



Transcript

Medicaid Plans Post Fastest Growth in Core Expenses Since 2014

October 17, 2018

Douglas B. Sherlock, CFA

sherlock@sherlockco.com

(215) 628-2289

<Title Page>

I'm Doug Sherlock. Welcome to our summary of the benchmarking study for Medicaid plans. This is the fourth and last in a series of presentations of 2017 performance metrics for various peer groups of health plans. We've posted three previous presentations on our web site, along with transcripts, so I hope you will access them if the Blue, Independent/Provider-Sponsored or Medicare health plan information would be helpful.

Health plan managers endeavor to achieve optimal administrative costs. By "administrative" I mean the spectrum of costs ranging from Provider Services to Claims to Corporate Service and Medical Management. Optimal costs are low costs unless higher costs yield an ROI. If optimal costs are achieved, favorable health care trends amplify operating profits and mute operating losses. In a competitive environment, "managing what you measure" implies comparison with the leaders of your industry. We offer what many call "the Gold Standard" for health plan benchmarks based on the performance of these leaders.

The 12 Medicaid-focused plans that are the subject of this presentation serve 9.2 million people with comprehensive insurance. The average plan had about 760,000 members and the median size was 578,000. We believe this universe and the resulting analysis and data to be quite robust.

Before I begin though, I want to express some appropriate thanks. This year marks the 21st year of the Sherlock Benchmarks. Cumulatively, it reflects the experience of

Page 1 of 14

COPYRIGHT © 2018 SHERLOCK COMPANY. ALL RIGHTS RESERVED.



approximately 818 health plan years and includes Blue Cross Blue Shield Plans, Independent / Provider – Sponsored Plans, Medicaid Plans in addition to the Medicare Plans. All in, the 40 participating plans serve 53 million insured Americans with comprehensive insurance.

This achievement has been possible through the efforts of my talented colleagues and the professionalism of the participating plans especially our primary contacts within those plans. Since the subject matter of this web conference is free of charge and beneficial even to more casual analysts, I hope you share my gratitude.

<Slide 2>

I'm going to breeze through this slide. It shows the topics that I will address, and lists some of the appendices. Note that the appendices contain last year's values and a list of all of the functions in each of the products offered by these health plans. This detailed function classification plus the product classification means that administrative expenses are segmented into more than 700 expense/product cells, each of which are separately analyzed. We only summarize broad trends in today's presentation. Finally, we touch on our methods of surveying, validation, analysis and reporting.

For those who have participated in web conferences in prior years, you may notice a difference in that we'll mention trends in Compensation, Staffing ratios and Outsourcing. That eight out of twelve plans repeated participation makes this possible.

We will be posting the slides and the transcript of this within the next 24 hours. I very much welcome your questions at the end of this presentation and the audience will be muted during the presentation itself.

<Slide 3>

The next two slides will offer context to Medicaid cost management with background on the effects that the Affordable Care Act has had on overall health coverage. Slide 3 shows the US Census Bureau's analysis on health insurance coverage from 2013 through 2017. The proportion of uninsured Americans dropped from 13.3% in 2013 to 8.8% in 2017, a 4.6 percentage point decline. I have circled those percents in red. Of the 13.3 million newly covered, the 7.6 million additions to Medicaid beneficiaries composed about 57% of the newly covered people. These values are circled in blue.

Page 2 of 14

COPYRIGHT © 2018 SHERLOCK COMPANY. ALL RIGHTS RESERVED.



<Slide 4>

While the classifications and definitions differ, the US Census Bureau's estimates are directionally supported by Gallup on Slide 4. According to Gallup, the percent of people aged 18 and older who say that they are uninsured fell from 20.8% in the fourth quarter of 2013 to 14.8% in the fourth quarter of 2017, a 6.0 percentage point decline. While the Group responding "Plan fully paid for by self or family member" comprised the largest increase in coverage, at 2.7 percentage points, Medicaid came in second with a 1.9 percentage point increase. The proportion of uninsured, however, increased year-over-year from fourth quarter of 2016 to 2017 by 1.7 percentage points.

