NAVIGANT

FEBRUARY 2018

THE IMPACT OF STAR RATINGS ON RAPIDLY GROWING MEDICARE ADVANTAGE MARKET

Richard Bajner, Eric Meinkow, Janet Munroe, James R. Smith, FACHE, and Christopher Stanley, M.D., Navigant; and John McHugh, Ph.D., Columbia University

EXECUTIVE SUMMARY

The ongoing uncertainty around the Affordable Care Act's (ACA) individual market has contributed to financial losses for commercial payers, and an exodus of some from that market. In response, many private payers are expanding or shifting their focus to Medicare Advantage (MA), the private version of the federal Medicare program.

MA plans continue to increase in popularity, with approximately one-third of all Medicare beneficiaries enrolled in these plans. But with aggressive MA expansion by large payers, competing plans must find ways to differentiate their value to grow enrollment.

Increasing star ratings is a key way to attract new enrollees and expand market share, and can translate into additional bonus payments and greater rebates to offer richer benefits. A Navigant analysis shows that, for MA plans:

- A 1 star rating improvement could, on average, lead to a year-over-year 8 percent to 12 percent increase in plan enrollment.
- Improving from a 3 star to 4 star rating could increase revenue between 13.4 percent and 17.6 percent through increased enrollment revenue and additional bonus payments.

MEDICARE ADVANTAGE BACKGROUND

Whereas the federal government pays for Medicare benefits under traditional Medicare coverage, Medicare Advantage (MA) plans are offered by private payers who contract with the Centers for Medicare & Medicaid Services (CMS) to provide MA benefit plans. Medicare pays the contracted payer to cover and administer benefits; in turn, plans negotiate with local and regional healthcare providers to deliver services to enrollees. The MA program has served beneficiaries since the 1970's, and now primarily offers health maintenance organization (HMO) and preferred provider organization (PPO) benefit plans. As part of the ACA, minimum medical-loss ratios were set at 85 percent, meaning MA plans must spend at least 85 percent of plan revenue on healthcare services for members.

MA plans are growing in their popularity among older Americans, and subsequently, payers. Nationwide, the percentage of Medicare beneficiaries choosing MA plans expanded from 13 percent in 2004 to 33 percent in 2017 to approximately 19 million enrollees. This trend is expected to continue, with the Congressional Budget Office projecting an MA plan penetration rate of 41 percent by 2027. And while the share of Medicare benefit spending on hospital inpatient services fell by one-third between 2006 and 2016, spending on MA plans doubled.

The majority of MA growth is attributable to aging Baby Boomers, the first generation accustomed to PPO and HMO benefit plans, with other reasons including richer benefits, lower member premiums and copays compared to Medigap policies, and higher consumer satisfaction with current plan offerings.

Figure 1: Medicare Advantage Plans Appeal to Payers, Providers, and Enrollees

WHY PAYERS LIKE MA:

- Plan premiums, which can average around $1,000 per member per month, are paid by the federal government, ensuring a steady revenue stream.
- More profitable than administrative services only self-funded plans.
- Provides retention potential for plan's commercial members who age out of commercial into traditional Medicare.
- MA members are much more likely to stay with their MA payer, unlike commercial members who tend to switch around plans.

WHY HOSPITALS AND HEALTH SYSTEMS LIKE MA WITHIN A VALUE-BASED ARRANGEMENT:

- MA plan benefit design strongly favors in-network utilization, helping providers reduce inpatient and outpatient leakage.
- Offers additional upside opportunity to improve quality by closing gaps in care (feeds directly into determining plan's star rating), improve coding accuracy (ensures appropriate funding from CMS for assigned members' conditions), lower unnecessary utilization, and share in rebates which reduces certain expenses.

WHY MEDICARE BENEFICIARIES LIKE MA:

- MA benefit plans must include the same covered benefits as traditional Medicare benefits, plus enhanced benefits like vision, dental, and hearing aids.
- A cheaper option compared to traditional Medicare, including lower out-of-pocket liability.
- Less confusing than freestanding drug benefit programs, requiring little paperwork as claims submissions often aren't required.
- Emphasize preventative care through 100 percent coverage for annual preventive physician visit, gym memberships, nurse help hotlines, and more.

