Transcript

Medicaid MCO Administrative Cost Trends: A Review of 2015 Results

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<Title Page>

I'm Doug Sherlock. Welcome to our summary of the benchmarking study for Medicaid plans. This is the fourth in a series of presentations summarizing 2015 performance metrics for various peer groups of health plans. We've posted previous presentations on our web site, along with transcripts, so I hope you won't hesitate to access them if the Blue, Independent/Provider-Sponsored or Medicare health plan information would be helpful.

<Slide 2>

This chart shows the rates of Per Member administrative cost changes while holding the product mix and universe constant. To do this, we re-weight prior year cost values to current year mixes. The dark blue is Core expenses and the light blue is the cluster of expenses we call Account and Membership Administration. (Core expenses exclude Sales and Marketing.)

Core Expenses declined the first time in administrative costs since 2009, while the rate for Account and Membership Administration grew at their fastest rate since 2011. (By the way, the figure numbers on this and other slides reference our free newsletter, *Plan Management Navigator*, which is available on our web site.) Core expenses PMPM for Medicaid plans participating in our study fell by 5.5% holding constant the product mix of the continuously participating plans, which we show in the chart. Account and Membership Administration costs increased by 4.9% on a constant universe and mix basis.

This is the second year since plans were subject to certain ACA related taxes. Last year saw enormous growth of over 600% of Miscellaneous Business Taxes, while this year saw growth of 34%. These values are not included in the trends in this figure.

<Slide 3>

Kaiser Family Foundation reports that, as of March 2015, 39.3 million people were served with comprehensive services by Medicaid Managed Care Organizations. The 11 Medicaid health plans participating this year collectively served 7.9 million members with comprehensive products, including Medicaid. That product, collectively comprised 55% of plan revenue. Medicare SNP, which we believe to be about 80% dual eligible, was 5.9%. So, while Medicaid is typically the predominant product, it is not the only product offered by our participants.

While we believe that the combined Sherlock Benchmark plans serve a significant share of MCO members, we recognize that they are "self-selected." That is, they may operate at cost levels and trends that reflect that they measure their activities. On the grounds that "you manage what you measure," these selected plans may disproportionally include those with an interest in optimizing their costs.

Incidentally, I want to thank the participants in this year's benchmarking study, some of whom are on today's web conference. A by-product of their participation is this summary. It benefits Medicaid plans as a whole, and we are grateful for this.

The plans use the benchmarks to learn whether they are world class organizations, to identify those organizations that are best-in-class and to prioritize targets for improvement. These last two are linked because the shortest way to emulate best practice is to achieve improvements in areas that represent the largest differences between you and the best in class. Our benchmarks are also used in many strategic initiatives from budgeting, to evaluation of outsourcing, to evaluating business combinations.

Let me add a word about Sherlock Company. As you may know, we have been performing health plan benchmarking studies for many years. Sherlock Company is

now completing its 19th consecutive annual survey of health plan operations and today's benchmarks are based on the cumulative experience of nearly 740 health plan years. In all of our various universes this year, the 44 health plans serve more than 59 million members. The Sherlock benchmarks' focus is on administrative expenses and related operational drivers, but they also include metrics of health care utilization.

Sherlock benchmarks are well-accepted, and are, in the words of four consulting firms, "the gold standard" for such metrics. Thus, health plans serving most people with private health coverage are users of Sherlock Benchmarks since January 2015. Participants include most Blue Cross Blue Shield plans (directly or through subsidiaries), the leading provider-sponsored plans and sometimes publicly-traded companies. The results are actionable since the indicators are unambiguous, and linked to actual performance.

The Sherlock Benchmarks benefit from our business model. Credibility is facilitated through voluntary participation. Respondents have a stake in the data quality and believe it meets the insight-to-effort test.

