Transcript

Medicare Plans' Administrative Expenses Accelerate in 2023

October 8, 2024

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<Title Page>

Good afternoon. I'm Doug Sherlock. Welcome to our summary of the 21st annual *Sherlock Benchmarks* for Medicare plans. Thank you all for participating in this call. To speed through it, the audience will be muted during the presentation itself. I very much welcome your questions at the end of this presentation. We will be posting the slides and the transcript of this call within 24 hours.

Before I start, as always, we owe a debt of gratitude to the plans that participated in the Benchmarks and our principal contacts in particular. Thank you for your considerable efforts to harmonize your classifications with your peer group while also honoring your other responsibilities to your plans.

Thank yous are also due to the most effective and efficient team in management consulting, Chris, Erin, John and Andrew. Thanks to their efforts, and the infrastructure that we've built, this cycle has gone well.

This is the third in a series of presentations of the 2024 editions of the Benchmarks based on 2023 calendar year results. We've posted two previous presentations on our web site, along with transcripts, so I hope you will access them if the BlueCross BlueShield or Independent/Provider-Sponsored health plan information would be helpful.

The 11 Medicare-focused plans that are the subject of this presentation have a combined revenue of $59 billion, of which Medicare Advantage and SNP composes an average of

38%. We believe this universe is robust, and the resulting values and analyses are informative.

This is the 27th consecutive year of the *Sherlock Benchmarks*. Our cumulative experience exceeds 1,000 health plan years, and this year includes Independent / Provider – Sponsored Plans, Blue Cross Blue Shield Plans, Medicaid Plans as well as Medicare Plans.

<Slide 2>

I'm going to breeze through this slide. It shows the topics that I will address, and summarizes the appendices. The focus of this presentation is Medicare plan costs, their trends and their notable contributing functions. We'll also touch on trends in Compensation, Staffing Ratios and Outsourcing that affect these trends. Finally, we have an interesting comparison of the costs of Medicare Advantage by the different universes that supply the product to their members.

Note that the appendices contain last year's values and a list of all of the 70 or so functions in each of the products offered by these health plans. There are 9 such comprehensive products so, in the Benchmarks themselves, administrative expenses are segmented into more than 600 expense/product cells, each of which are separately analyzed. We only summarize broad trends here. Finally, the appendices touch on our methods of surveying, validation, analysis and reporting.

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In March of 2024, Medicare beneficiaries totaled about 67 million people, a 2% increase year-over-year. While membership in the Fee-for-Service option *decreased* by 2.0%, people selecting private insurance, that is, the Medicare Advantage option, *increased* by 6.5% over the prior year, to almost 34 million people.

This graph shows a two-decade view of the market-based reconfiguration of this government-sponsored health benefit program. The Medicare Advantage share of Medicare beneficiaries increased in almost every year and in 2024, for the first time, represented a majority of Medicare beneficiaries, 50.8%.

Underlying this increase in market share is the growth in beneficiaries and even faster growth in Medicare Advantage. Since 2005, the number of Medicare beneficiaries has climbed by 23 million. Of this, about 28 million people have elected Medicare Advantage while the FFS membership share decreased by about 5 million.

According to KFF, the Congressional Budget Office projects that 64% of beneficiaries will be enrolled in Medicare Advantage plans by 2034. This seems plausible considering that growth in MA has averaged four times the rate of growth of Medicare as a whole over the past ten years.

It is hard to overstate the significance of this increase in share. Medicare beneficiaries are seniors who have much higher health care use than do working-age people so for them the cost of product failure is high. It is these high-risk people who have opted out of a government program in favor of a private alternative.

This year's Benchmarking study captured administrative cost trends for health plans offering the private alternative. The plans that participated in the various 2024 *Sherlock Benchmarks*, Medicare and the other Sherlock universes, serve about 7% of all eligible Medicare Advantage members. If you exclude from the denominator the five largest Medicare Advantage plans, which are not included in this set, the various Sherlock universe's MA business serve about 24% of the total Medicare Advantage membership.

Eleven plans participated in the Medicare edition of the *Sherlock Benchmarks*. While Medicare is typically their predominant product, it is not the only product offered by our participants. On average, Medicare Advantage and Medicare Special Needs plans comprise 38% of plan revenue in this universe.

