



*Transcript*

# MEDICARE ADVANTAGE PLAN ADMINISTRATIVE COST TRENDS: FIRST OVERALL PMPM COST GROWTH SINCE 2013

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<Title Page>

I'm Doug Sherlock. Welcome to our summary of the benchmarking study for Medicare plans. This is the third in a series of presentations summarizing 2016 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 or Independent/Provider-Sponsored health plan information would be helpful. We'll report on the Medicaid Universe in the next few weeks.

<Slide 2>

I'm going to breeze through this slide. It shows the topics that I will address, and lists the appendices. Note that the appendices contain last year's values and a list of all the functions in each of the products offered by these Medicare-focused plans. That means that administrative expenses are segmented into nearly 800 expense/product cells, each of which are separately analyzed. We only summarize broad trends here.

I will be posting the slides and the transcript of this within the next 24 hours. I very much welcome your questions at the end of this presentation and the audience will be muted during the presentation itself.



<Slide 3>

In March of 2017, the 58 million beneficiary Medicare program quietly passed an important milestone: for the first time, one-third of all beneficiaries were members of private health plans. That is, they have opted out of the traditional Medicare program in favor of a private alternative. This has been going on for a while – since 2005 Medicare beneficiaries have increased by 15 million people, but only about 800,000 have gone into the traditional program. This share means that this government product has a constituency, with the additional moral weight of their membership skewing to lower income.

Ten plans participated in this study. While these and the combined Sherlock Benchmark plans serving Medicare in other universes serve approximately 11.8% of all eligible Medicare Advantage members, we recognize that they are “selected.” That is, they may operate at cost levels and trends that reflect that they measure their activities. For instance, on the grounds that “you manage what you measure,” these selected plans may tend to include those with an interest in optimizing their costs.

While Medicare is typically the predominant product, it is not the only product offered by our participants. On average, Medicare Advantage comprises 40% of plan revenue in this universe.

Regarding the Benchmarks, it is a cliché that the health insurance market is uncertain, which makes planning for health plans’ futures a great challenge. However, keeping costs low is a strategy that makes sense in any planning scenario, and there is some empirical evidence that the use of benchmarks contributes to cost control efforts. Serving that need is the goal of Sherlock Company.

This year is also a significant milestone for us since it marks the 20<sup>th</sup> year of the Sherlock Benchmarks. Cumulatively, it reflects the experience of approximately 780 health plan years, and includes Blue Cross Blue Shield Plans, Independent / Provider – Sponsored Plans, Medicaid Plans and Medicare Plans. This has been possible through the efforts of my talented colleagues, some visionary health plan officers including an IPS CEO, a Blue Cross Blue Shield CFO and the professionalism of the participating plans especially our primary contacts within those plans, some of whom are on the line today. The word “gratitude” only faintly expresses my view. Indeed, since the subject matter



of this web conference is free of charge and beneficial even to more casual analysts, I hope you share my appreciation.

<Slide 4>

This slide summarizes administrative cost trends for Medicare plans since 2011. From 2011 to 2014, growth trends generally fell for both total administrative costs and Account and Membership administration. Much of the early acceleration of growth in administrative expenses were due to the Affordable Care Act, with much of the growth driven by increased expenses in Information Systems. Since its nadir in 2014, growth trends have generally increased.

Total Administrative Costs, in dark blue, declined in both 2014 and in 2015 but increased to a marginal rate of 0.8% in 2016. Account and Membership Administration growth, in light blue, increased to 6.6% in 2015, but tapered off in 2016 to 3.1%.

By the way, when I speak of growth in costs in this presentation, it will generally be in *per member* terms.

<Slide 5>

The comparisons on the prior slide are further developed in the second and fourth columns of this slide. These two columns reflect continuous plans, whose cost values have been reweighted to eliminate differences due to product mix. The arced blue arrow is to draw your attention to the comparison with prior year's values.

You can see that Account and Membership costs grew more rapidly than did expenses overall. Circled in red, this chart shows the 3.1% per member Account and Membership Administration cost increase, and in blue the 0.8% Total administrative cost increase.