The upshot of these two slides is that, since 2013, the number of people without insurance has declined. This is due to the Affordable Care Act. State adoption of federally subsidized Medicaid has been an important, perhaps the most important, source of new insurance over that period. The plans participating in this universe are a part of this growth.

<Slide 5>

Slide 5 summarizes the administrative cost trends for Medicaid plans since 2012. The growth in expenses throughout this presentation reflect three conventions. First, it will be in per member terms. Second, rates of change will be calculated for continuously participating plans. Third, we will emphasize trends calculated after reweighting the trends to exclude the effects of any changes in product mix.

The Account and Membership Administration cluster is comprised of the enrollment, claims, customers services, and information systems functions and is represented by the *light blue* line in this slide. By core expenses, these are *total* expenses less Sales and Marketing represented by the *darker blue line*. We exclude these expenses since rules for Medicaid marketing vary from state to state.

Both Core and Account and Membership Administration expenses accelerated from last year, with Core expenses higher by 5.5% and Account and Membership up by 5.9%. 2017 represented the second fastest growth since 2014. We have not shown this but, after the effect of the sharp decline in Miscellaneous Business Taxes, PMPM total administrative expenses actually *declined* by 3.5% in 2017.



<Slide 6>

In this slide and those that follow, we'll flesh out the trends in the clusters, as well as the individual functions. As we will develop, ten out of the eleven Core functions increased, while Rating and Underwriting and Sales function grew in the Sales and Marketing cluster. The fastest growing functional area was Actuarial, while the Corporate Services function was the most important source.

We will also drill into the drivers. By that I mean non-labor expenses, staffing costs and staffing ratios. Staffing Ratios and outsourcing were up, but compensation per FTE was down.

This slide shows each cluster's growth organized by year. The 2017 trends for Core and Account and Membership Administration from the prior slide are shown in the fourth column labeled "Constant-mix", "2017 Data." They have been circled in Blue and Red respectively.

The fourth and second columns reflect cost trends among continuously participating plans, backing out the effect of product mix changes between the two years. I consider these columns to be real increase. The arced arrows are to draw your attention to the comparison with prior year's values.

The two columns that are labeled "as-reported" reflect per member trends in continuous plans. Implicit in this calculation is that a shift in favor of higher administrative cost products, such as Medicare Advantage and Medicare SNP, would lead to the appearance of accelerated growth, while a shift in favor of less expensive products would lead to deceleration. Because there was a more rapid growth in the as-reported cost growth (7.1% versus 5.5%) you can infer that there was a shift toward more expensive cost products.

Low cost Medicaid HMO decreased by a median of 3.6%, while Medicaid CHIP grew at a median of 23.0%. (Recall that the Gallup Survey shows an increase in the proportion of members without insurance.) However, high cost Medicare Advantage SNP increased by 38%. Medicare Advantage increased by 1.9%, while Medicare Cost fell by 5.7%. The Commercial Insured product membership increased at a median rate of 7.8%, while Commercial ASO product grew at a median rate of 13.5%. Overall,



commercial membership grew by 5.7%. Overall membership increased by a median rate of 4.7%.

Total Medicaid median mix was 33% compared to 35% last year. Medicaid HMO was 30% down from 34%, while Medicaid CHIP was 1.5% up from 1.3% last year. Total Medicare was 12% slightly lower than 13% last year. The median for Medicare Advantage was relatively flat at 11%, both Medicare SNP and Cost were less than one-percent both years. The average commercial mix for plans participating *in both years* was at a median of 59% compared to 53% in the prior year. ASO membership was 18% versus 17% last year.

Every cluster experienced per member cost growth regardless of whether they are as-reported or constant-mix. The Corporate Services cluster experienced a rapid acceleration of growth, increasing by 12.0% compared to 2.1% in the prior year. Account and Membership increased by 5.9% versus 1.1% last year and Medical and Provider Management grew by 5.7% compared to a *decline* of 2.1% last year.