They collectively served 1.8 million members in these two products. MA alone served 16% of MA members not served by the largest five plans. We think that the plans here represent industry trends. However they are self-selected: on the grounds that "you manage what you measure," the participants may disproportionately reflect those with an interest in optimizing their costs.

<Slide 4>

This slide summarizes long term administrative cost trends for Medicare-focused plans. When I speak of growth in costs in this presentation, it will be in *per member* terms, for continuously participating plans, after excluding the effects of changes in product mix.

The darker of the two lines is the annual increase in *total* administrative expenses. In 2023, excluding the effect of Miscellaneous Business Taxes, Medicare plans reported administrative cost increases of 6.2%, an increase from 1.9% in 2022. The lighter line is the annual rates of increase in Account and Membership Administration. It accelerated from 3.7% in 2022 to 5.1% in 2023.Trends in total and Account and Membership have usually had a rough correspondence with one another.

The Account and Membership cluster is comprised Enrollment, Customer Services, Claims and Information Systems. For the purpose of this discussion, we also include in this cluster the administration of pharmacy and behavioral health. This trend in Account and Membership Administration is of particular interest since they are the core direct administrative services of health plans, enrolling members, fielding member calls and processing claims, and the information systems necessary to support or automate such activities. The cluster represents over 40% of MA administrative costs. Many of this cluster's activities tend not to be as subject to economies of scale as Finance and Accounting or Corporate Executive.

In the slides that follow, we'll discuss the trends in this cluster, plus those of Sales and Marketing, Medical and Provider Management and Corporate Services. We will also touch on the trends of the underlying functions. We use the same health plans in both comparison years to avoid the distortions from changes in the universe.

As we will develop, all but two functions increased with Information Systems being the most important source of growth. We will also drill into the expense drivers, as noted earlier, and on outsourcing trends.

<Slide 5>

This slide provides greater detail on the trends illustrated in the previous slide. These columns are organized by year, 2022 and 2023, showing each cluster's growth. The columns are subdivided into "as reported" and "constant mix", with the latter backing out the effect of changes in product mix between the two years.

On the previous slide, we showed the 2023 increases in per member Total Administrative Expenses, of 6.2%, and in per member Account and Membership Administration, of 5.1%. These rates of change are shown on the fourth column, labeled "2023 Increase", "Constant-mix", and I have circled those values in blue. The second column, with 2022 comparisons, is directly comparable to the fourth column since both hold the mix *and* universe constant. The dark blue arced arrow is to draw your attention to the comparison with prior year's values. You can see last year's 1.9% Total increase I mentioned. I consider these constant mix increases to be the real increases.

The two columns that are labeled "as-reported" reflect per member trends in continuous plans, *without* holding mix constant. The as-reported expense increase of 5.2% was outpaced by the constant-mix increase of 6.2%. Implicit in the difference between these columns is that a shift in favor of less expensive products, like Medicaid, that leads to the appearance slower growth. The effect was not very strong and indeed As-Reported cost growth exceeded Constant Mix growth in the key clusters of Medical and Provider Management and Account and Membership Administration. The as-reported columns are linked by an unfilled arced arrow.

For continuously participating plans, membership in high-cost Medicare Advantage increased at a median rate of 3.8%, while Medicare SNP grew at a rate of 15.7%. Low cost Medicaid HMO, however, grew by a median of 3.4% and Medicaid CHIP increased by 5.4%. While these trends appear to show a trend towards more expensive products, there was also wide variation, and mean changes showed declines. An additional offsetting factor is that Commercial Insured membership declined by a median of 7.6%, while Commercial ASO increased by 0.6%. The latter is far less expensive. Overall, the median membership growth was 1.8%.

For all 11 plans, Medicare Advantage (including SNP) comprised an average of 38% of revenues and 18% of membership for comprehensive products. Commercial represented 37% of the revenues and 52% of the membership. Medicaid membership was 28%, and its revenue proportion was 19%. Med Sup was 2% of membership.