Slide 3 shows the topics that this presentation will cover. We'll first touch upon the increase in popularity of Medicaid then we'll cover the decline in administrative expenses among Sherlock Benchmark participants. Next we'll examine the rates of decline on an as-reported and constant mix basis and drivers of decline. Lastly, we'll talk about costs by cluster and costs by product on a PMPM and percent of premium basis.

<Slide 4>

These next two slides show the effect of Medicaid expansion on being uninsured for health care. The US Census Bureau reports this in the chart on this slide. Based on a September 2016 Census analysis, Medicaid growth was the second most important factor in the increased coverage, among forms of health coverage between 2013 and 2015, after direct purchase. Put a different way, the total number of uninsured declined by 12.8 million: The increase in Medicaid enrollment explains 58% of the reduction in uninsured.

<Slide 5>

Gallup reports similar results. According to Gallup, the percent of people aged 18 and older who say that they are uninsured fell from 21.2% in the second quarter 2013 (likely an overstatement) to 13.3% in the second quarter of 2016. The 2.8 percentage point increase in Medicaid was second only to "Plan Fully Paid for by Self or Family Member," at 5.1%. If you consider that some of these may have previously received coverage through their employer (which declined by less than 1 percentage point), the importance of Medicaid is even greater.

<Slide 6>

As mentioned concerning Slide 2, core administrative expenses decreased by 5.5% in 2015, compared to a 6.3% increase in 2014. (Core expenses exclude Sales and Marketing.) These comparisons are also reflected on Figure 4 in the columns to the right, which hold constant both the universe and product mix. In my view, eliminating the effects of product mix changes provides a more accurate picture of trend. The arrows highlight those two columns.

The Provider and Medical Management cluster expenses declined by 4.5%, versus the increase of 5.6% last year. Account and Membership Administration was the only cluster of expenses to have an increase. It grew at 4.9% in 2015 versus an increase of 3.8% in 2014. This was the highest rate of growth since 2011. The Corporate Services cluster had the largest decline at 9.2%. This compares with an increase last year of 5.5%. Finally, Sales and Marketing cluster expenses declined by 5.3%, accelerating the decline of 4.2% last year.

The as-reported trends are shown to the left of the constant-mix columns. For the most part, they show similar trends. The sharper decline in costs on an as reported basis than on a constant mix basis stems from a mix shift in favor of relatively low cost Medicaid products. While Commercial's share declined (especially the insured share), Medicare and Medicaid increased.

The following slides will go into more detail to explain these cluster trends.

<Slide 7>

The previous slide showed both as-reported trends, as well as the constant-mix trends, but this slide is only for as-reported trends.

Core expenses as-reported costs declined by 10.3% in per member administrative costs from last year. Please note that it excludes any changes that are attributable to changes in the universe, thus only includes the same six plans that participated in both years. It does, however, include changes associated with product mix differences. Corporate Executive & Governance declined faster than any function, but the most important cost driver was the growth in the Information Systems function.

The Provider and Medical Management cluster expenses declined 2.8%, PMPM. Last year's trend was an increase in costs by 4.6%. Provider Network Management and Services grew by 2.1%, while Medical Management posted a decrease of 5.1%. Medical Management's decline was the first since 2009. The PMPM dollar cost of Medical Management is more than double that of Provider Network Management and Services so its sharp decline and large weight made this function dominate overall trend in this cluster.

The Account and Membership Administration cluster is the largest and contains the central activities of health plan operations. This cluster's PMPM costs grew by 6.0%. Account and Membership Administration was the only cluster of expenses to have an increase this year. While Claim Encounter Capture and Adjudication fell slightly, Customer Services grew slightly. Enrollment dropped by 11.6%. Information Systems was the largest function and grew the most at very nearly double-digits. For those reasons, its trend was the greatest weight in overall trend for this cluster.

The most important reason for the decline in Core Costs was the 9.4% drop in the Corporate Services cluster of expenses. Corporate Executive and Governance and Finance and Accounting fell by double digits. Actuarial expenses also decreased PMPM by near double digits, the first decline since 2011. The Corporate Services *function* is the largest in the cluster and includes sub-functions such as HR, Legal, Facilities, Mailroom and so forth. It also declined, while Association Dues and License / Filing Fees grew slightly. The Corporate Executive & Governance trend, weighted by its high relative size, drove the trend in the entire cluster.

