Transcript

Medicare Plans Administrative Expense Growth Accelerated in 2017

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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 of 2017 performance metrics for various peer groups of health plans. 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. We'll report on the Medicaid Universe in the next few weeks.

Health plan managers endeavor to achieve administrative optimal costs. By "administrative" I mean the spectrum of costs ranging from Sales to Claims to Corporate Service and, importantly, Medical Management. If that goal is achieved, favorable health care trends amplify operating profits and mute operating losses. "Managing what you measure" facilitates your achievement of that goal. In a competitive environment, measurement implies comparison with the leaders of your industry. We offer what many call "the Gold Standard" for health plan benchmarks based on the performance of these leaders.

The 11 Medicare-focused plans that are the subject of this presentation serve 5.1 million people with comprehensive insurance. We believe this universe and the resulting analysis and data to be quite robust.

Before I begin though, I want to express some appropriate thanks. This year marks the 21st year of the Sherlock Benchmarks. Cumulatively, it reflects the experience of approximately 818 health plan years and includes Blue Cross Blue Shield Plans, Independent / Provider – Sponsored Plans, Medicaid Plans in addition to the Medicare Plans. All in, the 40 participating plans serve 53 million insured Americans with comprehensive insurance.

This achievement has been possible through the efforts of my talented colleagues and the professionalism of the participating plans especially our primary contacts within those plans. Since the subject matter of this web conference is free of charge and beneficial even to more casual analysts, I hope you share my gratitude.

<Slide 2>

I'm going to breeze through this slide. It shows the topics that I will address, and lists some of the appendices. Note that the appendices contain last year's values and a list of all of the functions in each of the products offered by these health plans. That means that administrative expenses are segmented into more than 700 expense/product cells, each of which are separately analyzed. We only summarize broad trends here. Finally, we touch on our methods of surveying, validation, analysis and reporting.

For those who have participated in web conferences in prior years, you may notice a difference in that we'll mention trends in Compensation, Staffing ratios and Outsourcing. Seven out of eleven plans repeat participation makes this possible.

We 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 2018, Medicare beneficiaries totaled 61 million, a 5.4% increase year-over-year. While the Fee-for-Service option increased by 4.3%, people selecting private insurance, the Medicare Advantage option, increased by 7.5% over the year to 21 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 13.4 million. Of this increase, 11 million have elected Medicare Advantage while 2.4 million chose the FFS program. Obviously, this ignores migrations of members in and out of the two alternatives but, when all is said and done, 74% of the net incremental membership selected Medicare Advantage. Members in private Medicare Advantage plans accounted for about 35% of Medicare-eligible beneficiaries, up from 34% in 2017.

The plans that participated in the 2018 Sherlock Benchmarks, Medicare and the other Sherlock universes, serve approximately 10% of all eligible Medicare Advantage members. Excluding the 13 million Medicare Advantage members served by public companies, our universes serve 25% of all such beneficiaries.

Eleven 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 comprises 43% of plan revenue in this universe. 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 2017, excluding the effect of Miscellaneous Business Taxes, Medicare Plans reported administrative cost increases of 5.3%, the highest since 2012. In fact, since the nadir of 2014, where PMPM costs declined by 6.7%, costs have accelerated each year. We have not shown this but, after the effect of the Miscellaneous Business Taxes, PMPM total administrative expense actually *declined* by 4.6% in 2017.

The lighter line is the annual rates of increase in Account and Membership Administration. This expense cluster is Enrollment, Customer Services, Claims and Information Systems. This is of particular interest since it composes the core of the direct administrative activities of health plans, enrolling members, fielding calls and processing claims, whether manual or automated through information systems. These activities have the additional property of not being subject to economies of scale in the same magnitude as finance and accounting or corporate executive and governance.

Costs per member per month in Account and Membership Administration increased by 3.7%, higher than in 2016 but lower than in 2015.

The slides that follow, we'll discuss the trends in all four clusters, and touch on the trends of the individual functions. As we will develop, all sixteen functions increased except four: Sales, Advertising and Promotion, Finance and Accounting, and Association Dues and License / Filing Fees. Six functions, Rating and Underwriting, Marketing, Provider Network Management and Services, Customer Services, Actuarial, and Corporate Executive and Governance increased at double digit rates. The most important sources of increase were Marketing, Information Systems, and Rating and Underwriting.

