



Transcript

Medicare Administrative Costs: A Review of 2015 Results

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<Title Page>

I'm Doug Sherlock. Welcome to our summary of the benchmarking study for Medicare plans. This is the third in a series of presentations summarizing 2015 performance metrics for various peer groups of health plans. We've posted previous presentations on our web site, along with transcripts, so I hope you won't hesitate to access them if the Blue or Independent/Provider-Sponsored health plan information would be helpful. We'll report on the Medicaid Universe in the next few weeks.

<Slide 2>

This chart shows the rates of Per Member administrative cost changes while holding the product mix and universe constant. To do this, we re-weight prior year cost values to current year mixes. The dark blue is total expenses and the light blue is the cluster of expenses we call Account and Membership Administration.

Total Expenses declined, although not as much as last year, while the rate for Account and Membership Administration continued the trend of cost increases that was interrupted last year: the increase was almost a 12 percentage point change from 2014 results. (By the way, the figure numbers on this and other slides reference our free newsletter, *Plan Management Navigator*, which is available on our web site.) Total expenses PMPM for Medicare plans participating in our study fell by 3.2% holding constant the product mix of the continuously participating plans, which we show in the chart. Account and Membership Administration costs increased by 6.6% on a constant universe and mix basis.



This is the second year since plans were subject to certain ACA related taxes. Last year saw enormous growth of over 3000% of Miscellaneous Business Taxes, while this year saw growth of 21%. These values are not included in the trends in this figure.

<Slide 3>

Ten plans participated in this study. While these and the combined Sherlock Benchmark plans serving Medicare in other universes serve approximately 15.5% of all eligible Medicare Advantage members, we recognize that they are “selected.” That is, they may operate at cost levels and trends that reflect that they measure their activities. For instance, on the grounds that “you manage what you measure,” these selected plans may disproportionately include those with an interest in optimizing their costs.

While Medicare is typically the predominant product, it is not the only product offered by our participants. On average, Medicare Advantage comprises 53% of plan revenue in this universe.

Incidentally, I 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 this summary. It benefits Medicare plans as a whole, and we are grateful for this.

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.

Let me add a word about Sherlock Company. As you may know, we have been performing health plan benchmarking studies for many years. Sherlock Company is now completing its 19th consecutive annual survey of health plan operations and today’s benchmarks are based on the cumulative experience of nearly 740 health plan years. In all of our various universes this year, the 44 health plans serve more than 59



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 well-accepted, and are, in the words of four consulting firms, "the gold standard" for such metrics. Thus, health plans serving most people with private health coverage are users of our 2016 Sherlock Benchmarks since January 2015. Participants include most Blue Cross Blue Shield plans (directly or through subsidiaries), the leading provider-sponsored plans and sometimes publicly-traded companies. The results are actionable since the indicators are unambiguous, and linked to actual performance.

The Sherlock Benchmarks benefit from our business model. Credibility is facilitated through voluntary participation. Respondents have a stake in the data quality and believe it meets the insight-to-effort test.

Slide 3 shows the topics that this presentation will cover. We'll first touch upon the increase in popularity of Medicare Advantage then we'll cover the decline in administrative expenses among Sherlock Benchmark participants. Next we'll examine the rates of decline on an as-reported and constant mix basis and drivers of decline. Lastly, we'll talk about costs by cluster and costs by product on a PMPM and percent of premium basis.

<Slide 4>

Medicare Advantage replaces regular Medicare for an increasing proportion of beneficiaries. As of March 2016, about 32% of the 57 million eligible Medicare Beneficiaries, or 18 million, were served under Medicare Advantage. (We refer to March dates as best representative of annual participation levels.) This has steadily increased from March 2005 when 13% of Medicare beneficiaries were served by these plans and is up from March 2015 by 0.3 percentage points. As we mentioned in *Navigator*, the CBO projects the number of Medicare Advantage members to increase to 30 million in 2026, or about 41% of all eligible Medicare Beneficiaries.

Medicare Advantage is attractive to beneficiaries because of its superior value proposition. MA's supplemental benefits are, in MedPAC's view, subsidized by the Medicare program. But the MA plans also offer Part A and B benefits at lower cost (again according to MedPAC) allowing them to offer an even better value proposition.



Also, there is some evidence that Medicare Advantage penetration reduces fee-for-service cost trends, thereby benefiting all Medicare beneficiaries.

