



Transcript

Medicare Plans' Administrative Expenses Continue to Accelerate in 2018

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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 of 2018 results for various peer groups of health plans. We've posted two previous presentations on our web site, along with transcripts, so I hope you will access them if the Blue or Independent/Provider-Sponsored health plan information would be helpful. We're planning to report on the Medicaid Universe on October 9th.

The 11 Medicare-focused plans that are the subject of this presentation have a combined revenue of \$29 billion, of which an average of 51% are Medicare Advantage and SNP. We believe this universe and the resulting analysis and data to be quite robust.

All of the results that we will discuss today are the results of surveys reflecting significant efforts of the participants including participating in data validation. So, I thank the participating plans, especially our primary contacts within those plans. Since the subject matter of this web conference is free of charge and beneficial to health plans that do not or cannot participate in the study, I hope you share my gratitude.

I want to offer a framework for today's discussion. Much of the work that we do surrounds the administrative activities of health plans, though we also analyze health care utilization and medical management metrics. We stress administrative expenses since, while health plans may manage the care for many of their members, they provide administrative services in support of all of them.



This year marks the 22nd year of the Sherlock Benchmarks, and the 16th for the Medicare-focused universe. I estimate that by year end our cumulative experience will be 858 health plan years, and will include Independent / Provider – Sponsored Plans, Blue Cross Blue Shield Plans, Medicaid Plans and Medicare Plans.

The goal of *Sherlock Benchmarks* is to aid in plans' achievement of optimal costs, that is, to incur only those costs that are required to meet plans' strategic objectives. In that way, the Benchmarks establish a norm so that, above those levels, expenses should be justified with an ROI. The measurement of a return on investment is challenging but may ultimately be linked to with more rapid growth or a decline in health benefit trends.

There are at least two other reasons why optimizing administrative expenses is a high priority for health plan managers. First, the surge in expenses of adapting to the Affordable Care Act and onboarding Exchange and Medicaid members have passed. Second, administrative expense visibility has been heightened by the rhetoric of presidential candidates.

<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. That means that administrative expenses are segmented into more than 700 expense/product cells, each of which are separately analyzed. We only summarize broad trends here. 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. Seven out of eleven plans repeat 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>



In March of 2019, Medicare beneficiaries totaled 65 million, a 5.3% increase year-over-year. While the Fee-for-Service option increased by 4.3%, people selecting private insurance, the Medicare Advantage option, increased by 7.4% over the year to 23 million people.

This chart shows the longer view of the market-based reconfiguration of this government-sponsored health benefit program. Since 2005, the number of Medicare beneficiaries has climbed by 21 million. Of this increase, 17 million have elected Medicare Advantage while 4 million chose the FFS program. Obviously, this ignores migrations of members in and out of the two alternatives but, when all is said and done, 80% of the net incremental membership selected Medicare Advantage. Members in private Medicare Advantage plans accounted for about 35% of Medicare-eligible beneficiaries, up from 34.5% in 2018.

The plans that participated in the 2019 *Sherlock Benchmarks*, Medicare and the other Sherlock universes, serve approximately 9% of all eligible Medicare Advantage members.

Eleven plans participated in the Medicare edition of the *Sherlock Benchmarks*. While Medicare is typically the predominant product, it is not the only product offered by our participants. On average, Medicare Advantage and Medicare Special Needs plans comprises 51% of plan revenue in this universe. They collectively served 789,000 members in these products. By virtue of their share, we think that the plans here represent industry trends, but they are self-selected. That is, 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, which as you can see, have been accelerating. When I speak of growth in costs in this presentation, it will generally be in *per member* terms, for continuously participating plans, after having reweighted the trends to exclude the effects of any changes in product mix.

The darker of the two lines is the annual increase in *total* administrative expenses. In 2018, excluding the effect of Miscellaneous Business Taxes, Medicare Plans reported



administrative cost increases of 6.4%, the highest since 2012. In fact, since the nadir of 2014, where PMPM costs declined by 6.7%, costs have accelerated each year.

The lighter line is the annual rates of increase in Account and Membership Administration. This expense cluster is Enrollment, Customer Services, Claims and Information Systems. This is of particular interest since it composes the core of the direct administrative activities of health plans, enrolling members, fielding calls and processing claims, whether manual or automated through information systems. These activities have the additional property of not being subject to economies of scale in the same magnitude as finance and accounting or corporate executive and governance.