We will also drill into the drivers. By that I mean non-labor expenses, staffing costs and staffing ratios. Staffing Ratios were higher, while Compensation per FTEs was up. We'll also touch on outsourcing, which slightly increased.

<Slide 5>

On the previous slide, we showed accelerating trends in per member Total Administrative Expenses, of 5.3%, and in per member Account and Membership Administration, of 3.7%. These columns are organized by year, 2016 and 2017, showing each cluster's growth. The 2017 trends of the prior slide are shown on the fourth column, labeled "Constant-mix", "2017 Data", and I have circled them in blue and red respectively. The fourth and second columns reflect cost trends among continuously participating plans, backing out the effect of product mix and changes between the two years. I consider this the real increase. The arced arrows are to draw your attention to the comparison with prior year's values.

The two columns that are labeled "as-reported" reflect per member trends in continuous plans. Implicit in this calculation is that a shift in favor of more expensive products, like MA, would lead to the appearance accelerated growth, while a shift in favor of less expensive products would lead to deceleration.

I'll return with greater detail to this in a moment but because the constant-mix growth of 5.3% exceeds the 4.5% as-reported growth, for these plans, we can infer that there was a shift away from expensive Medicare Advantage products.

That is in fact what took place. While Medicare Advantage membership increased at a median rate of 6.2% (greater than the market as a whole by the way), the lower cost Commercial Insured membership increased at a 7.2% rate. Medicare Supplement increased by 15.1%. While Medicaid HMO grew by 5.5%, SCHIP increased by 18.5%. Overall membership grew at a median rate of 7.7%, and a mean rate of 2.2%.

Every cluster experienced per member cost growth regardless of whether they are as-reported or constant-mix. Medical and Provider Management was the fastest growing expense cluster, by 5.7% on a constant-mix basis. Measured by the differences in the annual rates of growth, Medical and Provider Management increased by 8.8 percentage points from 2016, on a constant-mix basis. Corporate Services cluster and Sales and Marketing followed closely, each increasing by 5.1% and 5.0%, respectively. Account and Membership Administration grew by 3.7%.

Overall, and I want to digress slightly, the average commercial mix was 58% the same from last year. 26% of the membership was in ASO, versus 19% last year. The various Medicare products was a mean of 25% of the total compared with 27% last year. The high revenue yield of Medicare Advantage, corresponding with beneficiaries' health needs, explains why 43% of revenues are Medicare Advantage. Medicaid was 16% of membership versus 15% last year.

The 11 participating plans collectively served 5.0 million members, up from 4.0 million last year. The average plan had 462,000 members and the median size was 371,000.

<Slide 6>

Slide 6 shows the rates of change and the most important reasons for the changes, after eliminating the effect of product mix differences. Again, these are the "real" rates of increase, so I will spend a lot of time on this and discuss trends in order of their importance. Costs increased by 5.3% PMPM.

The cluster of Medical and Provider Management grew the fastest at 5.7% and was the highest rate in the past five years. The acceleration and comparisons were evident in both Provider Network Management and Services and Medical Management / Quality Assurance / Wellness functions.

Provider Network Management and Services grew the fastest and was the most important source of the cluster's increase. Compensation was higher in every sub-function, as well as outsourcing. However, the function's staffing ratio and non-labor expenses were down from a year ago.

While less prominent, the Medical Management functional area posted its first increase since 2014. Average compensation per FTE was higher. Precertification, Case Management, Disease Management, and Other Medical Management sub-functions grew in 2017.

The Sales and Marketing cluster increased at the fastest rate in the past five years at 5.0%. For the second year in a row, the fastest growing functional area within this cluster was Marketing. The Other Marketing sub-function was a major driver in high Marketing cost. Examples of activities in the Other Marketing sub-function include strategic planning of a purely marketing nature, retail store marketing, and digital marketing strategy. Plans increased their Outsourcing, Compensation, and Staffing Ratio in the Marketing function, while Non-Labor Costs fell.

Rating and Underwriting was the second fastest growing function for this cluster mainly due to Risk Adjustment expenses. The increase in the Staffing Ratio was the primary reason for the cost increase, while outsourcing and compensation was slightly higher. Non-Labor Costs, however, were lower.