While overall cost growth was slower on an as-reported basis, there was variation between the clusters. Sales and Marketing was the fastest growing cluster at 6.7% on a constant-mix basis and 5.6% on an as-reported basis, which was the third fastest. Medical and Provider Management increased by 6.1% on a constant mix basis, *lower* than the 7.0% on an as-reported basis, respectively. Account and Membership Administration increased by 5.1% on a constant-mix basis below the 6.4% on an as-reported basis. Corporate Services grew by 3.5% on a constant-mix basis exceeding the 3.3% on an as-reported basis.

<Slide 6>

Now, I would like to comment on why the expenses in these clusters performed as they did. Slide 6 shows the rates of change and the most important reasons for the changes, after eliminating the effect of product mix differences, that is, on a constant mix basis. Costs increased by 6.2% PMPM, faster than last year's increase of 1.9%. Since these are what I consider the "real" rates of increase, I will spend a lot of time on this and discuss trends in order of their importance.

The chart on this slide notes both the rate of growth, that is, Greatest Change, and the effect on the overall PMPM cost increase, Highest Weight. The latter is effectively the growth in expenses, taking into account the size of those expenses.

The Account and Membership Administration cluster experienced a PMPM cost increase of 5.1%. This cluster was the one most responsible for the real increase in costs. For this and our related *Navigator* analysis, Account and Membership Administration includes Pharmacy and Behavioral Health expenses. The trends in administrative activities of these two benefits actually reduced cost growth by a median rate of 2.4 percentage points.

Information Systems was the most important source of this cluster's growth, as well as to overall growth. All Information Systems sub-functions increased, led by Applications Acquisition and Development.

While Information Systems was the most important source of growth for the cluster, Customer Services experienced the fastest growth. Compensation and Non-Labor Costs were responsible for this function's increase. All Customer Services sub-functions (Member Services, Printed Materials, Grievances) increased.

Claims adjudication posted an increase on Compensation and Non-Labor costs. The Payment Integrity sub-function increased sharply year-over-year.

Enrollment / Membership / Billing was *lower* than the prior year. Both sub-functions, Enrollment and Membership and Billing, were lower with the decline in Enrollment and Membership more pronounced than in Billing.

The Sales and Marketing cluster's costs grew by 6.7%. Medicare Advantage staffing ratios increased. External Broker Commissions was the second fastest growing function in the cluster but, due to its size, was its most important source of growth. After Information Systems, it was the most important source of cost increase among the functions. The increase was especially sharp in Medicare.

The Sales function was the fastest growing function within the Sales and Marketing cluster. The sub-functions of Account Services and Other Sales were up from the prior year.

Advertising and Promotion was the third fastest growing function in this cluster. The subfunction Media and Advertising increased as Charitable Contributions declined.

Rating and Underwriting and Marketing functional areas each increased at low single digit rates.

The Medical and Provider Management cluster saw a PMPM increase of 6.1%. While Provider Network Management was the faster growing functional area, the larger Medical Management function contributed more significantly to the cluster's increase. The cluster's Medicare Advantage Staffing Ratio and Non-Labor costs per FTE grew year-over-year.

Medical Management sub-functions that posted year-over-year growth were led by Health and Wellness, followed by Quality Components, Nurse Information Line, Medical Informatics, Utilization Review and Other Medical Management.

Provider Network Management and Services grew faster than Medical Management. Provider Relations Services was the fastest growing sub-function, while Other Provider Network Management was up slightly.

The Corporate Services cluster was slowest growing cluster, at 3.5%. The cluster's Compensation, Non-Labor Costs, and Outsourcing were higher, but Staffing Ratios were lower.

The Corporate Services *function* was the most important source of growth in this cluster. Sub-functions that grew from the prior year included Human Resources, Legal, Purchasing and Risk Management.

Actuarial was the most rapidly growing function for this cluster, on increased Staffing Ratios, Non-Labor and Compensation, while the use of Outsourcing declined. Corporate Executive and Governance and Association Dues and Licensing Filing Fees were up by mid to low single digits.

Finance and Accounting was the only function within this cluster to experience a PMPM decline in expenses. Staffing Ratio and Outsourcing declined as Non-Labor costs per FTE increased sharply.

<Slide 7>

This slide describes the *reported* rates of change, that is, the values with no adjustments for changes in product mix. They are however based on continuously participating plans. The overall increase was 5.2% as against 6.2% on a Constant Mix basis.

