Executive Insights

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Key Drivers Behind Continued Medicare Advantage Penetration

Over the past 25 years, Medicare Advantage (MA) has consistently penetrated the Medicare marketplace. While its penetration growth has been notably measured in the past 10 years, rising just 1.5 percentage points annually, L.E.K. Consulting doesn't expect it to stop anytime soon. In fact, our proprietary county-level projection model shows that as seniors seek to secure better management of their care but pay less, Medicare Advantage penetration will continue to rise — to as high as 70%.

When we published our first *Executive Insights* in this series in 2017, the Trump administration was still in its first year and the future of the ACA was a topic of frequent debate. Today, the status and long-term structure of healthcare reform remain in flux, but MA enrollment is still growing — and with largely bipartisan support. As recently as March 2019, a group of U.S. senators sent a letter to Seema Verma, administrator of the Centers for Medicare & Medicaid Services (CMS), commending the Trump administration for the actions it had taken to support Medicare Advantage and noting that the program is "anticipated to continue its steady growth, with enrollment projected to reach 38 million, accounting for ~50% of those eligible, by 2025."

In light of the ever-changing healthcare landscape and the central position Medicare Advantage growth has taken for many national payers, we thought it would be a good time to update our forecast. To that end, we have taken into account Medicare Advantage enrollment figures that were released in February 2019 and revised our projections through 2025 and beyond.

Since 2017, Medicare Advantage has benefited from several new (or enhanced) tailwinds that we expect to drive the program toward 70% penetration, including the following:

- Continued increases in overall Medicare healthcare costs (CMS forecasts growth of approximately 7.5% per year through 2027) and out-of-pocket costs for Medicare seniors (forecasted to grow 4.3% per year through 2023) are bolstering the need for a managed care option beyond traditional Medicare for seniors.
- Ongoing government support for Medicare Advantage remains robust, with Secretary of Health and Human Services Alex Azar focusing on Medicare Advantage as a key component of long-term cost containment. "What I really want to do is really make sure that [for] our Medicare Advantage program, which two-thirds of new enrollees are signing up for ...[,] we're doing everything that we can to make sure it's a strong, robust option for our seniors," he said in January 2018. "That's where my energies are; my focus is there."

Key Drivers Behind Continued Medicare Advantage Penetration was written by **Andrew Kadar**, Managing Director; **Andrew Garibaldi**, Managing Director; and **Daniel Parker**, Engagement Manager, in L.E.K. Consulting's Healthcare Services practice. Andrew Kadar and Daniel are based in San Francisco. Andrew Garibaldi is based in Boston.

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Figure 1
Comparison of Medicare options

Original Medicare has a 60-day inpatient coverage limit, with the remaining time paid for by the patient; with no out-of-pocket maximum, this can bankrupt some seniors with serious health requirements.

	Network coverage	Supplemental benefits	2019 patient costs					
			Deductible	Out-of-pocket max	Co-pays	Monthly premiums	Est. total annual cost range	
							Good health	Poor health
Original Medicare (Parts A and B)	Most in-network providers	None	~$1.5K (Part A $1,364, Part B $185)	No limit	20% (Part B only)	$135* (Part B only)	$4K-$5K	$13K-$20K
MedSupp	Most in-network providers	None	Varies (typically significantly lower than MA or Original)		Varies (typically lower than MA)	$67-$361 (in addition to Part B premium)	$5K-$6K	$5k-$10k^
Medicare Advantage (Part C)	Varies by plan (PPOs more than HMOs)	May include vision, dental and others (e.g., transportation, meals, OTC benefits, etc.)	Varies (typically similar to or lower than Original)	$6,700 IN, $10,000 OON (often lower depending on plan)	Varies (typically similar to or lower than Original)	Varies** (paid in addition to Part B premium; typically less than MedSupp)	$2K-$4K	$5K-$7K

MA plans have lower average premiums than MedSupp, but more limited provider networks and less treatment flexibility.

