Transcript

Medicare Plans' Administrative Expenses Experience Slower Growth in 2019

September 16, 2020 – November 2020

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

<Title Page>

I'm Doug Sherlock. Welcome to our summary of the *Sherlock Benchmarks* for Medicare plans. This is the third in a series of presentations of 2019 results for various peer groups of health plans. We will be posting the slides and the transcript of this presentation within 24 hours. I very much welcome your questions at the end of this presentation. To speed through it, the audience will be muted during the presentation itself.

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.

The 10 Medicare-focused plans that are chief the subject of this presentation have a combined revenue of $47 billion, of which an average of 32% is Medicare Advantage and SNP. We believe this universe and the resulting analysis and data to be quite robust.

This year marks the 23rd year of the *Sherlock Benchmarks*, and the 17th for the Medicare-focused universe. In the next month or so, at the close of the 2020 cycle, our cumulative experience will be 893 health plan years, and will include Independent / Provider – Sponsored Plans, Blue Cross Blue Shield Plans, Medicaid Plans and Medicare Plans.

<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. Repeat participation makes this possible.

<Slide 3>

In March of 2020, Medicare beneficiaries totaled 69 million, a 6.4% increase year-over-year. While the Fee-for-Service option increased by 4.9%, people selecting private insurance, the Medicare Advantage option, increased by 9.3% over the prior year to nearly 25 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 25 million. Of this increase, 19 million have elected Medicare Advantage while 6 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, 76% of the net incremental membership selected Medicare Advantage. Members in private Medicare Advantage plans accounted for about 36.0% of Medicare-eligible beneficiaries, up from 35.1% in 2019.

The CBO believes that most beneficiaries will be members of Medicare Advantage plans in 10 years. It is hard to overstate the significance of this. Remember, these are seniors who have much higher health care use than do working-age people so the cost of product failure is very high to them. It is these people who have opted out of a government program in favor of a private alternative.

This year's benchmarking studies endeavor to capture administrative cost trends for health plans. The plans that participated in the 2020 *Sherlock Benchmarks*, Medicare and the other Sherlock universes, serve approximately 8% of all eligible Medicare Advantage members.

Ten 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 32% of plan revenue in this universe. They collectively served 1.2 million 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 increasing since 2014. 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 2019, excluding the effect of Miscellaneous Business Taxes, Medicare Plans reported administrative cost increases of 5.2%, lower than both 2017 and 2018, but higher than most of the last eight years.

The lighter line is the annual rates of increase in Account and Membership Administration, which accelerated to 9.3% growth, its highest level in the past eight years. 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. (It also includes administrative costs of behavioral health and pharmacy benefits.) In addition to composing some central activities of health plans, this cluster's activities tend not to be quite as subject to economies of scale as finance and accounting or corporate executive and governance.

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, most functions increased and the

most important sources of growth were Information Systems, Medical Management and Advertising and Promotion.

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

<Slide 5>

On the previous slide, we showed increases in per member Total Administrative Expenses, of 5.2%, and in per member Account and Membership Administration, of 9.3%. These columns are organized by year, 2018 and 2019, showing each cluster's growth.

The 2019 trends of the prior slide are shown on the fourth column, labeled "Constant-mix", "2019 Increase", 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 in those plans between the two years. I consider this the real increase. The dark blue arced arrow is 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 more expensive products, like Medicare Advantage, would lead to the appearance slower growth, while a shift in favor of less expensive products would lead to apparent acceleration. The as-reported columns are linked by an unfilled arced arrow.

I'll return with greater detail to this in a moment but, because the constant-mix growth of 5.2% trailed the 5.8% as-reported growth, for these plans, we could guess that there was a shift toward more expensive products.

That is in fact what took place. Membership in high cost Medicare Advantage increased at a median rate of 4.8% as Medicare SNP grew by 5.7%, displacing Medicare Supplement which fell by 5.9%. Commercial Insured increased by 3.3% while Commercial ASO increased by 6.0%. Low cost Medicaid HMO fell by 1.0% and lower cost Medicaid CHIP increased by 4.6%.