Costs per member per month in Account and Membership Administration increased by 7.0%, the fastest growth rate since 2013.

In the slides that follow, we'll discuss the trends in all four clusters, and touch on the trends of the individual functions. As we will develop, all sixteen functions increased except Enrollment / Membership / Billing and Association Dues and License / Filing Fees. Six functions, Advertising and Promotion, Provider Network Management and Services, Information Systems, Actuarial, Corporate Services Function, and Corporate Executive & Governance increased by double-digit rates. The most important sources of growth were Advertising and Promotion, Medical Management, Information Systems, and Corporate Services Function.

We will also drill into the drivers. By that I mean non-labor expenses, staffing costs and staffing ratios. Estimated Medicare Advantage Staffing Ratios were higher. We'll also touch on outsourcing, which slightly increased.

<Slide 5>

On the previous slide, we showed accelerating trends in per member Total Administrative Expenses, of 6.4%, and in per member Account and Membership Administration, of 7.0%. These columns are organized by year, 2017 and 2018, showing each cluster's growth. The 2018 trends of the prior slide are shown on the fourth column, labeled "Constant-mix", "2018 Data", and I have circled them in blue. The fourth and second columns reflect cost trends among continuously participating plans, backing out the effect of product mix and changes between the two years. I consider



this the 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 less expensive products, like Medicaid HMO, would lead to the appearance accelerated growth, while a shift in favor of less expensive products would lead to apparent deceleration.

I'll return with greater detail to this in a moment but because the constant-mix growth of 6.4% exceeds the 5.4% as-reported growth, for these plans, we can infer that there was a shift toward less expensive products.

That is in fact what took place. Low cost Medicaid HMO increased by an average rate of 11.7% and Medicaid CHIP grew by 5.7%. Commercial Insured membership increased by an average of 2.5%, but Commercial ASO fell by 10.1%. Commercial total was lower by an average of 3.3%. Medicare Supplement was lower by 12.5%, on average. Conversely, high cost Medicare Advantage increased by 1.8%, on average, with Medicare SNP growing by 5.7%.

For all eleven plans, the average commercial mix was 49% lower than last year's 59%. Average ASO mix was 12% versus 19% last year. The membership share of various Medicare products was an average of 23% of the total compared with 16% last year. The high revenue yield of Medicare Advantage, corresponding with beneficiaries' health needs, explains why 51% of revenues are Medicare Advantage. Medicaid was 16% of membership approximately the same as last year.

Every cluster experienced per member cost growth regardless of whether they are as-reported or constant-mix. Corporate Services cluster of expenses was the fastest growing at 10.1% on a constant-mix basis. Medical and Provider Management and Account and Membership Administration increased by 7.3% and 7.0%, respectively. Sales and Marketing increased slightly by 0.5%.

The 11 participating plans collectively served 4.6 million members. On average, 35% were Medicare Advantage and 1% were Medicare SNP. The average plan had 415,000 members and the median size was 364,000.

<Slide 6>

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Slide 6 shows the rates of change and the most important reasons for the changes, after eliminating the effect of product mix differences. Costs increased by 6.4% PMPM. 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.

The Corporate Services cluster was the fastest growing cluster and posted its second fastest increase over the past five years at 10.1%. This cluster’s median Medicare staffing ratio and compensation were higher than last year, while non-labor costs per FTE was lower. Plans also outsourced more for this cluster.

Actuarial was the fastest growing function in the Corporate Services cluster. The staffing ratio, outsourcing, staffing costs, and non-labor costs were all higher for this functional area. Actuarial expense trends sometimes parallel Rating and Underwriting, which was also higher.

The most important increase for this cluster was in the Corporate Services Function. The HR, Legal, Facilities, Imaging, Risk Management, and Other Corporate Services sub-functions drove the increase in the Corporate Services functional area.

Conversely, Association Dues and License / Filing Fees posted near double digit declines but was the smallest functional area in this cluster and not as impactful as the other functions.

The cluster of Medical and Provider Management grew at the second fastest rate at 7.3%. Provider Network Management and Services grew the fastest, while Medical Management was a more important source of growth, due to its greater size.