Attractiveness relative to other Medicare plans
Unfavorable Neutral Favorable

Note: *Typical/average monthly premiums — Part B premiums are means tested based on income; **Range from $0-$400 — ~80% of enrollees have at least one choice for $0 premium; ^Increase in costs — driven chiefly by Part D drug costs — seniors in poor health may also choose plans with higher premiums
Source: L.E.K. research and interviews; AARP; CMS; KFF; Gorman Health Group; My Medicare Matters, Medicare Plan Finder

- Added CMS flexibility for Medicare Advantage plan providers in 2018 and 2019 has increased their ability to design benefits that meet the unique needs and preferences of each Medicare-eligible senior.
- Ongoing payer investments in their Medicare Advantage lines of business means established payers are making acquisitions (e.g., Anthem's purchase of HealthSun in 2017 and America's 1st Choice in 2018), expanding county coverage/plan benefit package offerings from 2017 to 2019 (at an estimated 12% per year). Furthermore, emerging payers are starting to offer Medicare Advantage plans (e.g., Devoted Health, Bright Health, Oscar Health) or expanding those they already offer (e.g., Clover Health).

While the majority of trends support continued increases in Medicare Advantage enrollment, Minnesota has represented one headwind of the program's recent growth. Minnesota was the only state in which Medicare Advantage enrollment dropped during the annual election period for 2019, primarily due to the elimination of Medicare Cost plans, which are "hybrid" Medicare Advantage offerings that allow enrollees to leverage Medicare Fee-for-Service when utilizing out-of-network providers.

Medicare Cost plans are generally a popular option for seniors due to their flexibility; but after the removal of Minnesota's offering in 66 of the state's 87 counties, 320,000 seniors were forced to enroll in a new form of Medicare by 2019. Of this group required to move from Medicare Cost plans, approximately two-thirds immediately enrolled in MA plans for 2019, a higher enrollment rate than national MA penetration averages. Despite the one-time impact of Minnesota's switch to more traditional Medicare Advantage plans, however, we believe Minnesota enrollment will normalize going forward as enrollees are expected to elect, and stick with, Medicare Advantage.

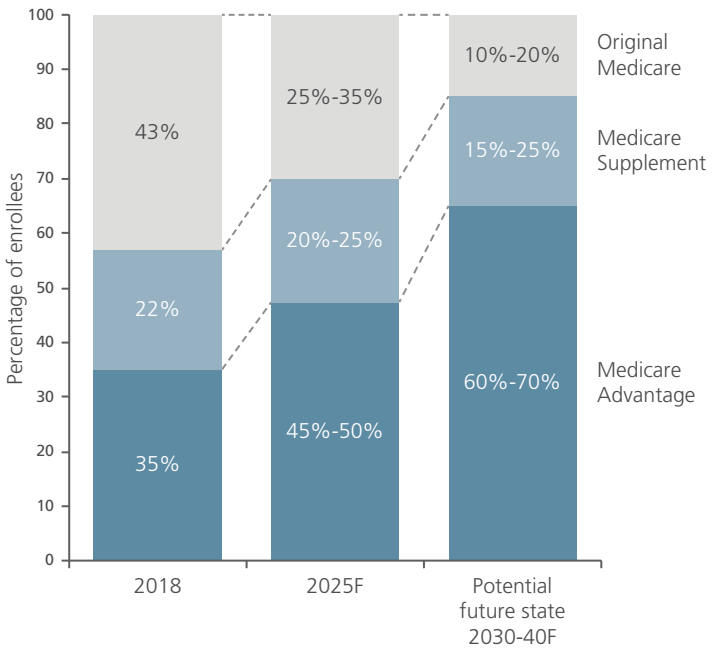
Driving the march

Medicare Advantage is one of the rare products in the U.S. healthcare system that not only satisfies the "triple aim" of healthcare improvement — that is, improving the experience of care and the health of populations while at the same time reducing per capita healthcare costs — but also appeals to the self-interests of three very powerful constituents that have been driving its march forward: consumers, health plans and the government.