<Slide 5>

As mentioned concerning Slide 2, total administrative expenses decreased by 3.2% in 2015, less sharp than the 6.7% decrease in 2014. That is, however, still a combined 10% decline in per member administrative costs over two years. These comparisons are also reflected on Figure 3 in the columns to the right, which hold constant both the universe and product mix. In my view, eliminating the effects of product mix changes provides a more accurate picture of trend. The arrows highlight those two columns.

Sales and Marketing cluster expenses declined by 4.0%, compared with a decline of 2.4% last year. The Provider and Medical Management cluster expenses declined by 9.9%, versus the slight decline of 0.8% last year. Account and Membership Administration was the only cluster of expenses to have an increase. It grew at 6.6% in 2015 versus a *decrease* of 5.3% in 2014. This cluster of expenses is the largest of the four. Finally, the Corporate Services cluster had the largest decline at 11.5%. This compares with a decline last year of 4.7%.

The as-reported trends are shown to the left of the constant-mix column. For the most part, they show similar trends. The overall decline in costs is somewhat less pronounced on a mix-adjusted basis since membership in the less expensive Medicaid product grew faster than Medicare in 2015.

The following slides will go into more detail to explain these cluster trends.

<Slide 6>

The previous slide showed both as-reported trends, as well as the constant-mix trends, but this slide is only for as-reported trends.

Total as-reported costs declined by 4.1% in per member administrative costs from last year. This was very close to last year's as-reported decline of 4.0%. Please note that it excludes any changes that are attributable to changes in the universe, thus only includes the same seven plans that participated in both years. It does, however, include changes



associated with product mix differences. Actuarial grew faster than any function, but the most important cost driver was the decline in the relatively large Sales function.

Sales and Marketing is the second largest cluster, behind Account and Membership Administration. Its costs declined by 1.6%, with only the Marketing function showing an increase. Rating and Underwriting, Sales and Advertising and Promotion had double-digit declines. Broker Commissions declined by low single digits. Because of the rate of Sales' decline combined with its weight, it was the most important source of cost reduction.

The Provider and Medical Management cluster expenses declined by 7.7%, PMPM. Last year's trend was an increase in costs by 1.6%. Provider Network Management and Services dropped by 4.4%, while Medical Management posted a decrease of 8.7%. Medical Management's decline was the first in the past five years. PMPM dollar cost in Medical Management are three times greater than Provider Network Management and Services so its sharp decline and large weight made this function dominate overall trend in this cluster.

The Account and Membership Administration cluster is the largest and contains the central activities of health plan operations. This cluster's PMPM costs grew by 6.0%. Account and Membership Administration was the only cluster of expenses to have an increase this year. Customer Services and Claim Encounter Capture and Adjudication fell slightly. Enrollment grew at 4.7%. Information Systems was the largest function and grew the most at very nearly double-digits. For those reasons, its trend was the greatest weight in overall trend for this cluster.

The most important reason for the decline in Total Costs was the 10.5% drop in the Corporate Services cluster of expenses. Corporate Executive and Governance and Finance and Accounting fell by double digits. Offsetting this decline was the large increase in Actuarial expenses, by 25 - 30%. The Corporate Services *function* is the largest in the cluster and includes sub-functions such as HR, Legal, Facilities, Mailroom and so forth. It decreased by mid-single digits, along Association Dues and License / Filing Fees. The Corporate Services trend, weighted by its relative size, drove the trend in the entire cluster.

<Slide 7>



This slide shows that rates of change in costs after eliminating the effect of the changes in product mix that occurred in 2015. As with the previous two slides, this also holds the universe of plans constant. Accordingly, we think of these as the “real” changes in costs. Total administrative expenses decreased by 3.2% in 2015, less than the 6.7% decrease in 2014.

Sales and Marketing expenses fell by 4.0% compared to the 2.4% decline last year. Three of the five functions in this cluster experienced declines, which were double-digits. Rating and Underwriting, Sales and Advertising and Promotion all decreased, in declining order of percent decline. By contrast, Marketing and External Broker Commissions increased by single digits. The Sales function had the highest weight in this cluster, thereby contributing most to the decline.

For continuously participating plans, Comprehensive Total membership had a median increase of 8.1%. This is higher than last year’s increases of 3.3%. Total Medicaid members increased by 23%, while the number of Medicare members grew by 9.5% compared with a median increase of 4.3% last year. Commercial Total experienced a median increase of 0.5%. Self-funded ASO products grew by 3.4%, while Commercial Insured had a median increase of 4.8%.

