no meaningful growth in the prior year. Provider Network Management and Services costs grew fastest. However, Medical Management grew nearly as rapidly, and because it is roughly double the size of the Provider Network, was the most important reason for the increase.

Account and Membership Administration costs increased by 3.8%, more modest in trend and in change in trend. While Information Systems costs actually declined, all of the other functions in that cluster increased. Enrollment and Customer Services were sharply up, and Claims (the largest factor in growth) was also. Enrollment was fastest growing. We find that sometimes Claims and IS trend in opposite directions reflecting automation or a change in benefit design so perhaps Medicaid growth played a role here. Enrollment and Customer Services costs increased, perhaps due to the stresses of the new enrollment and emphasis on exchange and Medicaid.

Plans reported decreases in Sales and Marketing costs in 2014 of 4.2% compared with a decrease of 1.0% on a constant mix basis last year. Every function declined, except for Sales and Commissions. Those declining functions included Rating and Underwriting, Advertising and Promotion and Marketing. A sharp decline in Rating and Underwriting was not only the fastest decline, it was also the greatest source of reduction in this Cluster's costs.

Overall, the fastest growing area was Enrollment and the greatest contributor to change was the Medical Management area.

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This slide also highlights the functional areas within each cluster that contributed to the changes. But in this case we looked at as-reported costs. Because these values are affected by changes in product mixes, we don't view them as helpful as the constant mix analyses.

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. In some instances, the functions that changed most dramatically also had the greatest

impact on cost trend. The core as-reported change was 6.1% increase and total expenses also increased by 2.9% As an aside, these are median changes so, while the values are more representative, they don't lend themselves to mathematical operations.

For the most part, the relationships are similar to what you see in the previous slide. The order of the changes in clusters are similar. But in general, cost growth is slower since the universe shifted in favor of low cost Medicaid products, obscuring the "real" trend.

I identified the differences with arrows. First, the fastest growing increase in as reported values was Medical Management, rather than Provider Network Management and Services. Association Dues and License and Filing Fees edges out Actuarial as the fastest growing Corporate Service function. Finally, among Sales and Marketing costs, Commissions are the greatest contributor to the decline, rather than Rating and Underwriting on the constant mix analysis. Association Dues and License and Filing Fees may also include some unique state-based fees, like solvency fees, that are effectively taxes.

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Here are the PMPM administrative cost levels for 2014, segmented by clusters of functions. (By the way, the figure numbers on the slide reference our free newsletter, *Plan Management Navigator*, which is available on our web site.) Median *core* administrative costs for comprehensive products were $27.99 per member per month. If you refer to Appendix A, you'll see that this PMPM cost is 14.3% higher than the $24.48 reported last year. This is an imperfect comparison since the plans in the annual universes differ. The difference reflects actual changes in costs, product mix changes and changes in plan participation. We estimate this year's universe had a greater commitment to Medicare, comprising 8.9 percentage points of the increase, real growth was 6.3 percentage points, the underlying cost level of the universe was 4.2% lower and 3.1 percentage points are unexplained.

To analyze the results, we have summarized into clusters the more than 50 functions that the plans report. Appendix C tells what functions go into each cluster reported here.

Account and Membership Administration is the dominant source of costs for health plans at $13.42. This is a universe of companies in which Provider and Medical Management is very important at $7.75 PMPM. The Corporate Services cluster, at $6.32 PMPM, is the smallest cluster of core expenses and also one with the greatest degree of scalabilty.

Again, we exclude Sales and Marketing expenses from core costs, but they total $9.71. By the way, have a look at the Sales and 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 variation. The coefficient of variation is greater than most of the other clusters and Core costs as a whole. That reflects why we exclude these from the core expenses: costs vary from state to state since the laws governing marketing also vary from state to state.

The median costs, expressed PMPM or as a percent of revenues, will be the way that we have been referring to cost metrics. Because medians are the 50th percentile value, the clusters won't necessarily sum to the median for total expenses. That is even more the case for the 25th and 75th percentiles.

While I'm discussing calculations, let me add that when we make comparisons we try to make them as close to apples-to-apples as possible. So, where this slide pertains to all eleven Medicaid plans that participated in the current benchmarking study, the slides showing cost *changes* reflected only those plans that participated in both the comparison years. Thus the rates of change for 2014 are for those that participated in both 2014 and 2013 surveys. Rates of change are rates of change in *per member* costs.

By the way, while the mix of the continuous plans shifted in favor of Medicaid, which is lower cost, the mix of plans that participated in either year also were more inclined to include Medicare in the current period. That increased costs between the 2014 versus 2013 universes. While for continuous plans, the migration towards low cost Medicaid dominated the trend, for both universes as a whole the growth in Medicare was dominant. As noted earlier, backing out the true growth rate and the effect of mix differences, this year's universe has costs that are below last years. Appendix A has last year's values.

