Transcript

Growth in Administrative Costs Ticks Up Slightly for Medicare-Focused Plans in 2021

September 15, 2022

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 principal contacts in particular. I know this has been a heavy lift because of their other commitments. Their responsibilities range from external reporting, targeted cost management projects, more general FP&A and strategic planning. Also, while we seem to be out of the woods on Covid, translating the activities within the plans to the Benchmark classifications may remain more cumbersome because of operational function leadership working remotely.

I also thank my colleagues for making this come together. Each cost translation challenge for each plan has a counterpart at Sherlock Company since the panel tasks us to assure uniformity of reporting, key to the reliability of the Benchmarks. Also, our team develops systems for receiving surveys, compiling them, performing some automated validation, summarizing and then publishing. Plus validation has components that cannot be automated. I have a great team.

This is the third in a series of presentations of the 2022 editions of the Benchmarks based on 2021 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 BlueCross BlueShield or Independent/Provider-Sponsored health plan information would be helpful.

The 10 Medicare-focused plans that are the chief subject of this presentation have a combined revenue of $54 billion, of which Medicare Advantage and SNP composes a median of 34%. We believe this universe and the resulting analysis and data to be quite robust.

This year marks the 25th year of the *Sherlock Benchmarks*, and the 19th for the Medicare-focused universe. In the next month or so, at the close of the 2022 cycle, our cumulative experience will be 963 health plan years, and will include 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 lists the appendices. The focus of this presentation is Medicare plan 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 to 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 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.

<Slide 3>

In March of 2022, Medicare beneficiaries totaled about 64 million people, a 1.7% increase year-over-year. While the Fee-for-Service option *decreased* by 3.4%, people selecting private insurance, the Medicare Advantage option, *increased* by 8.5% over the prior year to almost 30 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 over 20 million.

Of this *net* increase, about 24 million people have elected Medicare Advantage while the FFS membership eroded by about 3 million. In March of this year, members in private Medicare Advantage plans accounted for about 46% of Medicare-eligible beneficiaries, up from 43% in 2021.

The CBO believes that 61% beneficiaries will be members of Medicare Advantage plans by 2032. This appears plausible. Considering MA share increased by 2.9 percentage points last year and 3.1 percentage points the year before, at a 3 percentage point annual increase, late in this decade does not seem far-fetched.

It is hard to overstate the significance of this growth. 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 these health plans. The plans that participated in the 2022 *Sherlock Benchmarks*, Medicare and the other Sherlock universes, serve a little over 8% of all eligible Medicare Advantage members. If you exclude from the denominator the five largest participants, which are not included in this set, the various Sherlock universe's MA business serves about 18% of the total membership.

10 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 34% of plan revenue in this universe. They collectively served 1.6 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. 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 2021, excluding the effect of Miscellaneous Business Taxes, Medicare Plans reported administrative cost increases of 0.6%, a sharp deceleration from the 5.6% increase in 2020.

The lighter line is the annual rates of increase in Account and Membership Administration. It continued its deceleration from 2019 from an increase of 9.3% to an increase of 1.8% in 2020 to only an increase of 0.3% in 2021. This is the slowest growth since 2014. Over this eight-year period, this cluster's trends have a rough correspondence with Total expense trends.

This cluster has following core activities – 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 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 for instance.

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. 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, half of the functions increased with External Broker Commissions 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. These columns are organized by year, 2020 and 2021, 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 2021 increases in per member Total Administrative Expenses, of 0.6%, and in per member Account and Membership Administration, of 0.3%. These rates of change are shown on the fourth column, labeled "Constant-mix", "2021 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. You can see last year's 5.6% Total increase I mentioned. 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 these columns is that a shift in favor of more expensive products, like Medicare Advantage, would lead to the appearance faster growth, while a shift in favor of less expensive products would lead to apparent slower growth. Since in both years, the as-reported expenses grew faster than constant mix, a shift towards more expensive products like Medicare must have occurred. In other words, because the constant-mix growth of 0.6% trailed the 0.7% as-reported growth, we could infer that there was a shift toward more expensive products. That is in fact what took place. The as-reported columns are linked by an unfilled arced arrow.