Compared to the prior year, Account and Membership Administration's growth rate declined by 3.5 percentage points, while the rate of change for Total expenses increased 4.0 percentage points.

Corporate Services *cluster* posted the largest growth rate at 14.6% and posted the largest change at 26.1 percentage points. This is the smallest cluster of functions, however.



Provider and Medical Management costs fell by 3.1% compared to a decline of 9.9% in the prior year, a 6.8 percentage point increase. Sales and Marketing accelerated by 8.2 percentage points from a 4.0% decline to a 4.2% increase.

The first and third columns, signified by the arced *red* arrow, show the changes that the continuously reporting plans actually reported to us. In other words, this is before the effect of reweighting to eliminate the difference in product mix for those continuous plans. Total administrative costs increased by 0.1% per member, 4.2 percentage points faster than the 4.1% decrease last year.

The fact that growth is slower without reweighting is an indicator of faster growth in the less expensive product areas. While health plans participating during both 2016 and 2017 posted median membership growth of 7.1%, membership in lower cost Medicaid increased by 12.7%. Medicare SNP increased by 10.7% as Medicare Advantage membership increased by 1.9%. Total Commercial fell by 1.0%, the more expensive Insured products fell by 2.9%, while the less expensive ASO grew by 0.8%.

<Slide 6>

This slide explains the *reported* rates of change, that is, the values with no adjustments for changes in product mix. That's the red arrow columns from the previous slide.

Total expenses increased by 0.1% PMPM. The fastest growth was in the Corporate Services *cluster*, with a 13.9% growth compared to last year's 10.5% decline. The greatest change in that cluster of expenses was a sharp increase to Corporate Executive and Governance. The increase was primarily due to growth in non-labor costs, while staffing and staffing costs also grew. This function is limited to executives who are not directly tied to a function or department, as well as Board of Directors costs. This functional area also includes functions that support Corporate Executive & Governance such as strategic planning and business analysis. The rate of growth in this function is similar whether you adjust for product mix, suggesting that the increase is across products. The Corporate Services function increased at a single-digit rate but was the second greatest contributor to this cluster's growth because of its size. Finance and Accounting was the only area to post a decline, falling by less than 1%.

Sales and Marketing cluster expenses grew by 6.3% from a 1.6% decline in the prior year. Marketing experienced the largest change, increasing by double-digit rates. Sales



and Advertising and Promotion also experienced increases. Rating and Underwriting *decreased* by double-digits and External Broker Commissions expenses decreased slightly. Note, one plan initiated External Broker Commissions in the current year. We have omitted this because of the distortion, but the rate of change is understated.

The Medical and Provider Management cluster decelerated in its rate of decline, a drop of 3.4% versus a decline of 7.7% last year. Both Medical Management and Provider Network Management and Services slid at single-digit rates. Medical Management, since it is much larger than Provider Network Management and Services, dominated this cluster's decline.

Account and Membership administration increased by 3.8% *down* from 6.0% growth last year. Enrollment / Membership / Billing fell at high single-digit rates, while Customer Services declined by low double-digit rates. Conversely, claims was the cluster's fastest growing functional area, while Information Systems was the most important source of growth to this cluster because of its size.

In summary, Corporate Executive and Governance growth was the fastest. The Information Systems function's growth was rapid, but was slower than claims. Because of its size, however, it was the most important source of growth for Medicare plans.

<Slide 7>

Slide 7 shows the rates of change and the most important reasons for the changes, *after eliminating the effect of product mix differences*. These are the "real" rates of increase in my view. Sales and Marketing and Account and Membership Administration didn't grow quite as fast, but Corporate Services grew more rapidly on this basis. The decline in Provider and Medical Management was slower.

The fastest growing product was Medicaid, which is a low-cost product. The slower growth on an as-reported basis illustrates the effect of a mix favoring growth in this and other lower cost products.