As-reported trends posted similar acceleration as the Corporate Services cluster increased 11.8% compared to 4.8% in the prior year, Account and Membership Administration grew by 8.6% versus 1.0%, and Medical and Provider Management gained 6.8% over 2.5%.

As noted previously, the Sales and Marketing cluster is not included in Core expenses. Nevertheless, this cluster is central to the Commercial and Medicare products offered by Medicaid-focused plans. The Sales and Marketing cluster increased by 5.2% on a constant-mix basis, and by 5.0% on an as-reported basis. Total expenses, including Sales and Marketing, grew by 4.8% on a constant-mix basis and by 5.1% on an as-reported basis.

<Slide 7>

Slide 7 shows the rates of change and the most important sources of change, after eliminating the effect of product mix differences. Again, these are the “real” rates of increase, so I will spend a lot of time on this and discuss trends in order of their importance. Core Costs increased by 5.5% PMPM, sharply higher than 1.4% last year.



The Corporate Services cluster posted the most rapid PMPM increase, growing by 12.0%, and the fastest over the past five years. Within this cluster, Actuarial was the fastest growing function, up on higher non-labor costs per FTE. Compensation per FTE and outsourcing were also higher, while the average staffing ratio was only slightly higher.

The Corporate Services functional area (within the Corporate Services Cluster) represented the most important source of growth. Most sub-functions within this area grew except for Imaging and Printing and Mailroom. This functional area's staffing ratio coupled with compensation led to the increase. Non-Labor costs per FTE and outsourcing were higher, on average. Examples of activities in the Corporate Services functional area include HR, Legal, and Facilities.

The Account and Membership Administration cluster of expenses posted a PMPM increase of 5.9%. Customer Services grew at the fastest pace among functions in this cluster, with the Member Services sub-function responsible for the entire increase in this function. The staffing ratio for Customer Services increased significantly, while compensation also grew. Average non-labor costs were down, and outsourcing was up slightly.

The functional area with the greatest *effect* on the Account and Membership Administration cluster was Information Systems, due to its size. The Security Administration and Enforcement sub-function grew at the fastest rate, closely followed by Applications Maintenance and Applications Acquisition and Development. The subfunction of Operations and Support Services, however, fell.

For the continuously participating plans, the average staffing ratio and staffing costs per FTE were higher for Information Systems. Non-Labor Costs per FTE and Outsourcing were lower.

PMPM expenses in the Medical and Provider Management cluster grew by 5.7%. Provider Network Management and Services grew at the fastest rate, but the larger Medical Management / Quality Assurance / Wellness function was the most important source of growth because of its higher cost values.



The staffing ratio and non-labor costs for Provider Network Management and Services were higher than the previous year. Combined staffing costs were lower, while average outsourcing by the plans was higher. Staffing Ratios were also a major driver for increased Medical Management functional area expenses. Non-Labor costs per FTE were lower, as the average proportion of FTEs outsourced was slightly higher. Compensation was marginally lower.

The Medical Management sub-functions that posted cost increases included Precertification, Case Management, Disease Management, Health and Wellness, Utilization Review, and Other Medical Management.

The Sales and Marketing cluster grew by 5.2%, the fastest rate in the past five years. Rating and Underwriting represented the fastest growing functional area and most important source of growth within the Sales and Marketing cluster.

The risk adjustment sub-function was a major driver in higher Rating and Underwriting expenses. Plans sharply increased their staffing in this sub-function. Compensation was also slightly higher. Non-Labor Costs and outsourcing were lower.

Total Administrative expenses, including Sales and Marketing, were higher by 4.8%. For all functional areas, Actuarial posted the largest increase, while the Corporate Services Functional area was the most impactful source of growth.