For continuously participating plans, membership in high-cost Medicare Advantage increased at an average rate of 2.0%, while Medicare SNP grew at an average rate of 8.3%. Less expensive Medicare Supplement fell at an average rate of 0.8%. Commercial Insured membership declined by a mean of 3.5%, while Commercial ASO fell at a mean rate of 6.0%. Medicaid HMO increased by 17.7%, but Medicaid CHIP decreased by 20.2%. Overall, the median membership trend was an increase of 1.2% and an average increase of 2.8%.

For all 10 plans, Medicare Advantage including SNP composed an average of 14% of membership and 34% of revenues for comprehensive products. Medicaid membership was 30%, and its revenue proportion was 24%. Commercial represented 37% of the revenues and 54% of the membership.

Sales and Marketing was the fastest growing cluster at 1.6% on a constant-mix basis, but *decreased* on an as-reported basis by 0.5%. Medical and Provider Management followed at an increase of 1.0%, constant-mix, and up by 1.2% on an as-reported basis. Account and Membership Administration grew by 0.3% on a constant-mix basis and 0.8% on an as-reported basis. Corporate Services was the only cluster to decline on a constant-mix and as-reported basis by 3.7% and 5.8%, respectively.

<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 0.6% PMPM, slower than last year's increase of 5.6%. 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 speed of growth, 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 Sales and Marketing cluster grew the fastest at 1.6% on higher Non-Labor Costs per FTE.

External Broker Commissions was the fastest growing function and most important source of growth, which posted its second highest growth over the past five years. In the *Sherlock Benchmarks*, Commissions are considered Non-Labor. Rating and Underwriting also increased with both Risk Adjustment and Other Rating and Underwriting sub-functions increasing. Outsourcing decreased while Non-Labor increased. Marketing and Advertising and Promotion had a broad distribution of results. Sales declined modestly: its staffing ratios tended to fall.

The Medical and Provider Management cluster also experienced a PMPM increase, by 1.0%. The Provider Network Management and Services functional area posted a year-over-year increase. The growth in Provider Relations Services offset the declines in

Provider Contracting and Other Provider Network Management and Services sub-functions. The Provider Configuration subfunction of Contracting tended to sharply increase. For the Provider Network Management and Services function as a whole, Staffing Ratios were higher.

The Medical Management function fell at a single digit rate. The Staffing Ratio, Compensation, and Outsourcing were lower for this function in 2021. Case Management, Nurse Information Line, Health and Wellness, Quality Components, Medical Informatics, Utilization Review, and Other Medical Management all posted declines ranging from the single digits to the high teens. Precertification, however, increased.

Note that Provider Network Management was the fastest growing function in this cluster, while the decline in Medical Management was the highest weight in this cluster. The Provider Network Management was impacted by two plans whose trends were performance outliers relative to the group.

The Account and Membership Administration cluster experienced a PMPM cost increase of 0.3%.

Claims posted the highest median growth with Non-Labor Expenses per FTE sharply higher year-over-year. There are several subfunctions in this function, the largest of which, Other Claims, experienced growth over the prior year. Outsourcing increased for this function.

Information Systems costs posted the largest median decrease in this expense cluster, at a low single digit rate, though some plans accelerated their expenses in this function. Staffing ratios tended to decline, as did outsourcing and staffing costs per FTE. Non-labor costs increased per FTE. Of the subfunctions, only Security Administration and Enforcement unambiguously increased.

Customer Services increased by less than 1%. In its key Member Services subfunction Staffing costs increased, and non-labor costs per FTE declined.

Enrollment / Membership / Billing experienced a decline from the prior year, at a low single digit rate. The drop in the Enrollment and Membership sub-function outweighed the increase in the Billing sub-function. Outsourcing and Staffing Costs per FTE trended higher.

For our presentation here, as opposed to in the *Sherlock Benchmarks*, Account and Membership Administration includes the administration of Pharmacy and Behavioral Health expenses. Pharmacy and Behavioral Health administration reduced cost growth in this cluster: the increase would have been 1.8% rather than the 0.3% as shown here.