Sales costs were lower despite the higher staffing ratios. Advertising and Promotion expenses decreased entirely on lower Non-Labor expenses. Broker Commissions were flat.

The Corporate Services cluster grew by 5.1%, the second fastest for this cluster over the past five years.

The most important increase for this cluster was in the Corporate Services Function. The Legal, Facilities, and Purchasing sub-functions drove the increase in the Corporate Services functional area. The Corporate Executive and Governance function was the cluster's second fastest growing functional area primarily on higher average staffing ratios.

Conversely, Association Dues and License / Filing Fees experienced the fastest change, declining by double digits, but was the smallest function and not as impactful as the other functions. Actuarial was the fastest *growing* function with higher staffing ratios, compensation, and non-labor costs. Outsourcing was also up from 2016. Actuarial expense trends sometimes parallel that of Rating and Underwriting, which was also up in 2017.

The Account and Membership Administration cluster of expenses experienced a PMPM cost increase of 3.7%. Customer Services was the fastest growing function in this cluster, with the Member Services sub-function posting a large increase.

The staffing ratio for Customer Services increased significantly, while Compensation per FTE and Outsourced FTEs were slightly higher. Non-Labor costs per FTE, however, were lower.

While Customer Services posted the greatest growth in the Account and Membership Administration cluster, the slower increase in Information Systems had the greatest effect because of its size. The Other Application Maintenance sub-function had the highest rate of growth. The Information Systems staffing ratio was higher among plans, while outsourced FTEs was slightly up. Conversely, Compensation per FTE and Non-Labor costs per FTE were declined from last year.

<Slide 7>

This slide explains the *reported* rates of change, that is, the values with no adjustments for changes in product mix. These trends, again, are based on continuous plans. For the most part, there is a correspondence between the constant-mix and as-reported renderings. So, I will focus on *the differences* between the as-reported and the constant-mix trends.

On an as-reported basis, Marketing posted the greatest change, but Information Systems had the greatest weight. Medical Management increased its growth by a few percentage points from constant-mix to as-reported, but represents the third most important source of increase on an as-reported basis. Enrollment / Membership / Billing’s growth was notable as this function increased by double digits on an as-reported basis versus a low single digit increase on a constant-mix basis.

Let me close this section with a few summary observations. All my trend comments are based on continuously participating plans and includes the effect of staffing and costs performed on an outsourced basis. Overall, average staffing ratio was higher among continuing plans. Of these continuously participating plans, the average staffing ratio was 31 FTEs per 10,000 members, though it likely differs between products and market segments. Of the 14 functional areas with staff, ten had average ratio increases and four had declines. The largest increases included Corporate Executive and Governance, Rating and Underwriting, and Actuarial.

Compensation increased moderately but varied by function. Provider Network Management and Corporate Services increased notably, while the higher compensation areas of Corporate Executive declined.

Propensity to outsource was slightly higher than last year in total. Nine out of the 14 functional areas with staff increased outsourcing.

Marketing and Information Systems had the largest effect on the increase in total costs. Both functional areas posted higher Staffing Ratios and Outsourcing. Non-Labor Costs per FTE fell for both functions. Compensation for Marketing grew, while falling for Information Systems.

<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.

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 $39.80, 4.5% greater than the median value of $38.10 last year. This matches the as-reported increase of 4.5% among continuous participants. The prior year values are shown in Appendix A and are also excerpted on this page.

However, there is little correspondence with the overall administrative cost trends on Slide 5 and cluster increases that resulted in the values shown here. The Corporate Services Cluster, posted a median of $6.99 and reflected the fastest increase of 8.7%. Medical and Provider Management cluster's costs was $7.34 and experienced a *decline* of 1.6%. Sales and Marketing posted a 4.1% increase to a median of $12.57.

Account and Membership Administration increased by 6.8% to a median of $16.81. It was the slowest growing cluster in Slide 4. This cluster is about 42% of the overall costs to deliver coverage products to this universe. It is the core elements of Enrollment, Customer Services, Claims and Information Systems.

Dispersion for Total expenses, measured by the Coefficient of Variation, was similar to last year. Dispersion fell for the Sales and Marketing (though slightly), Account and Membership Administration, and Corporate Services clusters, but rose for Medical and Provider Management.