- **Consumers** like Medicare Advantage plans because they offer predictability, additional benefits, care coordination and lower estimated total annual healthcare costs than are offered by either Original Medicare or Medicare Supplement plan options (see Figure 1).
- **Health plans** appreciate Medicare Advantage plans because they make more money: Medicare Advantage plans yield higher nominal revenue and operating margin with per-member per-month (PMPM) revenue of $800-$1,200 and operating margin of $30-$60 PMPM versus $180-$220 and $10-$18 PMPM for Medicare Supplement, respectively.
- **Government** supports Medicare Advantage because it enables the effective deployment of cost trend management tools other than the fee schedule.

Over the past 20 years, enrollment in Medicare Advantage plans has grown at a slow but steady pace (see Figure 3).

Figure 2
Estimated distribution of Medicare eligibles*



Note: *The number of original Medicare eligibles — individuals who either are currently or were formerly entitled to or enrolled in either Part A or Part B Original Medicare
Source: L.E.K. analysis

Reality versus expectations?

Our first report in this series, published in 2017, included Medicare Advantage enrollment figures of 19 million members out of 56.7 million total Medicare eligibles, resulting in overall penetration of 33.5%. Given the value proposition and strong tailwinds behind Medicare Advantage, we were bullish on membership growth reaching approximately 22.2 million members in 2018 — and per CMS, the number of Medicare Advantage members hit 22 million last year. Looking ahead, we expect enrollment growth to continue in line with our previous forecasts of 7.7% compound

Medicare Advantage versus Original Medicare

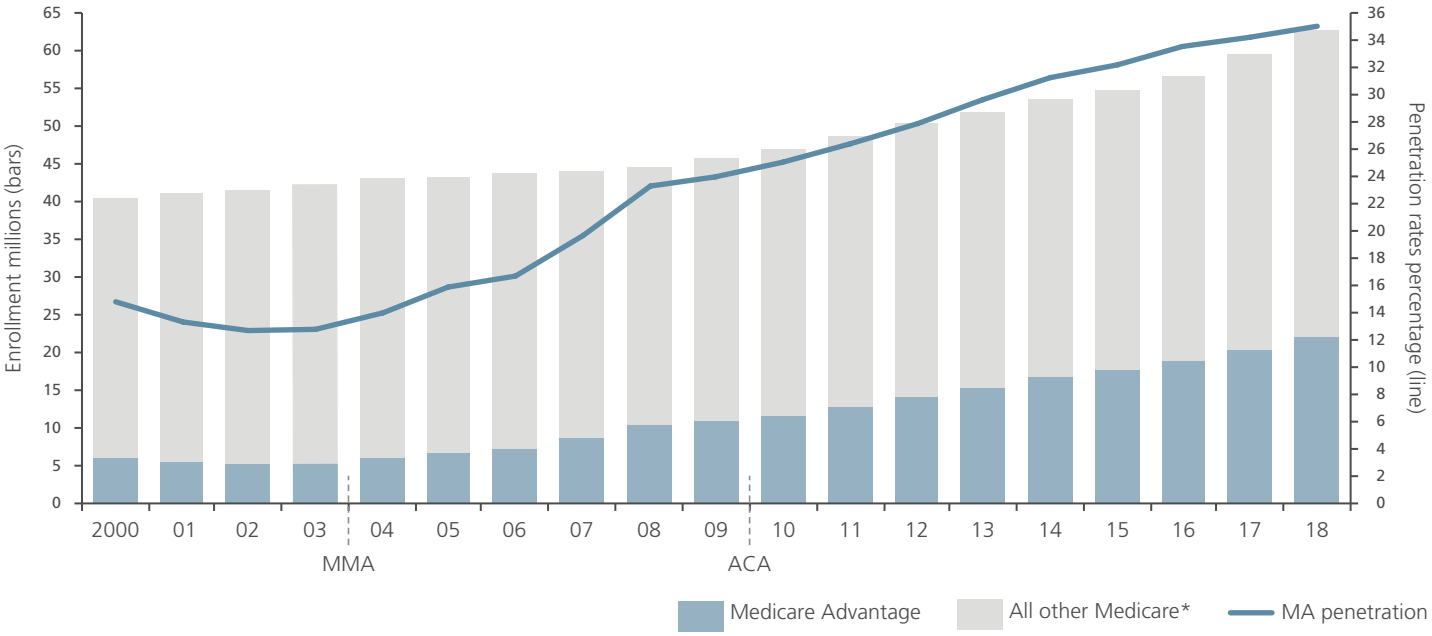
Much of the growth in Medicare Advantage penetration will come from Original Medicare, which could decrease more than 20 points, from 40% penetration to 10%-20% (see Figure 2).