MA PLAN STRATEGIES

Ongoing MA expansion by such payers as UnitedHealth Group, Aetna, Anthem, and Humana, has made it more difficult for plans to maintain control over their enrollee population. Therefore, plans must employ new strategies to preserve adequate enrollment and ensure ongoing viability.

One of the key strategies is to increase the plan's star rating, as per member per month (PMPM) rates paid by the CMS vary based on certain star rating thresholds. Plans that are rated 3.5 stars or less are paid a base rate based on the county in which it enrolls beneficiaries. However, if the plan increases the rating to 4 stars or more, the plan is paid a 5 percent bonus in addition to the base rate. Furthermore, plans achieving a 5 star rating can enroll members throughout the year, while plans below 5 stars can only enroll members during the late fall annual election period.

While the bonus payment provides additional revenue to the managed care organization (MCO) that operates and administers the MA plan, the improvement in star ratings can enhance the health plan's performance in another way. Plans receiving a bonus payment can also attain a greater level of rebate, as shown in Figure 2 below, compared with plans that receive a rating of 4 stars or less. Specifically, rebates are calculated, for each plan, as a percentage of the difference between the risk-adjusted service area benchmark and the risk-adjusted bid. This should have a snowball effect on enrollment and market share, as the rebate payments "must be used to provide supplemental benefits to enrollees," according to the Kaiser Family Foundation.

Figure 2: Applicable Bonus and Rebate Percentage Based on MA Plan Star Rating

	BONUS PAYMENT	REBATE PERCENTAGE
5.0 Star	5.0%	70%
4.5 Star	5.0%	70%
4.0 Star	5.0%	65%
3.5 Star	0.0%	65%
3.0 Star or less	0.0%	50%

ACHIEVING FINANCIAL VIABILITY

In general, MA plans have five primary mechanisms to achieve financial viability:

1. Comprehensive and accurate patient risk scoring and diagnosis coding accuracy to reflect member health status;
2. Quality programs to identify and close gaps in care, which supports star ratings;
3. Managing the total cost of care for the covered population while maintaining or improving quality.
4. Reducing administrative loss ratio by expanding enrollment to optimize the operational infrastructure needed and spread fixed costs; and
5. Negotiating value-based arrangements with MA providers to engage in population health management and share in the savings that can achieve.

For all of the five mechanisms above, achieving each of them is much easier with a higher enrollment base. Increasing enrollment is a function of two primary factors.

First, the market itself is expanding. With an aging population, the number of MA enrollees will expand even if penetration rates remain stable. However, as stated previously, the overall penetration rate is also projected to grow, which, given 2017 levels of enrollment, could mean an additional 5.2 million individuals will be enrolled in MA by 2027.

The second factor contributing to enrollment growth is benefit design. Products with more generous benefit design are able to attract increasing numbers of beneficiaries. In fact, a 2013 study in JAMA reported a 1 star higher rating was associated with a 9.5 percent increase in the likelihood to enroll. This was a somewhat expected result, as MCOs with higher star ratings can generate better rebates to be reinvested in more generous benefits, potentially leading to additional bonus payments. All of this can further differentiate a plan from its competitors and can directly contribute to enrollment growth.

NAVIGANT ANALYSIS

To test the hypothesis that increasing star ratings will lead to increased enrollment, we constructed a database of 497 MA contracts from CMS' publicly available data over the years 2012 to 2016. Variables included contract type, county level penetration rate, star rating, and other contract and county-level characteristics. The primary dependent variable was the year-over-year percentage change in enrollment, while the primary independent variable was the year-over-year change in star rating. Given the panel nature of the data, our model specified the within contract effect — if a plan were to increase or decrease star rating, the associated change in enrollment was estimated.

Results (See Figure 3)

The analysis found that a 1 star increase in rating was associated with an 8 percent to 12 percent increase in beneficiary enrollment in the year following the increase. This increase was independent of overall changes in enrollment (i.e., the change would be in addition to overall county level changes in enrollment).