<Slide 8>

Slide 8 explains the *reported* rates of change, that is, the values with no adjustments for changes in product mix. These also accelerated, growing by 7.1% versus 3.9% in the prior year. The acceleration was less dramatic compared with the constant-mix growth. These trends, again, are based on continuous plans. For the most part, there is a correspondence between the constant-mix and as-reported renderings. So, I will focus on *the differences* between the as-reported and the constant-mix trends.

Unlike on a constant-mix basis, on an as-reported basis, Corporate Executive and Governance posted the largest rate of growth, while Information Systems was the most important source of growth for both Core *and* Total expenses. Provider Network Management continued to outpace Medical Management's growth under the Medical and Provider Management cluster, but in the unadjusted comparison, it was also the



most important driver of growth. For Account and Membership Administration, Information Systems continued to be the most important source of increase, but displaced Customer Services as the fastest growing function. Corporate Executive and Governance outpaced all other functions in the Corporate Services cluster rather than Actuarial, the fastest on a constant-mix basis.

Let me close this section with a few summary observations. All my trend comments are based on continuously participating plans and includes the effect of staffing and costs performed on an outsourced basis.

Overall, the average staffing is higher than last year among continuously participating plans. The average staffing ratio for the eight plans was 26 FTEs per 10,000 members, though we estimate that it differs between products and market segments. For instance, it was likely 22 FTEs per 10,000 members for Medicaid.

Of the 14 functional areas with staff, ten had average ratio increases and four had declines. The largest rate of growth is found in Rating and Underwriting, and Corporate Executive and Governance followed.

Compensation increased slightly and varied by function. Corporate Executive posted the largest increase, while the Corporate Services functional area followed. In total, eight of the 14 functions with staff experienced compensation increases from a year ago. The average compensation for Core staff was \$95,000 per FTE, including benefits. Propensity to outsource was slightly higher than last year in total, at about 20% of Core Staffing. Ten out of the 14 functional areas with staff increased outsourcing.

To reiterate, on a constant-mix basis, Actuarial costs posted the fastest rate of growth of the core functions followed by the Corporate Services function. The Corporate Services Functional Area and Information Systems were the most important sources of cost growth. Meanwhile, Corporate Executive and Governance and Information Systems were the fastest growing and most important source of growth, respectively, on an as-reported basis.

<Slide 9>



To this point, we have focused on rates of change rather than the underlying values of the components of administrative costs. The next few slides speak to the values of these activities, though it is necessarily a summary.

Note the difference in the unadjusted raw numbers between last year's values and this year's. Core median PMPM expenses of \$28.82 was 2.5% lower than the median of \$29.56 last year. The prior year values are shown in Appendix A and are also excerpted on this page. The trends bear no relationship to prior years because of universe and mix-changes.

Account and Membership Administration is the largest cluster of expenses and is comprised of activities central to health plan operations, increased by 6.9% to a median of \$16.35 PMPM. Medical and Provider Management costs per member per month were \$7.13 PMPM, 2.6% lower than last year's value of \$7.32. The Corporate Services cluster costs were higher PMPM than last year at \$6.75 versus \$6.17, an increase of 9.4%. (This actually parallels the trends in the three previous slides.) Total Expenses grew by 5.8% to \$38.35 PMPM. The Sales and Marketing cluster grew by 0.5% to a median of \$7.69 PMPM

<Slide 10>

As you know, we favor an approach to understanding costs that reduce or eliminate the effect of product mix. This slide illustrates why. Note that this slide includes Sales and Marketing except for the measures noted at the bottom.

Medicare and Medicaid are government-sponsored products serving seniors and the low-income population. The median costs for Medicaid products fall between commercial insured and self-funded commercial ASO. Median costs for Medicaid HMO was \$27.13 PMPM and Medicaid CHIP was \$26.24 PMPM. Medicaid HMO's average share of members is 43% and its revenue share is 40%. Medicaid CHIP's average member mix and revenue mix was 1%. For all Medicaid, the median per member cost was \$26.93.