Growth in Medical Management was driven by the sub-functions of Nurse Information Line, Health and Wellness, Quality Components, and Other Medical Management. The staffing ratio, staffing costs per FTE, and non-labor costs per FTE were higher in Medical Management compared to last year, while the propensity to outsource was lower.

The Account and Membership Administration cluster of expenses experienced a PMPM cost increase of 7.0%. Information Systems was the cluster’s fastest growing function and was the most important source of growth both for the cluster and overall. The



staffing ratio was lower for Information Systems, but outsourcing, compensation, and non-labor costs were higher.

Conversely, Enrollment / Membership / Billing fell by single digits. The decline was driven by the Billing sub-function.

The Sales and Marketing cluster was the slowest growing cluster in 2018, at 0.5%. The cluster's staffing ratio was higher, but compensation, non-labor costs, and outsourcing were lower.

Advertising and Promotion was the fastest growing functional area, as well as the most important source of growth. The Marketing, Sales, Rating and Underwriting, and external commissions functional areas increased at low-to-mid single digit rates. The staffing ratio, outsourcing, and staffing costs were higher in Advertising and Promotion, while non-labor costs per FTE were lower.

<Slide 7>

This slide explains the *reported* rates of change, that is, the values with no adjustments for changes in product mix. These trends, again, are based on continuous plans. For the most part, there is a correspondence between the constant-mix and as-reported renderings. Both greatest changes and highest weights functional areas were the same regardless of constant-mix or as-reported basis. However, on an as-reported basis, the Sales and Marketing cluster grew at a much faster rate, while Medical and Provider Management also grew faster.

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, average estimated Medicare Advantage staffing ratio was higher among continuing plans. Of these continuously participating plans, the average staffing ratio was 54 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, ten experienced median increases. The largest increases included Finance and Accounting, Provider Network Management and Services and Sales.

The median compensation, including benefits, per FTE was about \$93,000. The change in median compensation per FTE was flat and varied by function. Eleven functions



increased slightly, but the higher compensation area of Corporate Executive and Governance declined by low double-digit rates.

The overall propensity to outsource was flat compared to last year. However, nine out of the 14 major functional areas with staff increased outsourcing.

<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.

A very rough gauge of trend is difference in the raw numbers between last year's values and this year's. The median PMPM value of \$55.45, 39% greater than the median value of \$39.80 last year. The prior year values are shown in Appendix A and are also excerpted on this page. Again, the membership share of the various Medicare Advantage products increased from 16%, on average, to 23%.

So, there is little correspondence with the overall administrative cost trends on Slide 5 and cluster increases that resulted in the values shown here. Account and Membership Administration increased by 27.5% to a median of \$21.43. This cluster is about 39% of the overall costs to deliver coverage products to this universe. It is the core elements of Enrollment, Customer Services, Claims and Information Systems.

The Corporate Services Cluster posted a median of \$8.89 and reflected the second fastest increase of 27.2%. Medical and Provider Management cluster's costs was \$9.16 and experienced an increase of 24.8%. Sales and Marketing posted a 10.8% increase to a median of \$13.93.

Dispersion for Total expenses, measured by the Coefficient of Variation, was higher than last year, by 8 percentage points. Dispersion increased by 1 percentage points for Sales and Marketing, 6 percentage points for Medical and Provider Management, 7 percentage points to Account and Membership, and 12 percentage points for Corporate Services cluster.

<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. Medicare and Medicaid are government-sponsored products serving seniors and the low-income population. Medicare products are relatively high cost at \$90.95 and \$155.00 PMPM for Medicare Advantage and Medicare Special Needs Plans, respectively.

Among the comprehensive insured products, Medicaid products fall between commercial insured and commercial ASO. Medicaid HMO, has median PMPM cost of \$31.70, while the median PMPM for CHIP is \$25.01.

Note that Medicare Supplement is a lower than average cost product at \$42.53 PMPM. We include this as a comprehensive product in the Sherlock Benchmarks though it pays only when Medicare does not. Four of the 11 plans offer the product.

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 self-insurance. It also means that their Sales and Marketing costs are spread through a greater number of members driving down per member costs. The Median Commercial ASO product was \$21.89. Meanwhile, the Commercial Insured HMO, Indemnity and PPO, and POS median costs were \$47.12, \$46.24, and \$49.28, respectively.