Account and Membership cluster posted the largest variance between as-reported and constant-mix growth. The as-reported increase was 6.4%, while the constant-mix increase was 5.1%, a 1.2 percentage point difference. In this cluster, Customer Services was the fastest growing increase and Information Systems was responsible for the greatest share of the increase. On an as-reported basis, the Customer Services and Claims growth rates were marginally higher, while the decline in Enrollment was slightly slower. Information Systems increased slightly slower on an as-reported basis. As previously noted, Account and Membership *includes* Pharmacy and Behavioral Health administration. Administrative expenses in Behavioral Health and Pharmacy each decreased at a slower rate on an as-reported basis compared to a constant mix basis.

Sales and Marketing as-reported PMPM costs grew by 5.6% and compares to the constant-mix increase of 6.7%. Rating and Underwriting flipped from a slight increase on a constant-mix basis to a slight decline on an as-reported basis. Meanwhile, the External Broker Commissions experienced the largest variance from as-reported to constant-mix from mid-to-high single digit rate to a low single digit rate. Sales replaced

Commissions as the highest weight in its cluster. Recall the slight shift towards Medicaid, which has no broker Commissions.

Medical and Provider Management cluster grew at a faster rate on an as-reported basis, 7.0% versus the constant-mix increase of 6.1%. On an as-reported basis, Provider Network Management and Services experienced a slightly slower increase, while Medical Management's posted a slight acceleration. As with the Constant Mix increase Provider Network Management and Services was fastest growing, while Medical Management was the most important factor in this cluster's growth.

The Corporate Services cluster increased at a slower rate on an as-reported basis at 3.3%, similar to the 3.5% increase on a constant-mix basis. Actuarial's increase in expenses were sharply lower on an as-reported basis and reflected the largest different of all functions in this cluster. The decline in Finance and Accounting slightly accelerated on an as-reported basis. The increase in Corporate Services function was marginally slower, while Corporate Executive was slightly faster on an as-reported basis. The increase in Association Dues and License Filing fees was faster by one percentage point on an as-reported basis. Association Dues, on this rendering, was the fastest growing function in this cluster, while Corporate Services remained the most important source of growth.

Let me close this part of our presentation with a few summary observations. All my trend comments here and following are based on continuously participating plans. Cost factors include the effects of outsourced activities in that they are converted to internal FTEs, staffing costs and non-labor expenses.

The median compensation per FTE was approximately $109,000, higher than last year's median. Compensation in 11 of the 14 functions with staffing increased, led by Information Systems and Advertising and Promotion.

Medicare Advantage median staffing ratios were higher than last year. The median was 60 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, half were greater than last year. Corporate Executive and Governance and Actuarial posted the largest increases from the prior year.

Median Non-Labor Costs per FTE were higher than last year among continuous plans, about $94,000 per FTE. Twelve of the functional areas experienced an increase in Non-

Labor Costs per FTE. Corporate Executive and Claims were functions that experienced the largest increases.

Overall propensity to outsource was slightly lower, to 12% of the total FTEs, and eight of the fourteen functional areas with staff decreased the percent of their staff that was outsourced. Marketing and Advertising and Promotion experienced the largest declines.

<Slide 8>

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. This slide contains the results of the entire set of plans in this universe as well as the difference from the prior year. The product mix for all eleven plans in 2023 differed in that there was more focus on Medicare Advantage, but less on both Commercial Insured and ASO. For the reasons of product mix and universe differences, year over year comparisons do not capture cost trend accurately.

The median PMPM value of $52.53, 10.1% higher than the median value of $47.73 from 2022. The prior year values are shown in Appendix A and are also excerpted on this page. The constant mix growth was 6.2%.

Account and Membership Administration is the largest cluster of expenses at a median value of $21.52, higher than last year's median of $19.87, or by 8.3%. This cluster composed 41% of total expenses. Its size means that it has a substantial effect on overall comparisons. This cluster includes the central activities of Information Systems, Enrollment, Claims and Customer Services. On a constant mix basis, costs for continuously participating plans increased by 5.1%.