The functions that comprise Core Expenses include all of the administrative activities of Medicaid focused health plans, except those of Sales and Marketing. Rules for Sales and Marketing for Medicaid vary from state to state so we treat this cluster a little differently.

The Sales and Marketing cluster's costs declined at a median rate 6.2% versus a decline of 4.8% last year. The median rates of increase for most functions in this cluster declined. The sole exception was Rating and Underwriting which increased. Since Sales and Marketing expenses are very small for Medicaid products (broker Commissions are non-existent for this product), the rates of growth in this cluster largely pertain to other products offered by these Medicaid focused plans.

<Slide 8>

This slide shows that rates of change in costs after eliminating the effect of the changes in product mix that occurred during 2015. As with the previous two slides, this also holds the universe of plans constant. Accordingly, we think of these as the "real" changes in costs. Core administrative expenses decreased by 5.5% in 2015, a sharp reversal from the 6.3% increase in 2014.

For continuously participating plans, Comprehensive Total membership had a median increase of 11.1%. This is higher than last year's increase of 1.8%. Total Medicaid members increased by 22%, while the number of Medicare members grew by 13.0%. Commercial Total experienced a median *decrease* of 1.5%. Self-funded ASO products grew by 7.0%, while Commercial Insured had a median decrease of 9.2%.

In terms of product mix, Medicaid gained 2 percentage points, and Medicare increased by half a percentage point. Commercial Total's share of product mix decreased by 3.6 percentage points with Commercial Insured down 4 percentage points and Commercial ASO down by less than 1 percentage point.

Provider and Medical Management fell from an increase of 5.6% in the prior year to a drop of 4.5% this year. This cluster is comprised of two functional areas, Medical Management / Quality Assurance / Wellness, and Provider Network Management and Services. The Provider Network Management and Services function increased by mid-single digits percents, while Medical Management declined by mid-single digits. This was the first time in the past five years that this cluster experienced declines. Medical Management is several times the size of Provider Management and drove this cluster's decline in costs.

Note that regardless of whether a medical management activity is included with quality improving activities for MLR rules, we reflect its costs as administrative for the purposes of this analysis.

Account and Membership Administration expenses grew at 4.9% in 2015 versus a increase of 3.8% in 2014. Information Systems increased by low double digits. Customer Services declined slightly at 1.6%, while Claims decreased by mid-single digits. Enrollment/Membership/Billing declined by high single digits. Information Systems had both the highest percentage increase and the highest weighting. Both Core and Account and Membership Administration *include* Pharmacy, Mental Health, and ICD-10 IS expenses.

Corporate Services expenses fell by 9.2% in 2015 versus the 5.5% growth last year. All functions except Association Dues and License / Filing Fees had declining costs. Actuarial declined by near double digits, the first decline since 2011. The Corporate Executive & Governance function was weighted the most and drove this cluster's decline.

Sales and Marketing expenses fell by 5.3% compared to the 4.2% decline last year. Three of the five functions in this cluster experienced declines, which ranged from double-digits to low 20 percents. Advertising and Promotion, Sales and Marketing all decreased, in declining order of percent decline. By contrast, External Broker Commissions and Rating and Underwriting increased by single digits and mid teens percents, respectively. The Sales function had the highest weight in the decline in this cluster, but Marketing declined most.

<Slide 9>

Here are the PMPM administrative cost levels for 2015, segmented by clusters of functions. (Again, the figure numbers on the slide reference our free newsletter, *Plan Management Navigator*, which is available on our web site.) The median core administrative expenses for comprehensive products were $29.06 PMPM. We highlight the "median" column with an arrow. This is 3.8% higher than last year's reported PMPM costs of $27.99.