<Slide 10>

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 9.6%, 1.1 percentage points higher than last year's value. In many cases, the relationships between the costs of various products measured in percents parallel those measured in PMPM values.

Medicare Advantage and Medicare SNP at 10.4% and 8.4%, respectively, are similar to the commercial insured products at 11.1%, while the PMPMs are much greater. This similarity in percents is consistent with many administrative requirements of insured people tending to track their health needs.



Medicare Supplement was the highest among comprehensive products at 18.5%. It has many of the same administrative expenses of a regular insurance product, but its health care costs are less because it is a secondary payor.

The ASO product has a median value of 6.0%. Like the PMPM ratios, this percent is substantially lower than the ratios for insured products that go from 10.6% for POS to 11.9% for Indemnity and PPO. HMO is at 10.8%. The percents more or less parallel the PMPM values.

Like the ASO product, Medicaid HMO is also low cost at 7.2%. CHIP is higher than average at 10.6%.

<Slide 11>

This slide shows the administrative expenses by cluster of functions, expressed in percent. As in the previous page overall costs were at 9.6% of premium equivalents, 1.1 percentage points higher than last year. Account and Membership Administration was 0.5 percentage points higher than last year at 3.9%, while Medical and Provider Management was greater by 0.2 percentage points to 1.7%. Corporate Services cluster was higher by 0.1 percentage points to 1.6%. Note, Sales and Marketing was *lower* by 0.5 percentage points to 2.2%. Except for Sales and Marketing, there is little correspondence with real cost trends and changes in these percents.

<Slide 12>

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. Medicare-focused plans generally held a cost advantage over both universes for all clusters. Collectively, this represents the experience of 2.1 million people, close to 10% of all Medicare Advantage members.

When we compare Medicare Advantage products offered by the Medicare universe to those of Blue Cross Blue Shield Plans, the median values are \$21.14 PMPM lower than BCBS Plans, or 2.1 percentage points lower on a percent of premium and equivalents basis. The median administrative costs for Medicare plans were \$0.48 PMPM *higher* than Independent / Provider - Sponsored plans, but lower by 1.5 percentage points on a percent of premiums and equivalent basis.



<Slide 13>

Let me close by summarizing.

The overall cost trends accelerated by 6.4% (constant-mix) or 5.4% (as-reported), the second highest in the past six years. Account and Membership continued its cost growth from last year.

Corporate Services posted the sharpest growth with Medical and Provider Management and Corporate Services increasing by single digits from last year. Sales and Marketing was the only cluster to increase slower than last year.

Advertising and Promotion was the fastest growing functional area, while Information Systems was the most important source of growth because of its size.

Staffing ratios increased to 54 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, ten had median ratio increases. The largest increases include Finance and Accounting, Provider Network Management and Services, and Sales.

Median Compensation was relatively flat from last year at \$93,000 per FTE. Eleven functions increased slightly, but the higher compensation area of Corporate Executive and Governance declined by low double-digit rates.

Propensity to outsource was flat compared to last year. However, at 20%, nine out of the 14 functional areas with staff increased outsourcing.

This 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.

On October 9th, we plan on hosting a similar web conference for Medicaid-focused plans. 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. Now I would like to open this for questions.



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Questions and Answers

Q: What were the trends in medical costs for this population of plans?

A: PMPM health benefit costs increased for Medicare Advantage by an average of 5.2% among continuously participating plans. This corresponds with an average increase of 3.8% in Medicare Advantage premiums per member. These increases do not consider the effect of any differences in benefit design, population demographics, geographic mix or other factors that are extraneous to true health care trend.

Q: Does the Medicare universe have Blue Cross Blue Shield or other health plans in it?

A: There are no Blue Cross Blue Shield plans included with the Medicare universe. Some Provider-Sponsored Plans with a high commitment to Medicare are included in its universe. However, the sets of plans on the comparative chart on slide 12 are mutually exclusive.

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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.

On October 9th, we will have a similar web conference on the results of the Medicaid plans. We hope that you will consider participating in those web conferences as well.

Let me thank the participants for the hard work that goes into the 16th annual edition of the Medicare benchmarks. We know, because we measure this, 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.