



North America  
United States  
Health Care  
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Industry  
**Managed Care**

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**Industry Update**

## GHG Forecasts MA Rate Pressure Could Persist in 2016

Scott Fidel      Shawn Bevec  
Research Analyst      Research Associate  
(+1) 212 250-3716      (+1) 212 250-8564  
scott.fidel@db.com      shawn.bevec@db.com

### GHG provides assessment of 2015 MA rates and early outlook for 2016 rates

On Friday afternoon, we participated in a Gorman Health Group webinar in which the health consulting firm provided its assessment of the final 2015 Medicare Advantage rate proposal released by CMS on April 7. Gorman's assessment is that final 2015 MA rates will amount to an all-in 3.02% cut which is in line our and most Street ests of a 3.0-3.5% headwind. Gorman also now believes that the MA industry is unlikely to see any real rate relief until at least 2017 as MA rate pressure will likely persist into 2016, particularly given that this will be an off-cycle year in terms of congressional elections.

### Gorman Health estimates final 2015 all-in MA rate cut at -3.02%

GHG is a health care consulting firm that specializes in advising MA plans. GHG assessed the final 2015 MA rate proposal as an all-in rate cut of -3.02% next year. Note this is slightly better than our -3.4% est and is well within the -3.0-3.5% range of most Street ests. In 2014, MA is expected to be paid at 106% of Medicare FFS while this will decline to 103.6% in 2015. Gorman noted that the move by CMS to slow the phase-in of the new risk adjustment model from 75% phase-in in 2014 to only 33% in 2015 was highly unusual and likely reflected the need for CMS to offset the negative FFS cost trends that heavily weighed on the MA rate book, particularly given election year political factors. Please see Figure 1 in the body of this note for Gorman's detailed final 2015 MA rate build for both the preliminary and final rates.

### MA rates could face another year of pressure in 2016 despite Street hopes

The bull case thesis on MA has been recently predicated on a view that the significant ACA-related rate headwinds will largely be phased in over 2014-2015 and as a result the industry could finally experience some positive MA rate increases (albeit modest) beginning in 2016. However, the rate pressures in 2014-2015 have been so intense particularly due to extraordinarily low Medicare FFS cost trends. As a result, CMS has been deploying unusual measures to help offset some of these headwinds and give the industry more time to adjust to sharper cuts in the MA rate book. The trade-off for the industry now appears to be that all of the rate pressure will likely not be baked into rates by 2016. While the all-in MA rate outlook could improve a bit in 2016 relative to 2015, we now expect all-in rates could remain negative. The slower phase-in of the new risk adjustment model means that there is still 170 bps of further rate pressure beyond 2015 to fully shift to the new model. Additionally, GHG believes that the in-home HRA proposal will likely return to the Advance Notice next year for the third consecutive time. As we have discussed in previous research, we estimate that the in-home HRA proposal would create a rate headwind of 1-4% on average. The implementation of the in-home HRA proposal and renewed transition to the new risk adjustment model could add 200-600 bps of incremental rate pressure in 2016, beyond the potential for the MA growth rate to remain negative. Finally, CMS will likely not face the same type of political pressure in 2016 as it will be an off-cycle year for elections.

### Valuation & Risks

We apply an 11-13x blended composite multiple on 2015E EPS for Diversified MCOs. Downside risks to our Neutral industry view include rising medical costs; regulatory actions; and Medicare and Medicaid rate pressures. Upside risks include subdued utilization trend and strong industry pricing.

### Companies Featured

Aetna (AET.N),USD70.82	Buy
CIGNA (CI.N),USD77.11	Buy
Centene (CNC.N),USD58.30	Hold
Health Net (HNT.N),USD32.44	Hold
Humana (HUM.N),USD108.16	Sell
Molina (MOH.N),USD34.59	Hold
Universal American (UAM.N),USD7.29	Hold
UnitedHealth Group (UNH.N),USD78.95	Buy
WellCare Health Plans (WCG.N),USD63.11	Hold
WellPoint (WLP.N),USD95.05	Hold