<Slide 9>

As you know, we favor an approach to understanding costs that reduce or eliminate the effect of product mix. This slide illustrates why. Medicare and Medicaid are government-sponsored products serving seniors and the low-income population. Medicare products are relatively high cost at $81.73 and $126.78 PMPM for Medicare Advantage and Medicare Special Needs Plans respectively.

Among the comprehensive insured products, Medicaid products fall between commercial insured and commercial ASO. Medicaid HMO, has median PMPM cost of $27.23, while the median PMPM for CHIP is $23.75.

Note that Medicare Supplement is a higher than average cost product at $54.35 PMPM. We include this as a comprehensive product in the Sherlock Benchmarks though it pays only when Medicare does not. Seven of the 11 plans offer the product.

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 also means that their Sales and Marketing costs are spread through a greater number of members. The Median Commercial ASO product was $21.81. Meanwhile, the Commercial Insured HMO, Indemnity and PPO, and POS median costs were $47.89, $47.22, and $41.45, respectively.

<Slide 10>

This is similar to the previous slide, only expressed in percents of premium equivalents. By that I mean, for a denominator, we have added medical expenses to the fees. The median administrative expense relative to premiums was 8.5%, matching last year's value. In many cases, the relationships between the costs of various products measured in percents parallel those measured in PMPM values.

Medicare Advantage and Medicare SNP are similar to the commercial insured products at 8.6% and 9.1%, respectively, while the PMPMs are much greater. This similarity in percents is consistent with many administrative requirements of insured people tending to track their health needs.

Medicare Supplement was the highest among comprehensive products at 26.7%.

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 go from 6.4% for POS to 10.2% for Indemnity and PPO. HMO is at 10.2%. The percents more or less parallel the PMPM values.

Like the ASO product, Medicaid HMO is also low cost at 7.3%. CHIP is higher than average at 10.0%.

<Slide 11>

This slide shows the administrative expenses by cluster of functions. As in the previous page overall costs were at 8.5% of premium equivalents, equal to last year. The Sales and Marketing and Medical and Provider Management clusters were equal to last year at 2.7% and 1.5%, respectively. The Corporate Services cluster was higher by 0.2

percentage points at 1.5% and the Account and Membership Administration cluster was higher by 0.1 percentage point to 3.4%. There is little correspondence with real cost trends and changes in these percents.

<Slide 12>

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. Medicare-focused plans generally held a cost advantage over both universes for all clusters.

When we compare Medicare Advantage products offered by the Medicare universe to those of Blue Cross Blue Shield Plans, the median values are $15.90 PMPM lower than BCBS Plans, or 2.7 percentage points lower on a percent of premium and equivalents basis. The median administrative costs for Medicare plans were $34.27 PMPM lower than Independent / Provider - Sponsored plans, or 6.0 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 lower Sales and Marketing, Account and Membership Administration, and Corporate Services Cluster Medicare Advantage costs compared to the IPS plans. Conversely, IPS plans held an advantage in the Medical and Provider Management cluster.

<Slide 13>

Let me close by summarizing.

The overall cost trends accelerated by 5.3% (constant-mix) or 4.5% (as-reported), the highest since 2012. Account and Membership continued its cost growth from last year.

All expense clusters accelerated, except for the Corporate Services cluster. Medical and Provider Management posted the sharpest growth. The rate of growth for Sales and Marketing and Account and Membership each increased by less than 1 percentage point.

Marketing was the fastest growing and most important source of growth, while Information Systems was also notable due to its size.

Staffing ratios increased to 31 FTEs per 10,000 members. Of the 14 functional areas with staff, ten had average ratio increases and four had declines. The largest increases included Corporate Executive and Governance, Rating and Underwriting, and Actuarial.

Compensation increased moderately but varied by function. Provider Network Management and Corporate Services increased notably, while the higher compensation areas of Corporate Executive declined.

Propensity to outsource was slightly higher than last year in total. Nine out of the 14 functional areas with staff increased outsourcing.

This presentation, (transcript and slides) will be posted on our web site in the next few hours. In addition to these slides, we include last year's values, some descriptive materials.

In the coming weeks, we will hose 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

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

Let me thank the participants for the hard work that goes into the 15th annual edition of the Medicare benchmarks. We know, because we measure this, 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.