Seniors with Original Medicare will presumably find their 20% coinsurance responsibility more burdensome as their healthcare costs continue to rise. According to CMS, overall healthcare costs will increase by approximately 5.6% a year through 2027, while Medicare costs are forecasted to grow at a rate of 7.5% a year.

Meanwhile, age-related conditions will likely convince seniors and soon-to-be seniors that they need the degree of care management Medicare Advantage plans provide. The number of seniors with multiple chronic conditions rose by approximately 8 percentage points from 2000 to 2010, according to the Centers for Disease Control and Prevention. Meanwhile, United Health Foundation notes that the population about to turn 65 is 7 percentage points more likely to be obese and 6 percentage points more likely to have diabetes than those who turned 65 in 1999.

According to a proprietary study we conducted at L.E.K., Medicare Advantage would be the best plan option for approximately 20% of seniors who end up defaulting to Original Medicare. Such seniors are typically worried about their health but aren't proactive about seeking related plan information, and so aren't making a conscious (never mind well-informed) decision to remain in Original Medicare. That means they are likely to respond positively to outreach and guidance around choosing Medicare Advantage.

Figure 3
L.E.K. Medicare Advantage enrollment trend and projection (2000-2018**)



Note: *Includes enrollment in Original Medicare and Medicare Supplement and excludes Puerto Rico and U.S. territories; **Assumes enrollment figures released in February each year from CMS represent the previous year's enrollment
Source: CMS, KFF, Mark Farrah Associates, NAIC, L.E.K. analysis

annual growth rate (CAGR) to reach 47% penetration, or just over 37 million members in 2025 (see Figure 4).

Still headed for 70% penetration

After factoring in enrollment and penetration rates over the past two years, we still expect Medicare Advantage to reach up to 70% penetration sometime between 2030 and 2040.

Medicare Advantage versus Medicare Supplement

The future of Medicare Supplement, which is used to help pay some of the costs that Original Medicare doesn't cover, is uncertain. Like Original Medicare, Medicare Supplement plans face higher medical costs while offering a similar lack of strategic levers to manage healthcare spend.

And starting on January 1, 2020, a provision in the Medicare Access and CHIP Reauthorization Act will ban Medicare Supplement insurers from selling any Medicare Supplement policy that covers the annual Medicare Part B deductible (i.e., first-dollar coverage) to new Medicare enrollees. The change will impact the current Medicare Supplement choice favorites, Plan F and Plan C. Both changes could lead more seniors to choose a Medicare Advantage plan.

We base our forecast on a number of factors, among them the fact that not only have several urban and rural counties already achieved a Medicare Advantage penetration rate of 55%-65%, but also their penetration rates continue to grow in 14 of the top 20 counties (see Figure 5).

Medicare Advantage products should also continue to offer a differentiated and enhanced value proposition vis-à-vis Original Medicare and Medicare Supplement (see sidebar), which should grow as healthcare becomes more expensive and Medicare Advantage plans become more targeted toward seniors' condition-specific and holistic healthcare needs.