In terms of product mix, Medicaid gained an average of 2 percentage points, and Medicare decreased by 2 percentage points. Commercial Total’s share of product mix increased by half a percentage point with Commercial Insured down 4 percentage points and Commercial ASO up by 5 percentage points.

Provider and Medical Management fell from a slight decline of 0.8% in the prior year to a drop of 9.9% this year. This cluster is comprised of two functional areas, Medical Management / Quality Assurance / Wellness, and Provider Network Management and Services. The Provider Network Management and Services function increased by mid-single digits percents, while Medical Management declined by low double digits. This was the first time in the past five years that Medical Management costs declined. Medical Management is several times the size of Provider Management and drove this cluster’s decline in costs.



Note that whether a medical management activity is included with quality improving activities for MLR rules, we reflect its costs as administrative for the purposes of this analysis.

Account and Membership Administration expenses grew at 6.6% in 2015 versus a decrease of 5.3% in 2014. Enrollment and Information Systems both increased, by mid and very high single digits, respectively. Customer Services declined slightly at 1.0%, while Claims remained flat. Information Systems had both the highest percentage increase and the highest weighting. Both Total and Account and Membership Administration include Pharmacy, Mental Health, and ICD-10 IS expenses.

Corporate Services expenses fell by 11.5% in 2015 versus the 4.7% decline last year. This was the slowest growth in this cluster since at least 2008. All functions except Actuarial had declining costs. Actuarial grew by 25% - 30%, the highest in the past five years. The Corporate Services function was weighted the most and drove this cluster's decline.

<Slide 8>

Here are the PMPM administrative cost levels for 2015, segmented by clusters of functions. (Again, the figure numbers on the slide reference our free newsletter, *Plan Management Navigator*, which is available on our web site.) The median total administrative expenses for comprehensive products were \$44.72 PMPM. We highlight the "median" column with an arrow. This is 6.4% higher than last year's reported PMPM costs of \$42.02.

The cost differences between this year's and last year's universes stem from three factors: differences between the mix of products that are offered by the two panels, the actual changes in cost trends for the plans and the changes in the underlying costs of the participants between the two years. Most of this year's plans also participated last year. Slide 2 provides insight to both their trends and the effect of their product mix. Since overall expenses fell more on an as-reported basis than they did when one holds the mix constant, the mix in the 2015 survey must have been less expensive than that of the prior year. In other words, the continuously participating plans were less committed to Medicare. They were also more committed to Medicaid HMO, which is less expensive.



To analyze the results, we have summarized into clusters the more than 50 functions that the plans report. Appendix C tells identifies functions comprising each cluster.

Account and Membership Administration is the dominant source of costs for health plans at \$17.44 PMPM. The Medicare universe is one in which Provider and Medical Management activities are vitally important. Our plans reported median costs of \$8.52 PMPM. The Corporate Services cluster, at \$7.97 PMPM, is the smallest cluster of expenses and also the one with the greatest degree of scalability. Sales and Marketing expenses totaled \$11.25 PMPM.

We have been reporting PMPM costs as medians, and will do so when we discuss costs expressed as a percent of revenues. Medians minimize the effect of outliers in the way that averages do not. But, because medians are the 50th percentile values, the clusters won't necessarily sum to the median for total expenses. That is even more the case for the 25th and 75th percentiles, especially since the values for each cluster is separately calculated.

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 ten Medicare 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 2015 are for those that participated in both 2015 and 2014 surveys. Rates of change are rates of change in *per member* costs.

We can't provide much detail during this presentation, but many of you are interested in staffing. After all, staffing costs comprise a median of 50% of Medicare plan administrative expenses, though much higher in Customer Services, Provider Network Management and Services and Claims, and lower in Information Systems. Staffing ratios run at approximately 28 FTEs per 10,000 members, including the effect of outsourced FTEs. We also estimate values for pure Medicare Advantage based on the reasonable assumption that the same mix of resources (labor and non-labor) is used to support all types of members. Staffing ratios for these members are 49 FTEs per 10,000 members, including the effect of outsourced FTEs.

About 11% of such staff in Medicare plans is outsourced, while a median of 18% of Information Systems staff is outsourced.