Slide 7 shows many of the same trends as are evident in Slide 6. Information Systems seems to be a key area for these plans regardless of how trends are calculated. This suggests the breadth of expanded effort in Information Systems across many products. The Corporate Executive and Governance function is key to understanding the growth



in expenses and was the fastest growing functional area on both an As-Reported and on a Constant-Mix basis.

<Slide 8>

Up until now, I have focused solely on the administrative expenses that managers can control. For instance, we have excluded from this discussion capital costs such as interest and dividends because they are the result of financing decisions made at the board level or at least beyond the purview of the operating managers.

Similarly, we have excluded Miscellaneous Business Taxes from this analysis. These taxes, which are primarily associated with the Affordable Care Act, layer in additional costs. Unless the health plan restructures to consolidate government business in one non-profit, these taxes cannot be affected by management, especially operational management. From an operating perspective, perhaps the central attribute of such taxes is to leverage the need to manage administrative costs.

On a constant-mix basis, per member Miscellaneous Business Tax costs increased by 9.0% down from an increase of 20.8% last year and a surge of 3,224.6% in the prior year. The median cost of such taxes is \$10.84 per commercial insured member, or approximately 13% of all administrative costs after the effect of the taxes. By comparison, that cost was \$2.25 PMPM in 2010.

These taxes are primarily focused on insured products. The median Annual Fee on Health Insurers is \$4.39 PMPM and the median Exchange User Fee is \$12.24 for Exchange members.

<Slide 9>

To this point, we have focused on rates of change rather than the underlying values of the components of administrative costs. The next few slides speak to the values of these activities, though it is necessarily a summary.

A very rough gauge of trend is difference in the raw numbers between last year's values and this year's. The median PMPM value of \$42.76, 4.4% lower than the median value of \$44.72 last year.



The prior year values are shown in Appendix A, and are also excerpted on this page. The total medians are lower as are the component clusters. Note that the universes vary as well. There is very little correspondence with the overall administrative cost trends on Slide 5 and the decreases shown here.

Recall that Corporate Services was the fastest growing cluster in slide 5, but it decreased by 6.4% from last year to \$7.46 PMPM. Account and Membership grew modestly as shown in slide 5, but the costs of \$17.16 were 1.6% lower than last year's \$17.44. Medical and Provider Management expenses were \$7.22 and were 15.3% lower than last year, compared to the approximately 3% decline shown in slide 5. Sales and Marketing increased 10.1% to \$12.38, compared to the slower increase in slide 5.

The dispersion for total PMPM costs was slightly less, as measured by the coefficient of variation. Sales and Marketing and Account and Membership Administration also experienced lower dispersion, while Medical and Provider Management became significantly more clustered. Only the Corporate Services cluster became more disbursed.

<Slide 10>

I have been emphasizing the effect of product mix changes on trend and this slide shows what I mean. Medicare Advantage at \$77.60 PMPM serves seniors at costs essentially double that of comparable insured products for those of working age. Medicare SNP, often serving dual Medicare and Medicaid eligibles as a comprehensive product, is the most expensive product at \$125.17 PMPM.

Note that the ASO product has costs that are about half of that of the insured commercial products. The overwhelming reason for the differences stems from Sales and Marketing cost differences. Enrollment is also lower for ASO products, probably related to group size. Median ASO PMPM costs were \$22.53. Administrative Services Only relationships composed 29.6% of commercial membership.

Other low-cost products included Medicaid at \$24.23 and CHIP at \$17.40 PMPM. These products offered to the poor and disabled composed 22.6% and 1.5% of Comprehensive members. Commercial Insured products for HMO, POS, and PPO cost \$41.20, \$41.63,



and \$47.99, respectively. Health plans participating during both 2016 and 2017 posted median membership growth of 7.1%, but there was a shift in favor of Medicaid.

Medicare Supplement is a secondary payor to the regular Medicare program, and it costs \$61.26 PMPM.

<Slide 11>

This slide shows the percent of premiums (or equivalents in the case of ASO) for all of the products. At the Comprehensive row, you can see that administrative expenses are 8.6% of premiums.