Dual eligibles

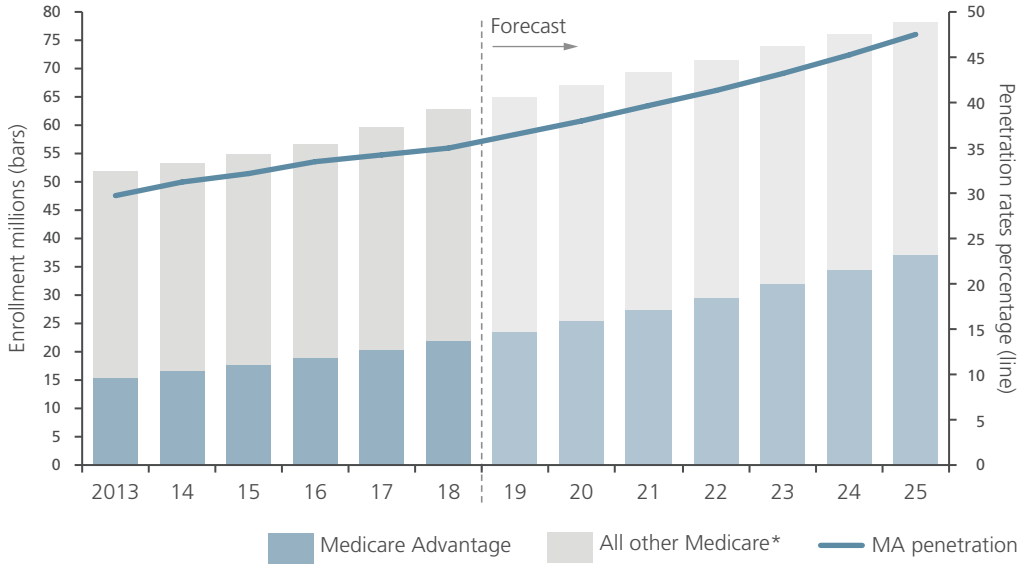
Dual eligibles, a segment where Medicare Advantage penetration has historically lagged, is also currently making up for lost time.

"Dual eligibles" is a term used to encompass Medicare beneficiaries who also receive Medicaid assistance. Medicare Advantage penetration of dual eligibles, which represents roughly 20% of Medicare eligibles, has lagged behind Medicare Advantage penetration of seniors due to a lack of coordinated state offerings and managed care. However, states are moving aggressively to manage the cost of this high-needs population. Dual Eligible Special Needs Plans (D-SNPs), which comprise the vast majority

of special needs plans (SNPs), have been growing at more than 10% per year, outpacing overall Medicare Advantage enrollment growth. And large managed care organizations have indicated they expect to see continued growth in the SNP market. For example:

- **UnitedHealthcare** executives at the Barclays Global Health Conference in spring 2018 said they continued to see D-SNP as a high-growth opportunity, noting that only 20% of D-SNP eligible individuals were enrolled in a D-SNP
- **WellCare** executives indicated at the Morgan Stanley 16th Annual Global Healthcare Conference in September 2018 that the dual population was significantly underpenetrated and presented a large opportunity
- **Humana** executives at the annual J.P. Morgan Healthcare Conference in January 2019 indicated that states and the federal government have demonstrated increased coordination for D-SNPs

Figure 4
L.E.K. Medicare Advantage enrollment trend and projection (2013-2025F**)



Note: *Includes enrollment in Original Medicare and Medicare Supplement and excludes Puerto Rico and U.S. territories; **Assumes enrollment figures released in February each year from CMS represent the previous year's enrollment
Source: CMS, KFF, Mark Farrah Associates, NAIC, L.E.K. analysis

Other large payers are likely to look toward SNPs, given the potential they offer for high profitability, plan design flexibility and year-round enrollment opportunity. We expect to see continued strong growth within SNPs in the coming years as they get more sophisticated when it comes to managing these complex patient populations.

Noted regulatory uncertainty

While we remain bullish on the emerging value proposition of Medicare Advantage as the highest-value product choice for a majority of seniors in the current environment, there are at least two regulatory uncertainties that could meaningfully impact the outlook for Medicare Advantage enrollment and penetration and that we monitor closely; proposals for "Medicare for All" and CMS' recently announced Primary Cares Initiative.

Several Democratic candidates running for president in 2020 have introduced formal proposals or otherwise supported movement toward Medicare for All should Democrats regain control of the government. These proposals are still in their early days and could have dramatically different impacts on Medicare Advantage enrollment as we know it today. A "single payer" proposal such as the version proposed by Sen. Bernie Sanders could bring an end to private health insurers' involvement in Medicare and thus Medicare Advantage entirely. On the other hand, a "Medicare *Advantage* for All" approach or enabling early buy-in into Medicare (and Medicare Advantage) could dramatically expand Medicare Advantage enrollment.