For all ten plans, Medicare Advantage including SNP composed an average of 12% of membership and 32% of revenues for comprehensive products. The median Medicaid membership was 12%, and its revenue proportion was 28%. Commercial represented most of the balance: about half the revenues and most of the membership.

Except for Corporate Services, every cluster experienced per member cost growth regardless of whether they are as-reported or constant-mix. Account and Membership Administration was the fastest growing at 9.3%, on a constant-mix basis. Medical and Provider Management and Sales and Marketing grew by 7.1% and 4.9%. respectively. The Corporate Services cluster fell by 2.8%.

<Slide 6>

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 5.2% 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 Account and Membership cluster was the fastest growing cluster and posted its fastest growth rate compared to the past eight years at 9.3%. As footnoted, that includes the effect of Behavioral Health and Pharmacy administration, which surged this year after declines in the previous two. Without these two activities, growth would have been only 7.1%. Customer Services was the cluster's fastest growing functional area and, because of its far greater cost-weight, Information Systems was the most important source of growth for this cluster and in total. Conversely, both Enrollment and Claims fell by single digits.

This cluster's median Medicare staffing ratio and compensation per FTE was higher than last year, while the propensity to outsource and Non-Labor Costs per FTE were lower.

The cluster of Medical and Provider Management grew at the second fastest rate at 7.1%. The Medical Management function was the fastest growing and most important source of growth in this cluster. Growth in Medical Management was driven by the sub-functions of Quality Components and Health and Wellness. Non-Labor Costs per FTE and Compensation was higher, but Staffing Ratio and Outsourcing was lower.

The other function in this cluster is Provider Network Management and Services. It is smaller and grew less rapidly than Medical Management. While all sub-functions increased, Provider Contracting grew especially rapidly. Staffing Ratio increased in this function and in each sub-function, though Staffing Costs per FTE generally decreased. For the function as a whole, Non-Labor Costs per FTE fell and Outsourcing was effectively unchanged.

The Sales and Marketing cluster increased at 4.9%. The cluster's staffing ratio, non-labor costs per FTE and outsourcing were higher, but its compensation was lower. Advertising and Promotion was both the fastest growing and most important source of growth. Rating and Underwriting increased at low double-digit rates: notably its outsourcing sharply increased. Broker Commissions, and Marketing increased at single digit rates. The Sales function was slightly lower.

The Corporate Services cluster was the only cluster to post a decline, dropping by 2.8%. The increase in Finance and Accounting was the greatest rate of change for this cluster. It grew faster than any time during the past five years, and higher staffing and non-labor costs were the drivers.

However, the decline in Corporate Services Function, Corporate Executive and Governance, and Association Dues and License / Filing fees outweighed the increase in Finance and Accounting and the low single digit increase in Actuarial.

This cluster's median Medicare staffing ratio, non-labor costs, and outsourcing fell, while Staffing Costs per FTE was higher.

<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. There is a close correspondence between the constant-mix and as-reported renderings. Both greatest changes and highest weights functional areas were generally the same regardless of constant-mix or as-reported basis. In the Corporate Services cluster, the Corporate Services function became the most important source of change in the cluster on an as-reported basis, as compared with Finance and Accounting on a constant-mix basis.

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

Overall, average estimated Medicare Advantage staffing ratio was higher among continuing plans. Of these continuously participating plans, the average staffing ratio was 62 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, eight experienced increases. The largest increases included Provider Network Management, Advertising and Promotion, and Services, and Finance and Accounting.

The median compensation per FTE was just under $100,000, which increased slightly between the two years. The median compensation per FTE was flat and varied by function. Eight functions increased (though some slightly), but the higher compensation area of Corporate Executive and Governance declined by low double-digit rates.

Propensity to outsource was lower, overall, and only two of the fourteen functional areas with staff Rating and Underwriting and Information Systems 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.