Sales and Marketing, the second largest cluster, had median costs of $13.80 and compares to $12.96 from last year, 6.5% greater. This function includes Rating and Underwriting, Sales, Marketing, broker Commissions and Advertising.

Medical and Provider Management cluster's costs were $9.79 PMPM, higher by 9.5% from $8.93 last year. This group of functions includes Provider Network Management and Services and Medical Management.

The Corporate Services cluster costs was higher by 18.5% to $8.39 PMPM from $7.08 last year. Activities include Corporate Executive, Actuarial, Finance and Accounting, and a group of other activities like Facilities, HR and Legal, collectively called the Corporate Services *function*.

Dispersion for Total expenses, measured by the Coefficient of Variation, increased by 34 percentage points. Account and Membership Administration dispersion increased by 14 percentage points. Corporate Services cluster dispersion increased by 59 percentage points, as Medical and Provider Management increased by 51 percentage points. Sales and Marketing increased by 17 percentage points.

The opposite occurred when measured by the difference between 75^{th} and 25^{th} percentiles. The dispersion for Total expenses, Corporate Services cluster, and Medical and Provider Management narrowed. Conversely, Sales and Marketing and Account and Membership widened.

<Slide 9>

As you know, we favor an approach to understanding costs that reduce or eliminate the effect of product mix. This slide illustrates why understanding the very different administrative requirements for each product is essential to understand and compare expenses.

Medicare products are relatively high cost at $127.70 and $229.50 PMPM for Medicare Advantage and Medicare Special Needs Plans, respectively. While these high-cost products define the universe, they represent only part of these plan's product portfolios.

Medicare Supplement is a secondary payer to Fee-for-Service Medicare. It is a lower-than-average administrative cost product at $46.56 PMPM. We include this as a comprehensive product in the *Sherlock Benchmarks* though it pays only when Medicare does not. Eight of the 11 plans offered this product.

Medicaid products fall below average among the costs of various comprehensive products. Medicaid HMO, has median PMPM cost of $29.18, while the median PMPM for CHIP is $39.15. Not only are these products below the costs of the Medicare products, they are also below commercial insured and commercial ASO products.

The Commercial Insured HMO median PMPM costs were $59.51. Indemnity and PPO and POS median costs were $61.05, and $43.80, respectively. These are approximately one-half the per member cost of Medicare Advantage.

Self-insured Commercial ASO products are about half the cost of the insured Commercial products. An ASO group possesses the statistical advantages of larger size, which allows the sponsor, such as an employer, to self-insure. It also means that their Sales and Marketing costs are spread through a greater number of members driving down per member Sales and Marketing and Enrollment costs. The Median Commercial ASO product was $31.32 PMPM.

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This is similar to the previous slide, only expressed in percents of premium equivalents. By premium equivalent I mean we have added medical expenses to the fees to calculate the denominator on self-insured relationships. The median administrative expense relative to premiums for Comprehensive Total was 9.1%, 0.1 percentage point *higher* than last year's value.

Medicare Advantage and Medicare SNP are at 12.0% and 11.9%, respectively. On a percent of premium basis, Medicare Advantage and Medicare SNP are close in statistical proximity to Commercial Insured products at 10.3%, while Medicare products were vastly greater on a PMPM basis. This similarity in percents between commercial insured and Medicare Advantage reflects that many of the administrative requirements of insured people tend to track their health needs.

The ASO product has a median value of 7.0% of premium equivalents. Like the PMPM ratios, this ratio is substantially lower than the ratios for insured products that range from 9.1% for POS to 10.7% for Indemnity and PPO. HMO is at 9.3%. The percents for these insured products more or less parallel the relative PMPM values when compared with the Total.

Like the ASO product, Medicaid HMO is also low cost at 7.7%. CHIP is higher than average at 14.4%. Per member Sales and Marketing expenses are modest in ASO and the Medicaid products.

By contrast, Medicare Supplement was the highest ratio among comprehensive products at 23.9%. It has many of the same administrative expenses of a regular insurance product, but its health care costs and premiums on which they are based are less because it is a secondary payor. Therefore, the PMPM and percent ratios diverge quite a bit.