Excluding Pharmacy and Mental Health, median compensation per FTE averages just about \$90,000, though certain functions like Corporate Executive and Governance, Actuarial and Marketing are in six figures.

<Slide 9>

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, and the associated administrative expenses do as well.

The administrative costs of Medicare were \$84.71 PMPM, while the dominant Medicare Advantage product was \$81.21. Medicare SNP (which we believe to be mainly comprised of dual eligibles) cost \$142.91 PMPM to administer. Medicare Advantage administrative costs are higher than comparable products for younger people, chiefly because of the high health care needs of seniors. Health care costs normally require supporting claims processing and customer service activities, which are reflected in the administrative expense levels. Medicaid members were low cost insured plans, at \$27.62 PMPM, while CHIP, serving children, was nearly the lowest cost product.

Total costs for *insured* commercial products were higher than those for Medicaid, in part reflecting the Sales and Marketing costs that such commercial members require. ASO products had the lowest costs, reflecting that ASO products have lower Medical Management costs as well as being able to spread Sales and Marketing costs over larger groups of members.

By the way, this slide illustrates why we go to such strenuous efforts to mix adjust: product costs matter.

<Slide 10>

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 any given 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. Premium equivalents are ASO fees plus the health benefits of the self-insured groups.

Using percent of premiums, the cost metric ranking can be much different than the PMPM ranking. Medicare Advantage products, ranked highest PMPM, ranked below commercial insured products when calculated as a percent of premium. The underlying reason for the lower costs of Medicare Advantage measured as a percent of premium is that Sales and Marketing and Corporate Services costs are a smaller proportion of total administration. Medicare Advantage costs were 9.8% of premiums while Medicare SNP were 10.8%.

Recall that Medicaid products were relatively low cost on a PMPM basis. Expressed as a percent of revenues, Medicaid HMO, at 7.5%, is lower than average for the products served by this universe. Sales and Marketing costs are limited for these products. CHIP had moderate costs at 9.6%. The lowest cost product, measured as a percent, is ASO at 5.3%.

<Slide 11>

This slide shows median administrative expenses as a percent of premium equivalents were 8.6%. They excluded miscellaneous taxes imposed by state governments, the ACA taxes as well as capital costs. Medical and Provider Management replaced Corporate Services as the low-cost cluster in the slide 8 exhibit.

The percent of premium equivalent of 8.6% is 30 basis points lower than last year's value of 8.9%, as shown in Appendix B. A precise comparison is impossible since medians don't sum and the universes differ. All clusters were lower in 2015 compared with 2014.

<Slide 12>

As you know, health plans participating in our benchmarking studies segment their costs by product. So it is possible for us to compare the same products across universes. When I compare Medicare products offered by the Medicare universe to that of Blue Cross Blue Shield Plans, the median values are \$2.85 PMPM lower than BCBS Plans, or



0.7 percentage points higher on a percent of premium and equivalents basis. The median administrative costs for Medicare plans were \$0.70 PMPM higher than IPS plans, or 0.6 percentage points higher on a percent of premiums and equivalent basis.

A close analysis of the Blue Cross Blue Shield universe indicates that the chief difference is that the BCBS universe had much higher Account and Membership Administration expenses. These lower costs for Medicare plans were partially offset by higher Medicare Medical and Provider Management costs. These differences were also true when Medicare plans were compared against IPS plans. Medicare plans also had lower Sales and Marketing costs than both IPS and BCBS Plans. Corporate Services expenses for Medicare plans were higher than IPS plans, but lower than BCBS Plans.

<Slide 13>

This is the end of my formal presentation.

On a constant mix basis, administrative costs for continuously participating plans declined. Sales and Marketing cluster fell, with Sales having the most impact. Provider and Medical Management fell, with Medical Management falling by double digits – the first decrease in the past five years. Account and Membership Administration cluster was the only one to increase. This was primarily due to Information Systems. Enrollment also had an increase. The Corporate Services cluster fell due to declines in Finance and Accounting, the Corporate Services Function, and Corporate Executive and Governance.

Last year's massive increase in Miscellaneous Business Taxes due to the ACA fell to normal (albeit double digit) levels this year. These are of course not under the control of management but the effect of their increase was extremely important last year.

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.

I want to close with the common sense observation that low costs are not the same as optimal costs. But the benchmark of low costs shifts the burden of proof to functional areas with high costs to demonstrate an ROI on those higher costs.



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



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.