CMS' new Primary Cares Initiative will also be interesting to track to determine its impact on Medicare Advantage enrollment. While it is a voluntary program, CMS projects that as many as 25% of Original Medicare beneficiaries could be incorporated into the five-year program. Similar to Medicare for All proposals, if the Primary Cares Initiative focuses entirely on enabling providers to take on risk, it might increase the degree of care management within Original Medicare and thereby diminish the incentives to join a Medicare Advantage plan. On the other hand, if CMS enables a provider group or Medicare Advantage plan to take on responsibility for the total cost of care for all Medicare beneficiaries in a specific geographic region, it could dramatically expand Medicare Advantage enrollment.

Investing in long-term penetration growth

As we noted in the first *Executive Insights* in this series, Medicare Advantage penetration has grown at a slow but steady pace over the past 25 years. As seniors increasingly eschew

Figure 5
Top 20 counties by penetration

#	State Name	County Name	2018*		MA Penetration		
			Eligibles	Enrolled	2013	2018	Annual Percentage Point Change (PPT)
1	Florida	Miami-Dade	483,167	321,796	57.7%	66.6%	1.8%
2	New York	Monroe	160,252	105,873	62.7%	66.1%	0.7%
3	Pennsylvania	Cambria	37,383	23,521	60.8%	62.9%	0.4%
4	Pennsylvania	Beaver	43,568	27,317	64.5%	62.7%	(0.4%)
5	Pennsylvania	Westmoreland	95,357	59,697	65.9%	62.6%	(0.7%)
6	Pennsylvania	Armstrong	17,962	11,111	62.9%	61.9%	(0.2%)
7	Wisconsin	Calumet	8,823	5,411	60.1%	61.3%	0.2%
8	Pennsylvania	Allegheny	269,243	163,744	62.4%	60.8%	(0.3%)
9	New York	Erie	201,137	121,525	55.1%	60.4%	1.1%
10	Pennsylvania	Indiana	19,670	11,858	55.7%	60.3%	0.9%
11	Pennsylvania	Washington	52,393	31,527	61.6%	60.2%	(0.3%)
12	Michigan	Ottawa	53,024	31,885	54.3%	60.1%	1.2%
13	North Carolina	Stokes	11,394	6,779	54.4%	59.5%	1.0%
14	Texas	El Paso	131,105	77,944	43.7%	59.5%	3.1%
15	Pennsylvania	Butler	43,273	25,602	56.7%	59.2%	0.5%
16	Wisconsin	Outagamie	34,758	20,546	55.6%	59.1%	0.7%
17	New York	Niagara	51,018	30,097	50.6%	59.0%	1.7%
18	Louisiana	St. Charles	9,307	5,476	50.6%	58.8%	1.6%
19	Louisiana	Jefferson	90,725	53,175	53.2%	58.6%	1.1%
20	Pennsylvania	Lawrence	23,288	13,604	58.0%	58.4%	0.1%

*Note: Based on February 2019 data for year-end 2018; grey indicates increased penetration from 2013 to 2018
Source: Mark Farrah, L.E.K. analysis

Original Medicare in favor of lower payments, enhanced care management and more cost certainty, with encouragement from both health plans and, albeit indirectly, the government, we expect that growth to continue — to 47% penetration by 2025 and, eventually, up to as high as 70%.

Payers will therefore need to take aggressive action to grow market share of their Medicare Advantage offering. That could include expanding into new counties, investing in targeted sales to age-ins, and designing new products to attract new members and keep them healthy. Meanwhile, providers that have so far elected not to participate in Medicare Advantage will need to reconsider their stance and figure out a way to win in the new operating environment. As for investors, they should be looking for vendors that are set up to support Medicare Advantage's continued growth (and their own profitability) by offering payers superior care management, member engagement, sales and marketing, and other capabilities.

Sooner or later, Medicare Advantage will become the predominant Medicare product offering. The time to prepare for the changing of the guard is now.

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About L.E.K. Consulting

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