The median PMPM value of $42.50, 23% less than the median value of $55.45 last year. In addition to the actual trends, the participating plans in the universe and their product mix contribute to these declines. To give you a sense of what I mean, when we reweight the 2018 PMPM costs for the 2019 product mix, costs increase by 9.1% between the years, higher than the 5.2% constant mix growth from the continuous plans.

The prior year values are shown in Appendix A and are also excerpted on this page.

For the reasons of product mix and universe differences, it can be misleading to compare year-over-year changes. For the sake of completeness we touch on it anyway.

Account and Membership Administration decreased by 17% to a median of $17.84. This cluster is about 42% 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 $6.66 and was lower by 25% from last year. Medical and Provider Management cluster's costs was $7.39 and was 19% less than the prior year. Sales and Marketing 18% lower, with a median of $11.41.

Dispersion for Total expenses, measured by the Coefficient of Variation, was lower by 15 percentage points. Dispersion narrowed for all clusters except for Medical and Provider Management, which widened by 13 percentage points. When measured by the difference between 75th and 25th percentiles, the dispersion of each cluster narrowed as did expenses as a whole.

<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 products are relatively high cost at $94.65 and $171.10 PMPM for Medicare Advantage and Medicare Special Needs Plans, respectively. These high-cost products represent only part of these plan's product portfolios.

Medicare Supplement is a product sold to seniors in lieu of Medicare Advantage. It is a lower than average cost product at $43.17 PMPM. We include this as a comprehensive product in the *Sherlock Benchmarks* though it pays only when Medicare does not. Seven of the 10 plans offer the low cost product.

We believe that approximately 80% of Medicare SNP people are dual eligible which we group with Medicare. Medicaid HMO excludes those receiving Medicare benefits and has median PMPM cost of $35.04, while the median PMPM for CHIP is $25.35. These are below average cost products.

The Commercial Insured HMO, Indemnity and PPO, and POS median costs were $52.58, $49.49, and $47.54, respectively. These are roughly one-half the 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 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 $26.91.

By the way, the content on this slide gives rise to my earlier statement that the reweighted values from the prior year, when compared to the total PMPM costs of $42.50, equal a change of 9.1%.

<Slide 10>

This is similar to the previous slide, only expressed in percents of premium equivalents. By premium equivalent I mean, for a denominator, we have added medical expenses to the fees on self-insured relationships. The median administrative expense relative to premiums was 8.5%, 1.1 percentage points *lower* 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.

The ASO product has a median value of 6.5%. Like the PMPM ratios, this percent is substantially lower than the ratios for insured products that range from 7.9% for POS to 10.9% for Indemnity and PPO. HMO is at 10.1%. The percents for these insured products more or less parallel the PMPM values.

On the other hand, Medicare Advantage and Medicare SNP at 9.2% and 9.0%, respectively, are also similar to the commercial insured products at 10.2%, notwithstanding that the PMPMs are much greater. This similarity in percents between commercial insured and Medicare Advantage is consistent with many administrative requirements of insured people tending to track their health needs.

By contrast, Medicare Supplement was the highest ratio among comprehensive products at 18.7%. 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.

Like the ASO product, Medicaid HMO is also low cost at 8.8%. CHIP is higher than average at 11.1%. Note that per member Sales and Marketing expenses tend to be modest in both ASO and Medicaid.

<Slide 11>

This slide shows the administrative expenses by cluster of functions, expressed in percent. As in the previous slide, overall costs were at 8.5% of premium equivalents, 1.1 percentage points lower than last year. Account and Membership Administration was 0.2 percentage points lower than last year at 3.6%, while Medical and Provider Management was lower by 0.3 percentage points to 1.4%. Corporate Services cluster was lower by 0.3 percentage points to 1.3%. The Sales and Marketing increased by 0.1 percentage points to 2.2%.

There is little correspondence with PMPM cost trends and changes in these percents.