Source: Deutsche Bank

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# 2015 MA Rates Follow-Up

## Gorman Health Group Assessment of 2015 MA Rates

Figure 1: Gorman 2015 MA Rate Build

	<u>Advance Notice</u>	<u>Final Call Letter</u>	<u>Delta</u>
<b>Final Notice Cost Trends</b>			
Prior law benchmarks	-3.55%	-4.07%	-0.52%
ACA benchmarks	-1.65%	-3.30%	-1.65%
<b>Average Trend (enrollment weighted)</b>	<b>-1.90%</b>	<b>-3.37%</b>	<b>-1.47%</b>
<b>ACA and Other Previously Scheduled Changes</b>			
Phase-in of new ACA rates (average)	-2.02%	-2.09%	-0.07%
Average net impact of rebasing FFS, benchmark ceiling	n/a	-0.25%	-0.25%
<b>Subtotal, impact of ACA and rebasing</b>	<b>-2.02%</b>	<b>-2.34%</b>	<b>-0.32%</b>
<b>Change in published benchmarks (weighted average)</b>	<b>-3.92%</b>	<b>-5.71%</b>	<b>-1.79%</b>
<b>Risk Adjustment Changes</b>			
Risk adjustment recalibration revisions (slower phase-in)	0.00%	1.09%	1.09%
FFS normalization, change from prior year	3.16%	4.30%	1.14%
Revised HRA rules	-1.00%	0.00%	1.00%
Coding intensity adjustment	-0.25%	-0.25%	0.00%
<b>Subtotal risk adjustment changes</b>	<b>1.91%</b>	<b>5.14%</b>	<b>3.23%</b>
<b>Plan-Specific Factors</b>			
End of quality bonus demo (average impact)	-1.75%	-1.75%	0.00%
ACA industry fee	-0.70%	-0.70%	0.00%
<b>Combined impact (industry average)</b>	<b>-4.46%</b>	<b>-3.02%</b>	<b>1.44%</b>

Source: Gorman Health Group; Deutsche Bank



# Appendix 1

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Notes:

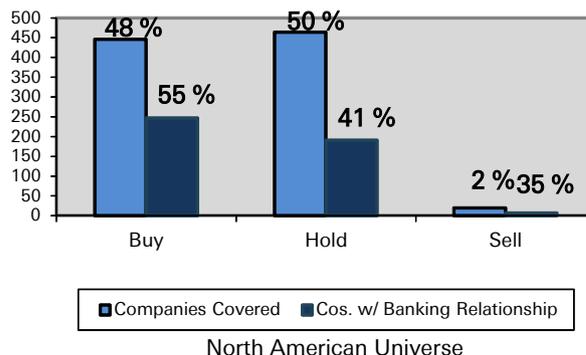
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**David Folkerts-Landau**  
Group Chief Economist  
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Guy Ashton  
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Richard Smith and Steve Pollard  
Co-Global Heads  
Equity Research

Michael Spencer  
Regional Head  
Asia Pacific Research

Ralf Hoffmann  
Regional Head  
Deutsche Bank Research, Germany

Andreas Neubauer  
Regional Head  
Equity Research, Germany

Steve Pollard  
Regional Head  
Americas Research

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## International locations

### Deutsche Bank AG

Deutsche Bank Place  
Level 16  
Corner of Hunter & Phillip Streets  
Sydney, NSW 2000  
Australia  
Tel: (61) 2 8258 1234

### Deutsche Bank AG

Große Gallusstraße 10-14  
60272 Frankfurt am Main  
Germany  
Tel: (49) 69 910 00

### Deutsche Bank AG

Filiale Hongkong  
International Commerce Centre,  
1 Austin Road West, Kowloon,  
Hong Kong  
Tel: (852) 2203 8888

### Deutsche Securities Inc.

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
Japan  
Tel: (81) 3 5156 6770

### Deutsche Bank AG London

1 Great Winchester Street  
London EC2N 2EQ  
United Kingdom  
Tel: (44) 20 7545 8000

### Deutsche Bank Securities Inc.

60 Wall Street  
New York, NY 10005  
United States of America  
Tel: (1) 212 250 2500

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