The cost differences between this year's and last year's universes stem from three factors: differences between the mix of products that are offered by the two panels, the

actual changes in cost trends for the plans and the changes in the underlying costs of the participants between the two years. Most of this year's plans also participated last year. Slide 2 provides insight to both their trends and the effect of their product mix. Since overall expenses fell more on an as-reported basis than they did when one holds the mix constant, the product mix in the 2015 survey must have been less expensive than that of the prior year. In other words, the continuously participating plans were less committed to Commercial. They were also more committed to Medicaid HMO, which is less expensive.

To analyze the results, we have summarized into clusters the more than 50 functions that the plans report. Appendix C tells identifies functions comprising each cluster.

Account and Membership Administration is the dominant source of costs for health plans at $13.74 PMPM. Our plans reported median costs of $7.19 PMPM for Provider and Medical Management. The Corporate Services cluster, at $5.70 PMPM, is the smallest cluster of expenses and also the one with the greatest degree of scalability. Sales and Marketing expenses totaled $8.56 PMPM.

We have been reporting PMPM costs as medians, and will do so when we discuss costs expressed as a percent of revenues. Medians minimize the effect of outliers in the way that averages do not. But, because medians are the 50th percentile values, the clusters won't necessarily sum to the median for total expenses. That is even more the case for the 25th and 75th percentiles, especially since the values for each cluster is separately calculated.

While I'm discussing calculations, let me add that when we make comparisons we try to make them as close to apples-to-apples as possible. So, where this slide pertains to all eleven Medicaid plans that participated in the current benchmarking study, the slides showing cost *changes* reflected only those plans that participated in both the comparison years. Thus the rates of change for 2015 are for those that participated in both 2015 and 2014 surveys. Rates of change are rates of change in *per member* costs.

We can't provide much detail during this presentation, but many of you are interested in staffing. Staffing ratios run at approximately 23 FTEs per 10,000 members, including the effect of outsourced FTEs. We also estimate values for Medicaid HMO based on the reasonable assumption that the same mix of resources (labor and non-labor) is used to

support all types of members. Staffing ratios for these members are 20 FTEs per 10,000 members, including the effect of outsourced FTEs.

About 13% of such staff in Medicaid plans is outsourced, while a median of 14% of Information Systems staff is outsourced.

Excluding Pharmacy and Mental Health, median compensation per FTE averages just about $91,000, though certain functions like Corporate Executive and Governance, Actuarial and Marketing are in six figures.

<Slide 10>

This slide shows the administrative expenses of each *product* offered by the Medicaid universe of plans. The health care needs of plan members vary quite a bit by product, and the associated administrative expenses do as well.

The administrative costs of Medicaid HMO were $27.62 PMPM, while Medicaid CHIP was $25.24 PMPM. Commercial ASO had the lowest per member administrative expenses. The median costs for this product is $24.67 PMPM.

Total costs for *insured* commercial products were higher than those for Medicaid, in part reflecting the marketing costs that such commercial members require. ASO products cost less than either Medicaid HMO or insured commercial, reflecting that ASO products have lower medical management costs, lower enrollment costs and lower Sales and Marketing costs.

Medicare Advantage administrative costs are higher than comparable products for younger people, partly because of the high health care needs of seniors. Health care costs normally entail claims processing and customer service activities, which are reflected in the administrative expense levels. The effects of health care needs are especially evident when comparing the Medicare SNP product, at $138.85 PMPM, versus Medicare Advantage, at $77.16 PMPM.

By the way, this slide illustrates why we go to such strenuous efforts to mix adjust: product costs matter.

<Slide 11>

While we prefer the PMPM metric for costs, there are some advantages to a percent of premium standard. It may provide a rough adjustment for cost of living or for the intensity of care required by the specific population served by any given product. Indeed, as an example of their acceptance, the rebate provisions of the ACA are triggered by the MLR, a percent approach to health plan expenses.