<Slide 11>

This slide shows the administrative expenses by cluster of functions, expressed in percent. Overall costs were at 9.1% of premium equivalents, 0.1 percentage points above that of last year. Medical and Provider Management costs as a percent of premiums were also higher by 0.1 percentage points to 1.7%. Sales and Marketing, Account and Membership Administration and Corporate Services cluster were each essentially the same at 2.5%, 3.6% and 1.4%, respectively.

<Slide 12>

Health plans in other *Sherlock Benchmark* universes also offer Medicare products. In this slide, we compare the results of the Medicare Advantage products offered by Blue Cross Blue Shield Plans and Independent/Provider-Sponsored plans to those of organizations focused on Medicare.

The cost definitions and activities are the same across the three universes. Most of the plans in our set of Medicare focused plans are drawn from IPS and BCBS universe but were selected based on their higher commitment to Medicare Advantage. The sets shown in this slide are however mutually exclusive. Together, these three universes serve about 2.5 million Medicare Advantage members, about 24% of all Medicare Advantage members not served by the largest five organizations. Not included in the comparisons are members served through SNP products.

Sometimes focus leads to cost advantages and to some degree we can observe this in this year's benchmark values. Medicare plans PMPM expenses were $11.06 lower than Blue Cross Blue Shield Plans. Measured as a percent of premiums, were 2.6 percentage points less.

The Medicare focused plans enjoyed a mixed advantage compared to the Independent / Provider - Sponsored plans. The IPS plans were lower by $0.06 on a PMPM basis, and higher on a percent of premium basis by 1.5 percentage points.

<Slide 13>

I want to digress to observe that the *Sherlock Benchmarks* universe of Medicare plans is remarkable because it reflects a high share of members not served by the largest of the Medicare Advantage plans.

According to the Kaiser Family Foundation and CMS figures, the five largest health plans serving Medicare Advantage possess 69.2% of the total, as shown on this slide. Of the 10.4 million not served by those plans, the *Sherlock Benchmarks* for Medicare include the results of 16.3%. If the additional 862,000 members served through other *Sherlock Benchmarks* universes are included (we show their values in the financial metrics volume of the *Sherlock Benchmarks* for Medicare) approximately 24% of those members are included in the *Sherlock Benchmarks*.

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In summary, the overall cost trends grew by 6.2% (constant-mix) or 5.2% (as-reported). Constant mix growth in Total and most clusters accelerated from last year. Information Systems had the greatest impact on cost growth.

There was a shift towards Medicaid products that require lower administrative expenses as well as a shift away from relatively expensive Commercial Insured products. Thus, the constant mix cost growth was faster than the as-reported cost growth.

Medicare Advantage products offered by these plans had a median cost of $127.70, far greater than the $29.18 of Medicaid per member month costs, and double that of commercial insured products. Sales and Marketing grew rapidly on Sales and Commissions. Account and Membership Administration growth was central to overall growth, with IS and Customer Services especially strong.

The median compensation per FTE was approximately $109,000, up from last year. Compensation in 11 of the 14 functions with staffing increased led by Information Systems and Advertising and Promotion.

Median Medicare staffing ratios increased to 60 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, half experienced increases. Corporate Executive and Governance and Actuarial posted the largest increases from the prior year.

Median Non-Labor Costs per FTE were higher than last year among continuous plans, about $94,000 per FTE. Twelve of the functional areas experienced an increase in Non-Labor Costs per FTE. Corporate Executive and Claims were functions that experienced the largest increases.

Overall propensity to outsource was slightly lower, to 12% of the total FTEs, and eight of the fourteen functional areas with staff decreased the percent of their staff that was outsourced. Marketing and Advertising and Promotion experienced the largest declines.

This presentation, (transcript and slides) will be posted on our web site in the next 24 hours. In addition to these slides, we include last year's values, some descriptive materials. Additional information, including Tables of Contents on the Benchmarks themselves are found on the website. Call me if we can elaborate.

Thank you for your attention to our presentation.

Q&A

In late October, we will have a similar web conference on the results of the Medicaid universe. We hope that you will consider participating in that web conference as well.

Once again, I want to thank everyone involved in the 21st annual edition of the Medicare benchmarks for their insights and hard work. Participation pays off in lower costs for the plans but we hope that the results benefits the industry as a whole.

This is Douglas Sherlock of Sherlock Company.