Transcript

Growth in Administrative Costs Slightly Ticks Up for Medicare-Focused Plans in 2020

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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. Thank you all for participating in this call. I also thank the plans that participated and our principle contacts in particular. I know that has been a heavy lift because of the COVID-19 environment. Thanks to my colleagues for making this come together.

This is the third in a series of presentations of the 2021 editions of the benchmarks based on 2020 calendar year results. 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 13 Medicare-focused plans that are chief the subject of this presentation have a combined revenue of $51 billion, of which Medicare Advantage and SNP on average composes 41%. We believe this universe and the resulting analysis and data to be quite robust.

This year marks the 24th year of the *Sherlock Benchmarks*, and the 18th for the Medicare-focused universe. In the next month or so, at the close of the 2021 cycle, our cumulative experience will be 929 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. The focus of this presentation, costs, their trends and their functional expense drivers. We'll also touch on trends in Compensation, Staffing ratios and Outsourcing that bear on these trends. Finally, we have an interesting analysis of the costs of the different universes that provide Medicare Advantage.

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 10 such products so, in the Benchmarks themselves, administrative expenses are segmented into more than 700 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 2021, Medicare beneficiaries totaled 63 million, a 1.9% increase year-over-year. While the Fee-for-Service option decreased by 3.4%, people selecting private insurance, the Medicare Advantage option, increased by 9.7% over the prior year to about 27 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 20 million.

Of this net increase, about 22 million have elected Medicare Advantage while the FFS membership eroded by about 2 million. In March of this year, members in private Medicare Advantage plans accounted for about 43% of Medicare-eligible beneficiaries, up from 40% in 2020.

The CBO believes that 51% beneficiaries will be members of Medicare Advantage plans in 10 years. This seems plausible, even conservative, considering MA share increased by 3.1 percentage points last year and 2.5 percentage points the year before.

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 high-risk 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 2021 *Sherlock Benchmarks*, Medicare and the other Sherlock universes, serve approximately 8% of all eligible Medicare Advantage members.

13 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 41% of plan revenue in this universe. They collectively served 1.7 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.

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This slide summarizes long term administrative cost trends for Medicare-focused plans. 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 2020, excluding the effect of Miscellaneous Business Taxes, Medicare Plans reported administrative cost increases of 5.6%, a slight acceleration from 2019. Overall growth has remained in a narrow band of growth from 2017.

The lighter line is the annual rates of increase in Account and Membership Administration. It declined very sharply from 9.3% in 2019 to 1.8% in 2020. It is the slowest growth since 2014. This cluster has following core activities – Enrollment, Customer Services, Claims and Information Systems. For the purpose of this discussion, we also include the administration of pharmacy and behavioral health in this cluster.

This trend in Account and Membership Administration is of particular interest since it composes the core of the direct administrative activities of health plans, enrolling members, fielding member calls and processing claims, whether manual or automated through information systems. In addition to composing 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 this cluster plus clusters of Sales and Marketing, Medical and Provider Management and Corporate Services, as well as touching on the trends of the underlying 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, as noted earlier, and on outsourcing trends.

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This slide provides greater detail on the trends. These columns are organized by year, 2019 and 2020, 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 2020 increases in per member Total Administrative Expenses, of 5.6%, and in per member Account and Membership Administration, of 1.8%. These rates of change are shown on the fourth column, labeled "Constant-mix", "2020 Increase", and I have circled them in blue. The second column 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. I consider these to be the real increases.

The two columns that are labeled "as-reported" reflect per member trends in continuous plans, without holding mix constant. Implicit in the calculations for this column 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.

Because the constant-mix growth of 5.6% trailed the 5.7% as-reported growth, we could infer that there was probably a shift toward more expensive products. That is in fact what took place. For continuously participating plans, membership in high-cost Medicare Advantage increased at a median rate of 2.5%, while Medicare SNP grew at a median rate of 12.6%. Less expensive Medicare Supplement fell at a median rate of 4.6%. Commercial Insured membership declined by a median of 3.9%, while Commercial ASO fell at a median rate of 1.2%. Medicaid HMO increased by 6.5%, but Medicaid CHIP decreased by 1.4%. Overall, the median membership trend was a decline of 1.1% and an average increase of 0.0%.