<Slide 12>

As you know, all the health plans participating in the *Sherlock Benchmarks* segment their costs by product. This makes it possible for us to compare the same products *across* universes, such as IPS and BCBS. Collectively, this chart represents the experience of 2.1 million people, about 8% of all Medicare Advantage members.

Medicare-focused plans generally held a cost advantage over both universes for all clusters. When we compare Medicare Advantage products offered by the Medicare universe to those of Blue Cross Blue Shield Plans, the median values are $19.98 PMPM lower than BCBS Plans, or 4.9 percentage points lower on a percent of premium basis. Compared to Independent / Provider – Sponsored plans, Medicare plans were $4.80 PMPM lower and 4.3 percentage points lower on a percent of premiums and equivalent basis.

We don't know the reason behind this superior performance. We do know that the Medicare Advantage universe has a higher concentration of Medicare Advantage members, so perhaps scale and focus contribute.

<Slide 13>

Let me close by summarizing.

The overall cost trends grew by 5.2% (constant-mix) or 5.8% (as-reported), Account and Membership continued its acceleration in cost growth from last year and was the fastest growing cluster. Again, without the surge in Pharmacy and Mental Health Administration, this growth would have been 7.1%. On a constant mix basis, cost growth decelerated, from 6.4% last year.

Medical and Provider Management and Sales and Marketing increased by single digits from last year, while Corporate Services cluster posted a decline.

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 62 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, eight had median ratio increases. The largest increases include Provider Network Management and Services and Advertising and Promotion.

Median Compensation was slightly up to almost $100,000 per FTE. Eight functions increased, but the higher compensation area of Corporate Executive and Governance declined by low double-digit rates.

Propensity to outsource was lower compared to last year, at 17%. Only two 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.

In the coming weeks, 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.

• • •

Q: Is the universe smaller than in prior years?

A: It is the same size but thinner in the sense of it having a higher concentration of plans with other business lines than Medicare. I attribute this to the knock-on effects of Covid-19. Participation became more difficult as plans adapted to membership declines and remote work, resulting from policy initiatives mandating lock-downs to curb Covid-19 infection. Since our benchmark process is sequenced, the earliest Blue Cross Blue Shield plans, was very high and Medicare was relatively low.

Q: From time to time you refer to Medicare staffing ratios. Do these plans operate separate staffs for their Medicare Advantage products?

A: Great question. For the most part, and for most functions, they do not operate separate staffs for Medicare or any other product they offer. But the plans do provide cost information from which we can estimates, and that is what we are referring to. To make this estimate, we start with the PMPMs, which are segmented by product, and the total costs per FTE, which they supply to us. So, to estimate the Medicare staffing ratio, we divide the PMPM by the total cost per FTE.

Q: Speaking of impact of Covid, do you have any insight into what year-end 2020 PMPMs will look like?

A: In short, we don't. Our benchmarks are retrospective. I do have a few comments. First, for those of you who are users of the Benchmarks, we do have an application helps to model the effects of scale and changes in product mix which will be directly applicable to this environmental condition. Second, we do model economies of scale and expect to publish on them in coming months. We use regression analyses for this. Third, we have done some modeling on short term economies of scale: after all, for health plans, all costs are fixed in the short term and all costs vary in the long term. Fourth, what we have seen among your peers that are publicly traded is a sharp increase in administrative expenses as a percent of premiums.

• • •

I want to close by hoping that none of you and yours were directly affected by the coronavirus but, if you were, I hope that you or they made a speedy and complete recovery.

Thank you again for your participation in this web conference. In early October, we will have a similar web conference on the results of the Medicaid universe. We hope that you will consider participating in those web conferences as well.

Once again, I want to thank everyone involved in the 17th 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.

I especially thank my outstanding team at Sherlock Company for making this possible.

Finally, I wish to remember Randy Edwards, former the CEO of Blue Cross Blue Shield of Georgia. He was the catalyst for the Sherlock Benchmarks. He passed away this past June. Let light perpetual shine upon him.

This is Douglas Sherlock of Sherlock Company.