We can't provide much publicly available detail on this, but many of you are interested in staffing. After all, staffing costs comprise on average 61.4% of core administrative expenses, though much higher in Customer Services, Actuarial, Provider Network Management and Services, Medical Management and Enrollment, and far lower in Information Systems and Corporate Services function. Core staffing ratios run at approximately on average 22 FTEs per 10,000 members, and when you look at inferred values for pure Medicaid, the staffing ratios are the same. About 25% of such staff is outsourced, but Nurse-based Counseling, Imaging, Other Claim and Encounter Capture and Adjudication, Total Information Systems, Actuarial and Facilities all had more than 20% of their staff outsourced, on average. Information Systems was 32% outsourced.

Excluding Pharmacy and Mental Health, core compensation per FTE averages just over $85,900, though certain functions like Medical Informatics, Other Medical Management, Total Information Systems, Finance, Actuarial, Human Resources, Legal and Corporate Executive are in six figures.

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This slide shows the administrative expenses of each *product* offered by the Medicaid universe of plans. 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 administrative costs of Medicaid HMO were $29.57 PMPM, while Medicaid CHIP was $14.52 PMPM. Other than CHIP, Commercial ASO had the lowest per member administrative expenses. The median costs for this product is $23.26 PMPM.

Total costs for *insured* commercial products were higher than those for Medicaid, in part reflecting the marketing costs that such commercial members require. ASO products cost less than either Medicaid HMO or insured commercial, reflecting that ASO products have lower medical management costs as well as lower Sales and Marketing costs.

Medicare Advantage administrative costs are higher than comparable products for younger people, partly because of the high health care needs of seniors. Health care costs normally entail claims processing and customer service activities, which are reflected in the administrative expense levels. The effects of health care needs are

especially evident when comparing the Medicare SNP product, at $139.03 PMPM, versus Medicare Advantage, at $99.72 PMPM.

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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 or for the intensity of care required by the specific population served by a product. Indeed, as an example of their acceptance, the rebate provisions of the ACA are triggered by the MLR, a percent approach to health plan expenses.

In any event, comparability is improved if one is careful to keep denominators consistent. I mention this as a calculation note since we use premium equivalents as the denominator for ASO relationships for consistency with insured products.

Using percents of premiums, the cost metric ranking can be much different than the PMPM ranking. Medicare Advantage products, ranked highest PMPM, ranked below average when calculated as a percent of premium. While Sales and 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* tend 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. Medicare Advantage costs were 12.0% while Medicare SNP was lower than average cost at 9.5%.

Recall that Medicaid products were relatively low cost on a PMPM basis. Expressed as a percent of revenues, Medicaid HMO, at 8.6%, is lower than average for the products served by this universe. CHIP is relatively high cost at 9.7% for much the same reason that Medicare tends to be low. The lowest cost product, measured as a percent, is ASO at 6.5%.

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This slide shows that *core* administrative expenses as a percent of premium equivalents were 7.1%. Including Sales and Marketing costs, administrative expenses equaled 9.6% of premium equivalents. Please note that it excluded taxes imposed by state governments as well as capital costs.

Note that the percent of premium equivalent of 7.1% is 30 basis points higher than last year's value of 6.8%, as shown in Appendix B. A precisely comparable comparison is impossible since medians don't sum and the universes differ. Both Corporate Services and Account and Membership Administration increased relative to last year's ratios.

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It can be helpful to place the results of the Medicaid study in context. In this slide we compare the plans with a high commitment to Medicaid with plans from the Independent / Provider Sponsored universe that also offer this product but to a less degree. We're only comparing the Medicaid products themselves so the different product mixes are similar.

Note that both the Core and Total PMPM costs are higher for the Medicaid-focused health plans. Core costs are $26.43 versus $17.91 for the IPS plans. Yet expressed on a percent of revenue basis the costs are lower, 8.9% versus 11.6%. We know that the premiums and health care costs are much higher for the Medicaid focused plans, and so it is possible that they tend to care for sicker people. But we cannot know this for certain.

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This is the end of my formal presentation. Administrative cost growth for continuously participating plans accelerated this year, possibly reflecting cost to adapt to the new health insurance environment. Enrollment and Customer Services are possible examples of this. Claims also increased. Information Systems costs declined.

There was a sharp increase in Miscellaneous Business Taxes. These are of course not under the control of management but the effect of their increase was significant.

Medical Management and Provider Network Management and Services increased and contributed to overall cost growth.

However, Sales and Marketing costs tended to decline for these plans, notwithstanding growth in membership in the Medicaid and Medicare products.

I have attached to the end of this presentation some appendices. They include last year's costs and a list of the functions included in each cluster of expenses.

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

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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. They not only enhance your own firm's performance but also raise the bar for all other plans.

Thank you.