HEALTHCARE BUSINESS TODAY
COVERING THE BUSINESS OF HEALTHCARE AND MORE

Trends and Spending for Medicare Advantage Signal Reforms for 2022

December 23, 2021

By Gregory F. Hagood, Senior Managing Director, SOLIC Capital Advisors

With an aging population, COVID's ongoing impacts, and unchecked costs, the American healthcare system is stretched thin. The number of people enrolled in Medicare has steadily increased in recent years, and along with it, Medicare spending. In particular, enrollment in Medicare Advantage, the private plan alternative to traditional Medicare, has more than doubled over the last decade.

As a direct result of this Medicare Advantage growth, we've seen very aggressive valuations for primary care groups. The underlying driver for this has been ability to expand practice profitability through value-based reimbursement – principally through Medicare Advantage plans.

Under Medicare Advantage contracting arrangements, primary care groups typically have the ability to participate in any shared savings under the Medicare Advantage capitation payments, thereby providing a source of profitability that was not available under traditional fee for service arrangements. In addition, large primary care groups have become very efficient at applying risk-based classifications and qualifying for quality bonus available under Medicare Advantage plans to further maximize reimbursement. These opportunities for enhanced profitability, combined with recession resistant growth as the Medicare population continues to expand, has attracted broad institutional investor interest with multiple primary care initial public offerings (IPOs), Special Purpose Acquisition Corp (SPAC) transactions and investments from private equity firms. These investors have placed particular emphasis around value-based care and payment models — seeking quick, high returns. But those days may be quickly coming to a close.

Colliding Trends in Medicare Advantage

According to a recent Kaiser Family Foundation (KFF) report, Medicare spending for Medicare Advantage enrollees was $321 higher per person in 2019 than if enrollees had instead been covered by traditional Medicare (an estimated $7 billion in additional spending in 2019). As spending for Medicare Advantage beneficiaries continues to grow faster and higher than for those with traditional Medicare, significant trends have emerged that may impact private practices and their investors. Some of these cost-related trends include:

- *Federal spending to almost double:* Between 2021 and 2029, federal spending on payments to Medicare Advantage plans is expected to increase by $316 billion, from $348 billion to $664 billion.
- *Accusations of fraud:* Currently, Medicare Advantage plans are incentivized to over diagnose / over treat patients, fueling costs. Large Medicare Advantage plans, such as United Healthcare and Kaiser Permanente, have been accused of upcoding, leading to fraudulent overbilling and expensive, well publicized lawsuits.
- *Calls for reform:* MedPac, in its most recent report to Congress, recommended lowering the benchmark per beneficiary capitated payments to insurers by 2%. Another possible reform was to reduce or eliminate the

bonus payments that Medicare Advantage plans receive for achieving 4 or 5 stars under the quality rating system, which will impact provider profitability. Currently, Medicare pays over $11B annually in bonuses related to the 5-star quality ratings.

The above trends are colliding, setting the stage for the Centers for Medicare & Medicaid Services (CMS) under the Biden administration to take a more aggressive stance on Medicare Advantage plans. Such a stance will most definitely have implications for practices, as well as current and future investors.

Winds of Change Portend Program Changes

Congress has and will continue to feel pressure to realign Medicare Advantage reimbursement in light of the outlined trends. This means either Medicare reforms and/or the high valuations on private practices will crash. While Medicare Advantage is a popular program and is not going away, changes such as the following are likely to occur:

- Congress may seek to reduce quality bonuses consistent with the MedPac report.
- Providers are likely to face intense audits related to comorbidity and acuity classifications.

Any reforms to Medicare Advantage programs will obviously face significant political headwinds. However, given the desire of the current Administration and Congress to find additional revenue sources to fund initiatives, combined with recent research showing the additional cost of Medicare Advantage relative to traditional Medicare, the environment may be ready for reform.

Additionally, reforms that reduce capitation reimbursement or quality bonuses are likely to have significant ripple effects on the investor-owned primary care physician practice management organizations (PPMs), that have been structured to maximize the value-based payments provided under Medicare Advantage. Traditional primary practices have historically had very thin profit margins with many hospital-owned primary care groups losing money. Any material reforms to Medicare Advantage reimbursement could quickly transform these investor-owned primary care practices into unprofitable ventures that may find it difficult to survive. Unlike primary care groups owned by health systems or managed care systems, which often receive subsidies to drive the profitability of the overall enterprise, unprofitable investor-owned primary groups would find it difficult to raise additional capital and would likely have to sell out to subsidized providers.

Such broad dislocation of investor-owned healthcare services has been seen before in such sectors as home health, skilled nursing and LTAC hospitals in which CMS payments reforms led to widespread bankruptcies. The question for primary care is not if such reforms are coming but when.

Author Bio

Gregory F. Hagood, CFA, is a senior managing director at SOLIC Capital Advisors, where he oversees the Investment Banking practice, including merger and acquisition advisory services as well as private placements of debt and equity. He has extensive transaction experience across multiple areas of the healthcare services industry, including provider practice management, hospitals and health systems, long-term care, and home health. Mr. Hagood is a Chartered Financial Analyst (CFA) and a CIRA and holds the Certification in Distressed Business Valuation.

###