For all 13 plans, Medicare Advantage including SNP composed an average of 18% of membership and 41% of revenues for comprehensive products. Medicaid membership was 22%, and its revenue proportion was 17%. Commercial represented 38% of the revenues and 58% of the membership.

Every cluster experienced per member cost growth regardless of whether they are calculated as-reported or constant-mix. Corporate Services was the fastest growing cluster at 19.8% on a constant-mix basis. Medical and Provider Management and Sales and Marketing followed at 5.9% and 2.5%, while Account and Administration grew by 1.8%.

<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. Costs increased by 5.6% PMPM, somewhat greater than the 5.2% from last year. These are what I consider the “real” rates of increase, so 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 speed of growth, Greatest Change, and the effect on the overall PMPM cost increase. The Highest Weight is effectively the growth in expenses, taking into account the size of those expenses.

The Corporate Services cluster was the fastest growing cluster at 19.8% and reverses last year’s decline. This rate of change has one-offs in the Corporate Services *function*. The cluster’s Medicare Staffing Ratio was higher and Outsourcing was lower.

The Corporate Services *Function* was the fastest growing function and most important source of growth. Most of its sub-functions increased: Legal, especially All Other Legal, Purchasing, Other Corporate Services and Risk Management had especially high rates of growth. One subfunction unequivocally declined, Printing and Mailroom. Many of the rest were broadly distributed such as Facilities and Audit which grew on average but their median growth was negative.

Corporate Services Function reporting was complicated by some one-offs. At least two of the reporting plans had a surge in litigation costs, including for risk corridor payments. There were also some corrections in classifications that affected comparability.

The Corporate Services function's Staffing Ratio and Non-Labor Costs per FTE increased. The propensity to outsource for this function was lower.

The Corporate Executive and Governance was the second fastest growing function for this cluster, growing nearly as rapidly as Corporate Services. As a smaller function, it was only the third largest contributor to overall cost growth. Staffing Ratio and Non-Labor Costs per FTE increased, and Outsourcing declined.

Finance and Accounting and Actuarial functions also posted increases, while Association Dues and License/Filing Fees was the only function within the Corporate Services *cluster* to fall. Actuarial staffing ratios, compensation and outsourcing all increased as non-labor costs declined. Finance and Accounting compensation and non-labor costs increased as outsourcing decreased.

The Medical and Provider Management cluster was the second fastest growing cluster, at 5.9%. The cluster's Medicare Staffing Ratio and Non-Labor Costs were higher, while Outsourcing was lower.

The larger Medical Management function was the more important source of cluster growth and grew at a faster rate compared to the Provider Network Management and Services function. Medical Management Staffing Ratio, Staffing Costs per FTE, and Non-Labor Costs per FTE were higher. The growth in Nurse Information Line, Health and Wellness, and Other Medical Management were all in the double digits. Conversely, the only sub-function to clearly decline was Disease Management.

The Provider Network Management and Services functional area also posted year-over-year growth. The brisk growth in Provider Relations Services and Provider Contracting offset the decline in the Other Provider Network Management and Services sub-function. For the function as a whole, the Staffing Ratio and Non-Labor Costs per FTE grew, while Compensation per FTE fell.

The Sales and Marketing cluster followed with a growth rate of 2.5%. The cluster's propensity to Outsource was lower while Staffing Costs per FTE increased.

Functions in this cluster that experienced year-over-year growth were Marketing, Broker Commissions and Advertising and Promotion. Advertising and Promotion increased at the fastest rate with both Media and Advertising and Charitable Contributions higher. Advertising and Promotion's Staffing Ratio, Compensation, Non-Labor Costs, and Outsourcing all increased.

Marketing was the second fastest growing function in this cluster driven by Product Development and Market Research. The Medicare Staffing was lower, especially in Other Marketing (strategy and leadership) though higher in Member and Group Communication. Outsourcing was higher and Compensation and Non-Labor Costs were lower.