The Corporate Services cluster was the only declining cluster, by 3.7%. The staffing ratio increased while the Corporate Services cluster's Non-Labor per FTE decreased.

Within this cluster, the large Corporate Services *function* posted the sharpest decrease and was the main driver in this cluster's decline. Several of its sub-functions declined from the prior year such as Legal, Facilities, Purchasing, Imaging and Printing and Mailroom. Non-Labor Costs per FTE and Staffing costs per FTE both declined.

Conversely, Finance and Accounting, Actuarial, and Corporate Executive and Governance experienced increases at a single digit rates. Actuarial increased outsourcing and Non-Labor costs per FTE as Staffing costs per FTE decreased. Finance and Accounting and Corporate Executive increased their staffing ratios and Outsourcing. The Credit Card fee subfunction of Finance and Accounting was sharply higher. Association Dues and License / Filing Fees posted a decline in median values.

<Slide 7>

This slide describes 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.

The difference in Sales and Marketing costs between As-Reported and Constant-Mix was the largest among clusters. This cluster's as-reported rate of change was a decrease of 0.5% compared to the increase of 1.6% on a constant-mix basis. The function with the largest difference from constant mix to as-reported was External Broker Commissions, from a mid-single digit increase to a minute decline. The Sales decline was far sharper on an As-Reported basis. The growth in Medicaid as well as the Commercial decline in this universe seems a plausible explanation for the sharp difference between this decline and the constant mix growth since Medicaid has few such expenses.

The Corporate Services cluster decreased by 5.8% on an as-reported basis versus a 3.7% decline on a constant-mix basis, nearly as dramatic a difference as that of the Sales and Marketing Cluster. The Corporate Services Function was the largest driver in this cluster's cost decline on both an As-Reported basis and Constant-Mix basis. Actuarial also flipped from a small increase to a small decrease on an As-Reported basis.

The Account and Membership cluster's growth accelerated from a constant-mix, 0.3%, to an as-reported basis, 0.8%. Claims grew faster on an as-reported basis, while Enrollment / Membership / Billing declined at a slower rate.

Meanwhile, administration of Behavioral Health sharply grew on an as-reported basis, while Pharmacy also increased. By contrast, on a Constant Mix basis, administration of Behavioral Health declined as that of Pharmacy benefits increased.

Medical and Provider Management cluster slightly accelerated its growth on an as reported basis to 1.2% compared to a increase of 1.0% on a constant-mix basis. Medical Management slowed its growth compared to the constant-mix basis, while Provider Network Management grew slightly faster.

Let me close this part of our presentation with a few summary observations. All my trend comments 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.

Overall, it appears median Medicare Advantage staffing ratios are lower than last year among continuing plans. The median was 61 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, eight decreased. (To be clear, this reflects both internal and outsourced staffing. Outsourced staffing is inferred, often calculated from invoice amounts by assuming that all products have the same mix of staffing and non-labor costs.) The largest percentage declines in median values were in Advertising and Promotion and Rating and Underwriting.

The median compensation per FTE was approximately $104,000, lower than last year's median. Compensation in five of the 14 functions with staffing declined, especially in Corporate Services function and Marketing.

Overall propensity to outsource was lower, to 10% of total FTEs. Nine of the fourteen functional areas with staff declined in the percent of their staff that was outsourced. This was led by Information Systems and Rating and Underwriting.

Median Non-Labor expenses increased to $80,000 per FTE, a 10% increase. Eight functions posted year-over-year growth in median values with Rating and Underwriting and Medical Management experiencing the sharpest increases.

Again, growth in External Broker Commissions, Claims, Provider Network Management and Services and Corporate Executive and Governance (somewhat offsetting the declines in the corporate services cluster) were central to the increase in expenses on a constant-mix basis for 2021.

<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 change from prior years. 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.

The median PMPM value of $46.69, 2.7% higher than the median value of $45.45 from 2020. In addition to the actual trends, the participating plans in the universe and their product mix contribute to the increase. To give you a sense of what I mean, when we reweigh the 2020 PMPM costs for the 2021 product mix, costs *increased* by 4.9%, between the years. The prior year values are shown in Appendix A and are also excerpted on this page.