Medicare products are relatively high cost at \$96.85 PMPM for Medicare Advantage, \$215.95 PMPM for Medicare Special Needs Plans, and \$57.71 PMPM for Medicare Cost. Average membership mix for Medicare Advantage was 7%, Medicare SNP was 1%,



and Medicare Cost was 3%. Average revenue mix for Medicare Advantage was 15%, Medicare SNP and Medicare Cost were each 3%. Medicare SNP is especially important since this is, we believe, primarily composed of dual-eligible members.

Note that Medicare Supplement is a higher than average cost product at \$55.52 PMPM. We include this as a comprehensive product in the *Sherlock Benchmarks* though it pays only when Medicare does not. Half of the plans in the Medicaid universe offer the product and its mean membership mix is 1%.

The mean mix of all Commercial products, Insured and ASO, was 46% of the membership and Commercial ASO was 15%. Commercial administrative expenses are both higher and lower than the median comprehensive total, which depends on their financing mechanism and indirectly bears on group size. An ASO group possesses the statistical advantages of larger size, which also means that their Sales and Marketing costs are spread through greater numbers of members. The costs of Commercial Insured products are accordingly higher than the median for Comprehensive products offered by these plans. The single most important Commercial Insured product is HMO at \$42.21 PMPM. Indemnity and PPO costs \$51.61 PMPM while POS costs \$41.45 PMPM.

ASO products represented a mean of 15% of comprehensive members. These products' costs are lower than for comparable insured products largely due to the modest per member Sales and Marketing expenses required for large groups that are capable of self-insuring. Thus, these products have a median cost of \$20.98 PMPM.

There is a note at the bottom that ties Medicaid to some of the earlier slides on trends and aggregate cost segmentations. Per Member Per Month Core Medicaid Total expenses were \$25.48 PMPM. Medicaid HMO and Medicaid CHIP were \$25.69 and \$20.18, respectively. Note the very modest differences between the median total costs at the top of the Figure and the Core expenses at the note at the bottom. Sales and Marketing costs for Medicaid are typically modest, but we do include Risk Adjustment / Rating and Underwriting in this cluster.

<Slide 11>

This is similar to the previous slide, only expressed in percents of premium equivalents. By that I mean, for a denominator, we have added medical expenses to the fees. The median administrative expense relative to premiums was 8.4%, matching last year's



ratio. In many cases, the relationships between the costs of various products measured in percents parallel those measured in PMPM values.

Medicaid HMO was lower than average on both a PMPM and percent of premium basis at 7.1%. Medicaid CHIP was lower than average on a PMPM basis but, at 11.3%, is higher than average on a percent of premium basis.

Medicare SNP, vastly higher on a PMPM basis than Commercial HMO Insured, is 11.4%, only 1.4 percentage points higher than Commercial HMO. Medicare Advantage expenses, while about two times greater than Commercial HMO Insured products on a PMPM basis, is almost equal on a percent of premium basis at 10.1%. Medicare Cost was the highest among Medicare products on a percent of premium basis at 13.4%.

While Medicare Supplement is above average cost when measured PMPM, at 22.3%, its cost ratio was the highest among the Comprehensive products.

Administrative expenses on a percent of premium basis for Commercial HMO, POS and Indemnity, and POS were 10.0%, 10.3%, and 6.4%, respectively.

Commercial ASO products are 5.3% on a premium equivalent basis. It is also relatively low cost when measured on a PMPM basis. The lower Sales and Marketing for self-insured groups is key reason for this difference.

Core expenses as a percent of premium for Medicaid Total was 6.2%, while Medicaid HMO was also 6.2%, and Medicaid CHIP was 8.7%. Again, the differences are minor since Sales and Marketing costs are modest for this segment.

<Slide 12>

Slide 12 shows the ratios of administrative expenses to premiums or equivalents. Core administrative expenses were 0.2 percentage points lower than last year's at a median of 6.6%. Both Medical and Provider Management and Corporate Services were the same as last year at 1.6% and 1.5%, respectively. Account and Membership Administration fell by 0.2 percentage points to 3.5%.