External Broker Commissions grew by low single digit rates from last year, faster than for the cluster.

The Account and Membership cluster of expenses experienced PMPM cost increase of 1.8%, the slowest since 2014. The Medicare Staffing Ratio was higher for this cluster. Outsourcing and Staffing Costs per FTE were lower.

Enrollment / Membership / Billing was the fastest growing function within this cluster, driven by the growth in the Enrollment and Membership sub-function. Billing costs declined. While the Staffing Ratio declined, and non-labor costs declined, staffing costs increased as Outsourcing increased.

Customer Services grew at the second fastest rate in this cluster. The Staffing Ratio and Staffing Costs per FTE was higher than last year, while Non-Labor Costs and Outsourcing was lower.

Information Systems posted its first median decline over the past five years. While Operations and Support Services and Applications Maintenance declined Applications Acquisition and Development was up slightly. This function's Non-Labor Costs, Staffing Costs, and Outsourcing was lower, while Staffing Ratio was higher.

Note, Account and Membership Administration also includes Pharmacy and Behavioral Health expenses. Without Pharmacy and Behavioral Health, the cluster's increase would be 1.1% rather than the 1.8% as shown here. Interestingly, Behavioral Health Administrative costs declined in 2020.

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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. Sales and Marketing and Corporate Services cost growth is slightly slower and Account and membership Administration, and especially Medical and Provider Management grew faster.

One difference in the source of the growth was that the Corporate Executive and Governance function edged out the Corporate Services function to be the fastest growing function in both overall and the Corporate Services cluster.

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, it appears median Medicare Advantage staffing ratios are higher than last year among continuing plans. The median was 62 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, eight grew. (To be clear, health plans report aggregate staffing, from which Medicare Advantage staffing is inferred by assuming that all products have the same mix of staffing and non-labor costs.) The largest increases were in Actuarial, Corporate Executive and Governance, and Medical Management.

The median compensation per FTE was approximately $100,000. Compensation in five of the 14 functions with staffing declined, especially Marketing, Sales and Provider Network Management and Services. Six increased especially Rating and Underwriting and Medical Management.

Overall propensity to outsource was lower and eight of the fourteen functional areas with staff declined. Rating and Underwriting, Enrollment / Membership / Billing, and Corporate Executive and Governance experienced the largest decreases. Of the continuously participating plans, 9% of employees were outsourced.

Growth in Corporate Services Function, Medical Management, and Corporate Executive and Governance were central to the increase in expenses for 2020. All three functions experienced higher Staffing Ratios and Non-Labor Costs per FTE, while Corporate Services Function and the Corporate Services function had declines in outsourcing. Compensation was higher for Medical Management.

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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.

The median PMPM value of $45.45, 6.9% higher than the median value of $42.50 from last year. In addition to the actual trends, the participating plans in the universe and their product mix contribute to these increases. To give you a sense of what I mean, when we reweigh the 2019 PMPM costs for the 2020 product mix, costs *decrease* slightly, by 0.2%, between the years. 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 is the largest cluster of expenses at a median value of $18.44, higher than last year's median of $17.84 by 3.4%. This cluster composed 41% of total expenses. This cluster's 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.

The Corporate Services cluster costs posted the largest increase from $6.66 PMPM last year to $7.58 PMPM or a change of 13.9%. 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.

Sales and Marketing, the second largest cluster, had median costs of $11.62 and compares to $11.41 from last year, 1.8% greater. This function includes Rating and Underwriting, Sales, Marketing, broker Commissions and Advertising.

Medical and Provider Management costs per member per month were $7.50, while last year's value was $7.39. This group of functions includes Provider Network Management and Services and Medical Management. Its value was higher by 1.4%.

Dispersion for Total expenses, measured by the Coefficient of Variation, increased by 7 percentage points. Dispersion increased for all of the clusters except for Corporate Services, which declined by 2 percentage points. When measured by the difference between 75th and 25th percentiles, the dispersion of each cluster increased.