Medicare Supplement was the highest product measured on a percent of premium basis at 27.7%. Medicare Advantage and Medicare SNP products, at 8.3% and 9.2% respectively, are much more similar to commercial products on a percent than on a PMPM basis. This fact illustrates how administrative requirements of insured people tend to track their health needs.

In other respects, the relationships between the costs of various products measured in percentages parallel those measured in PMPM values. The ASO products are 6.6% of premium equivalents, similar to the low PMPM value. It is substantially lower than the ratios for insured products that range from 9.1% for POS, 9.8% for HMO and to 11.1% for Indemnity and PPO.

<Slide 12>

This slide shows the administrative expenses by cluster of functions. As in the previous page, overall costs were at 8.6% of premium equivalents equal to last year. The median values for Medical and Provider Management, Account and Membership Administration, and Corporate Services were slightly lower compared to the 2015 values. Sales and Marketing was the only cluster to increase, up by 0.3 percentage points.

<Slide 13>

As you know, all the health plans participating in our benchmarking studies segment their costs by product. This makes it possible for us to compare the same products



across universes. When we compare Medicare products offered by the Medicare universe to those of Blue Cross Blue Shield Plans, the median values are \$16.09 PMPM lower than BCBS Plans, or 3.1 percentage points lower on a percent of premium and equivalents basis. The median administrative costs for Medicare plans were \$42.03 PMPM lower than IPS plans, or 4.3 percentage points lower on a percent of premiums and equivalent basis.

There was variation between the plans in each universe, but Blue Cross Blue Shield Plans generally had higher Sales and Marketing, Medical and Provider Management, and Account and Membership Administration Medicare expenses compared to Independent/Provider- Sponsored plans. Medicare Advantage expenses for Corporate Services cluster, however, were higher for the IPS plans. Medicare-focused plans generally held a cost advantage over both universes for all clusters. Again, there is a great deal of variation between the plans in each universe.

<Slide 14>

Total administrative costs this year were \$42.76 PMPM, lower than last year's costs of \$44.72.

The overall cost trends snapped the two-year streak of cost declines with a 0.8% PMPM increase, after backing out the effect of product mix differences. Without the adjustment for mix, the costs increased by 0.1%.

Compared to last year, Sales and Marketing and Corporate Services clusters flipped from cost declines to cost increases, while Account and Membership Administration muted its increase. Provider and Medical Management muted its decline from last year.

Corporate Executive and Governance was the fastest growing functional area on a constant mix and as-reported basis. Information Systems was the most important source of the slight expense growth.

This is the end of my formal presentation. This presentation, (transcript and slides) will be posted on our web site in the next few hours. You will also find the presentations on Blue Cross Blue Shield and Independent / Provider - Sponsored trends. In the coming weeks we will present on the results of the Medicaid-focused plans. Please contact me for information on licensing these universes. 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*

Question: Did I understand from you that the largest increase was payments to board members and chief executive officers?

Answer: It is true that the function Corporate Executive and Governance is a key source of cost increase. We were curious about that as well, and we tell you that this was due to an increase in non-labor costs, not staffing levels or compensation per FTE. Our classification system includes strategic planning, some project management and consulting that is enterprise-wide. So, while non-labor expenses are inferred, we think that the cause is consulting and similar services provided to the plan's board and executive team.

In fact, this may correspond with the increases in Claim and Encounter Capture and Adjudication and Information Systems. This segment has had remarkable growth in recent years, and among health systems it has often been a priority, so perhaps we are seeing entire processes being revisited.

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I want to again thank you for your participation in this web conference. More in-depth and actionable information is available in the Sherlock Benchmarks themselves, which anyone can license. Please contact me directly if you are considering licensing these materials.

In the following weeks, we will have similar web conferences on the results of the Medicaid plans. We hope that you will consider participating in that web conference as well.



Let me thank you all for the hard work that goes into the 14th annual edition of the Medicare benchmarks. We believe that participation pays off in lower costs, but the “by-product” is something that benefits the industry as a whole. Thank you!

This is Douglas Sherlock of Sherlock Company.