Total expenses, including Sales and Marketing, had a median percent of premium of



8.4%, the same as the prior year. Sales and Marketing increased by 0.1 percentage point to a median of 2.0%.

<Slide 13>

As you know, all the health plans participating in our benchmarking studies segment their costs by product. This makes it possible for us to compare the same products *across* universes. Medicaid-focused plans generally have costs in the middle of the sets when measured by PMPM, but somewhat low on a percent of premiums basis.

Compared with the Medicaid universe, Medicaid HMO Core expenses for Blue Cross Blue Shield Plans were \$28.35 PMPM greater than Medicaid-focused plans, while 7 percentage points higher on a percent of premium basis.

Independent / Provider – Sponsored plans were lower by \$7.19 PMPM versus the Medicaid-focused plans. On a percent of premiums basis, however, Independent / Provider – Sponsored plans were higher by 0.6 percentage points.

Total expenses, including Sales and Marketing, produced similar results to differences in Core Expenses. Blue Cross Blue Shield Plans were \$29.87 PMPM higher than Medicaid plans and higher by 5 percentage points on a percent of premiums basis. Independent / Provider – Sponsored plans were \$7.11 PMPM lower and 0.1 percentage points higher than Medicaid-focused plans.

There is variation between the plans, but Independent / Provider – Sponsored plans tend to have lower Corporate Services and Medical and Provider Management expenses in the Medicaid HMO product versus the Medicaid universe. Blue Cross Blue Shield Plans had notably higher Medical Management and Account and Membership Administration expenses compared to the Medicaid Universe.

One possible explanation for Medicaid plans lower percents measure of costs relative to IPS plans and higher PMPMs may relate to the fact that Medicaid plans have higher PMPM revenues for this product. This could stem from sicker members, though we cannot know this for certain.

<Slide 14>



Let me close by summarizing.

The Core cost trends accelerated by 5.5% (constant-mix) and 7.1% (as-reported), the second fastest since 2014. The Account and Membership cluster grew similarly.

All expense clusters accelerated, including Sales and Marketing. The Corporate Services cluster grew the sharpest, with the other clusters' growth ranging between 5% and 6%.

Actuarial was the most rapidly growing functional area, while the Corporate Services functional area was the most important source of growth. The Rating and Underwriting function was the fastest growing and largest driver in Sales and Marketing growth.

Staffing ratios increased to 26 FTEs per 10,000 members or an estimate of 22 FTEs per 10,000 for Medicaid.

Of the 14 functional areas with staff, ten had average ratio increases and four had declines. The largest increases were found in Rating and Underwriting followed by Corporate Executive and Governance.

Core Compensation increased moderately to \$95,000 per FTE but amounts and growth varied by function. Corporate Executive posted the largest increase, while the Corporate Services functional area followed.

Propensity to outsource was slightly higher than last year in total. Ten out of the 14 functional areas with staff increased outsourcing, and 20% of Core FTEs were outsourced.

In closing, presentation, (transcript and slides) will be posted on our web site in the next few hours. In addition to these slides, we include last year's values, some descriptive materials.

You will also find the presentations on Blue Cross Blue Shield, Independent / Provider – Sponsored, and Medicare-focused trends. Please contact me for information on licensing these universes. Additional information, including tables of contents on the benchmarks themselves are found on the website. Reach out if you have any questions.



Thank you for your attention to our presentation. Now I would like to open this for questions.

• • •

Questions and Answers

• • •

I want to again thank you for your participation in this web conference. More in-depth and actionable information is available in the Sherlock Benchmarks themselves, which anyone can license. Please contact me directly if you are considering licensing these materials.

Let me thank you all for the hard work that goes into the 16th annual edition of the Medicaid benchmarks. We believe that participation pays off in lower costs, but the “by-product” is something that benefits the industry as a whole. Thank you!

This is Douglas Sherlock of Sherlock Company.