Account and Membership Administration is the largest cluster of expenses at a median value of $19.36, higher than last year's median of $18.44 by 5.0%. 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.

Medical and Provider Management posted the largest increase in costs per member per month, by 20.8%, to $9.06. This group of functions includes Provider Network Management and Services and Medical Management.

Sales and Marketing, the second largest cluster, had median costs of $12.19 and compares to $11.62 from last year, 4.9% greater. This function includes Rating and Underwriting, Sales, Marketing, broker Commissions and Advertising.

The Corporate Services cluster costs *declined* by 3.6% to $7.31 PMPM from $7.58 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, decreased by 18 percentage points. Dispersion fell for all of the clusters, led by Medical and Provider Management, which fell by 37 percentage points.

When measured by the difference between 75th and 25th percentiles, the dispersion of every cluster declined, except for Corporate Services.

<Slide 9>

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

Medicare products are relatively high cost at $111.15 and $194.49 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 $31.82 PMPM. We include this as a comprehensive product in the *Sherlock Benchmarks* though it pays only when Medicare does not. Six of the 10 plans offer this product.

Medicaid HMO has median PMPM cost of $31.12, while the median PMPM for CHIP is $24.75. These are below average cost products.

The Commercial Insured HMO, Indemnity and PPO, and POS median costs were $50.72, $53.84, and $46.24, 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 $27.43.

<Slide 10>

This is similar to the previous slide, only expressed in percents of premium equivalents. By premium equivalent I mean, for a denominator on self-insured relationships, we have added medical expenses to the fees. The median administrative expense relative to premiums for Comprehensive Total was 8.7%, 0.3 percentage points *lower* than last year's value.

The ASO product has a median value of 6.2%. Like the PMPM ratios, this percent is substantially lower than the ratios for insured products that range from 8.7% for POS to 10.8% for Indemnity and PPO. HMO is at 9.5%. The percents for these insured products more or less parallel the PMPM values.

Medicare Advantage and Medicare SNP, at 11.0% and 12.4%, respectively. On a percent of premium basis, Medicare Advantage and Medicare SNP are close in statistical proximity to Commercial Insured products at 9.8%, while Medicare products were vastly 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 15.9%. 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 7.7%. CHIP is higher than average at 12.1%. 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. Overall costs were at 8.7% of premium equivalents, 0.3 percentage points lower than last year.

The Corporate Services, at 1.4%, cluster was 0.1 percentage points lower than last year, Sales and Marketing fell by 0.3 percentage points to 2.1%. Medical and Provider Management increased by 0.1 percentage point to 1.6% and Account and Membership grew by 0.04 percentage points to 3.6%. 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 Blue Cross Blue Shield. Collectively, this chart represents the experience of 2.4 million people, a little more than 8% of all Medicare Advantage members or, as I noted earlier, approximately 18% of the MA membership not enrolled in the five largest providers.

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 $46.74 PMPM lower than Blue Plans, or 5.1 percentage points lower on a percent of premium basis. Compared to Independent / Provider – Sponsored plans, Medicare plans were $45.58 PMPM lower and 4.8 percentage points lower on a percent of premiums 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 the superior performance of these Medicare health plans.

<Slide 13>

Let me close by summarizing.

The overall cost trends grew by 0.6% (constant-mix) or 0.7% (as-reported). Growth in Total and all clusters sharply declined from last year, led by Corporate Services' deceleration.

Median staffing ratios increased to 61 FTEs per 10,000 Medicare Advantage members. Of the 14 functional areas with staff, eight declined. The largest decreases in median values were in Advertising and Promotion and Rating and Underwriting. Membership increased and shifted in favor of higher cost products.

The median compensation per FTE was approximately $104,000. Compensation in eight of the 14 functions with staffing declined, led by the Corporate Services function and Marketing.

Overall propensity to outsource was lower and nine of the fourteen functional areas with staff declined. Information Systems and Rating and Underwriting posted the largest decreases as 9% of total 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. 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.

In 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 19th 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.