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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 $101.72 and $204.44 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 secondary payer to fee for service Medicare. It is a lower-than-average cost product at $38.13 PMPM. We include this as a comprehensive product in the *Sherlock Benchmarks* though it pays only when Medicare does not. Seven of the 13 plans offer this product.

Medicaid HMO has median PMPM cost of $28.50, while the median PMPM for CHIP is $23.59. These are below average cost products.

The Commercial Insured HMO, Indemnity and PPO, and POS median costs were $54.09, $54.51, and $48.19, 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 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 $22.90.

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 $45.45, equal a change of 0.2%.

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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 for Comprehensive Total was 9.1%, 0.5 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.

The ASO product has a median value of 6.8%. Like the PMPM ratios, this percent is substantially lower than the ratios for insured products that range from 8.4% for POS to 10.8% for Indemnity and PPO. HMO is at 9.7%. The percents for these insured products more or less parallel the PMPM values.

Medicare Advantage and Medicare SNP, at 10.5% and 12.6%, respectively. On a percent of premium basis, Medicare Advantage and Medicare SNP are close in proximity to Commercial Insured products at 10.0%, while Medicare products were much greater on a PMPM basis. 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 16.9%. 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 8.5%. CHIP is higher than average at 12.0%. Note that per member Sales and Marketing expenses tend to be modest in both ASO and Medicaid.

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This slide shows the administrative expenses by cluster of functions, expressed in percent. Overall costs were at 9.1% of premium equivalents, 0.5 percentage points higher than last year.

The Corporate Services cluster was 0.2 percentage points higher than last year at 1.5%, while Medical and Provider Management increased by 0.1 percentage point to 1.5%. Sales and Marketing grew slightly by 0.04 percentage points to 2.3%. Account and Membership Administration fell by 0.1 percentage points to 3.5%. 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 as a group 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 $46.17 PMPM lower than BCBS Plans, or 9.1 percentage points lower on a percent of premium basis. Compared to Independent / Provider – Sponsored plans, Medicare plans were $16.05 PMPM lower and 3.5 percentage points lower on a percent of premiums and equivalent basis. Incidentally, the cost advantage of the Medicare-focused plans extends over each cluster of functions.

We can only speculate that perhaps scale and focus contribute to this superior performance.

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Let me close by summarizing.

The overall cost trends grew by 5.6% (constant-mix) or 5.7% (as-reported), with a surge in growth for the Corporate Services cluster. Growth in all other clusters decelerated from last year with Account and Membership posting the slowest growth since 2014's decline.

Median staffing ratios increased to 62 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, eight grew. The largest increases were in Actuarial, Corporate Executive and Governance, and Medical Management. Membership declined, but shifted in favor of Medicare.

The median compensation per FTE was approximately $100,000. Compensation in six of the 14 functions with staffing declined such as Marketing, Sales, Provider Network Management and Information Systems. Other areas' compensation increased such as Provider Network and Medical Management, actuarial and Rating and Underwriting.

Overall propensity to outsource was lower and eight of the fourteen functional areas with staff also declined. Rating and Underwriting, Enrollment / Membership / Billing, and Corporate Executive and Governance experiencing the largest decreases. Of the continuously participating plans, 9% of employees were outsourced.

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 will host 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: You referred to a Medicare Staffing Ratio. What is that?

A: This is the staffing ratio for Medicare members. Let me get into the weeds here for a moment. While a plurality of the revenues and activities for this universe in the service of Medicare members, few health plans have staffs that are dedicated solely to this product. So, to calculate staffing ratios for Medicare and every other product, we divide the PMPM costs by the total costs per FTE for the health plan as a whole. We then divide the PMPM for the Medicare product by the total costs per FTE to arrive at a staffing ratio for the product. Effectively, we are assuming only that the proportion of labor and non-labor is the same across each product.

The staffing ratio includes outsourced staff. Sometimes the plans know what it is, say in the example of IS Contractors. But otherwise, they are derived based upon historic values for total costs per FTE among plans that do not outsource.

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I want to close by hoping that you are all returning to your pre-COVID lives and that you and yours were not too severely affected. If you were, it is our 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 18th 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.