In any event, comparability is improved if one is careful to keep denominators consistent. I mention this as a calculation note since we use premium equivalents as the denominator for ASO relationships for consistency with insured products. Premium equivalents are ASO fees *plus* the health benefits of the self-insured groups.

Using percent of premiums, the cost metric ranking can be much different than the PMPM ranking. Medicare Advantage products, ranked highest PMPM, ranked below commercial insured products when calculated as a percent of premium. The underlying reason for the lower costs of Medicare Advantage measured as a percent of premium is that Sales and Marketing and Corporate Services costs are a smaller proportion of total administration. Medicare Advantage costs were 8.1% of premiums while Medicare SNP costs were 10.1%.

Recall that Medicaid products were relatively low cost on a PMPM basis. Expressed as a percent of revenues, Medicaid HMO, at 7.2%, is lower than average for the products served by this universe. Sales and Marketing costs are limited for these products. CHIP had moderate costs at 11.7%. The lowest cost product, measured as a percent, is ASO at 5.8%.

<Slide 12>

This slide shows median core administrative expenses as a percent of premium equivalents were 6.6%. They excluded miscellaneous taxes imposed by state governments, the ACA taxes as well as capital costs. Medical and Provider Management replaced Corporate Services as the low-cost cluster in the slide 8 exhibit.

The percent of premium equivalent of 6.6% is 60 basis points lower than last year's value of 7.1%, as shown in Appendix B. A precise comparison is impossible since medians don't sum and the universes differ. All clusters were lower in 2015 compared with 2014, except Account and Membership Administration which increased slightly.

<Slide 13>

As you know, health plans participating in our benchmarking studies segment their costs by product. So it is possible for us to compare the same products across universes. When I compare Medicaid products offered by the Medicaid universe to that of Blue Cross Blue Shield Plans, the median values are $8.19 PMPM lower than BCBS Plans, or 3 percentage points lower on a percent of premium and equivalents basis. The median administrative costs for Medicaid plans were $6.92 PMPM higher than IPS plans, or 3 percentage points lower on a percent of premiums and equivalent basis.

A close analysis of the Blue Cross Blue Shield universe indicates that the chief difference is that the BCBS universe had much higher Account and Membership Administration, Corporate Services and Sales and Marketing expenses. These lower costs for Medicaid plans were partially offset by slightly lower Medicaid Medical and Provider Management costs. There were also differences when Medicaid plans were compared against IPS plans. IPS plans had lower costs in all clusters compared to Medicaid plans. They were especially lower in the Medical and Provider Management: some of the plans in this universe are associated with hospital systems so there may be some efficiencies stemming from a potentially smaller panel of providers.

<Slide 14>

Let me summarize my formal presentation.

On a constant mix basis, administrative costs for continuously participating plans declined – the first decrease since 2009. Provider and Medical Management fell, with Medical Management falling by high single digits. Account and Membership Administration cluster was the only one to increase. Information Systems was the central driver of the increased costs. The Corporate Services cluster fell due to declines in Finance and Accounting, Actuarial, and Corporate Executive and Governance. Sales and Marketing cluster fell, with Sales having the most impact.

Last year's massive increase in Miscellaneous Business Taxes due to the ACA fell to normal (albeit double digit) increases this year. These are of course not under the control of management but the effect of their increase was extremely important last year.

I have attached to the end of this presentation some appendices. They include last year's costs and a list of the functions included in each cluster of expenses.

I want to close with the common sense observation that low costs are not the same as optimal costs. But the benchmark of low costs shifts the burden of proof to functional areas with high costs to demonstrate an ROI on those higher costs.

Now I would like to open this for questions about the results of the Medicaid benchmarking study.

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If there are no further questions, I want to again thank you for your participation in this web conference. More in depth and actionable information is available in the benchmarking study itself, which anyone can license. Please contact me directly if you are considering licensing these materials.

I want to close by thanking once again all of you who participated in this study for your efforts. They not only enhance your own firm's performance but also raise the bar for all other plans.

Thank you.