Between the increased enrollment and the increased PMPM payment, MA plans will experience sizeable annual revenue growth as a result of star rating improvements. On average, in 2016, the median enrollment for a 3 star contract was approximately 9,600 beneficiaries. An improvement in rating from 3 stars to 4 stars, which would generate additional bonus payments and potentially higher rebates, would drive revenue up between 13.4 percent and 17.6 percent, resulting in an additional $12 million to $16.2 million in revenue for a plan.

Figure 3: Revenue Enhancement, 3 to 4 Star MA Plan Rating Improvement

	8% INCREASE	12% INCREASE
Base Enrollment	9,600	9,600
Total Enrollment Increase	8%	12%
Estimated New Enrollment	10,368	10,752
Base Rate	$800	$800
Rate Bonus	5.0%	5.0%
Rate + Bonus	$840	$840
Base Revenue	$92.16 M	$92.16 M
Revised Revenue	$104.5 M	$108.4 M
Revenue Increase	13.4%/$12M	17.6%/$16.2M

In addition to the bonus payment, a 3 to 4 star improvement can generate additional benefits through more generous rebates. As shown in Figure 4, for two equivalent plans that submit a risk-adjusted bid of $750 in a county with an $800 benchmark, a 4 star plan would provide 134 percent more value to its members in extra benefits.

Figure 4: Additional Rebate, 3 star vs. 4 star MA Plan

	3-STAR	4-STAR
Benchmark	$800	$800
Quality Bonus	0%	5%
Benchmark + Quality	$800	$840
Bid	$750	$750
Rebate Percentage	50%	65%
Rebate = Extra Benefits	$25	$59
Rebate Improvement	n/a	134%

CONCLUSION

MA plans rely on sufficiency of enrollment to maintain their ongoing viability. Increases in star ratings can have an immediate effect on the MA plans' bottom line through growth in enrollment and market share, in addition to the standard increase in rate. While the bonus payments can enhance revenue streams and rebates can be used for lower premiums and/or enhanced benefits, the changes can also have a positive effect on a beneficiary's likelihood of enrolling. Therefore, star rating improvements can help plans increase enrollment through new business, new enrollees, and enrollee switching.

There are additional benefits beyond the added revenue accruing to the MA plan based on star rating improvements. Plans can count on a more stable population of enrollees with lower rates of disenrollment due to higher quality and richer benefits. Further, the additional rebates generated through higher star ratings and improved quality allows the MA plan to be more creative in its benefit design. Increased enrollment and additional quality bonus payments may also enable the plans to include enhanced benefits that were not cost effective at lower enrollment rates.

As plans explore the benefits of increased financial viability due to star rating improvements, they should consider the role of providers. Strong star ratings are partially a result of contracting with providers that invest time and resources to close gaps in care. Therefore, plans should proactively seek additional collaborative arrangements with providers to share the financial benefits of quality and efficiency improvements, ultimately leading to greater plan satisfaction among all involved. Recently, payers faced ambivalence from providers about joining MA networks because participation did not offer additional revenue opportunities beyond 100 percent of Medicare. Moreover, value-based arrangements were only beginning to be negotiated broadly in commercial and MA areas. Now, given the shift to value-based models and comparatively less attractive commercial revenue streams which have flattened or eroded in recent years, providers may be more receptive to considering participating in MA networks under value-based arrangements.

navigant.com

About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage, and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the firm primarily serves clients in the healthcare, energy, and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at navigant.com.

linkedin.com/company/navigant-healthcare twitter.com/naviganthealth

©2018 Navigant Consulting, Inc. All rights reserved. W30563

Navigant Consulting, Inc. ("Navigant") is not a certified public accounting or audit firm. Navigant does not provide audit, attest, or public accounting services. See navigant.com/about/legal for a complete listing of private investigator licenses.

This publication is provided by Navigant for informational purposes only and does not constitute consulting services or tax or legal advice. This publication may be used only as expressly permitted by license from Navigant and may not otherwise be reproduced, recorded, photocopied, distributed, displayed, modified, extracted, accessed, or used without the express written permission of Navigant.