BofA SECURITIES

Managed Care

2025 Rate notice generally in-line, final rule likely higher

Government Regulations

Proposal at low end of expectations, final likely high end

Excluding risk score trend (which is a CMS projection and can vary widely by company), CMS proposed to cut MA rates -0.16% in 2025, which is an improvement from -1.12% last year. This is at the low end of the 0-1% expectation coming in and modestly better than the negative update HUM signaled last week. We note that 2/3 of the time, the final rule is better than the proposal, and on average it is 1.6% higher, making it likely that the final rule will end up at the higher end of expectations coming in. A better rate is never guaranteed, but seems like given this is an election year and most plans are either below target margins or outright losing money. The rule does not include any new negative policy surprises, but is slightly below on a lower trend update and higher coding impact. Overall, we view the rule as in-line and removes an overhang. The Final Rule is due by April 1. See the body of this note for more detailed discussion of how rates are calculated, historical trends over time, and how MCOs are actually impacted.

Behind weak rate– coding trend offset by normalization

The rate notice was impacted negatively by the continued phase in of the risk model revision changes, which dragged down payments by -4.44% in 2025, but offset by a +1.99% increase from normalization (nets to -2.45%). We note that last year, the net impact from both was -2.16%, driven by a combination of roughly 50/50 negative impact from risk score changes/normalization, and therefore the risk model component is significantly worse, which was due to CMS using more up-to-date coding data in their projections. We note that this higher coding impact was expected by the industry and the main reason HUM expected a negative update.

CVS, MOH, CNC better positioned than most MCOs

Based upon company star scores, we expect CVS (+3.29% absolute rate increase y/y), MOH (-0.01%) and CNC (-0.04%) to see better y/y rate changes vs the industry weighted rate of -0.16%. Meanwhile, UNH (-0.26%), HUM (-0.28%) and ELV (-1.70%) will see worse than average rates due to poor stars performance, while ALHC is in-line with the industry. We would also highlight that during periods of rate disruption, we would expect industry leaders like UNH/HUM to gain share.

Ultimately MA rates should bracket trend over time

The best way to think about MA rates is to compare the aggregate, fully adjusted MA rate, against what CMS expects cost trend to be on the Medicare FFS population (FFS trend). When looking at rates this way, the proposed rate is roughly in-line with historical levels as MA almost always screens 1-2% lower than FFS. It is the role of MA plans to come up with cost savings each year (medical management, shift to value based care, G&A savings from efficiencies and growth, improved coding and quality scores, etc). As a result, MA plans have grown membership in the mid/high single digits over the past decade with rates that avg 2% below trend.

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ALHC = Alignment Health

CMS = Centers for Medicare and Medicaid Services

CNC = Centene

CVS = CVS Health

ELV = Elevance

FFS = Fee for Service

HUM = Humana

MA = Medicare Advantage

MCO = Managed Care Organization

MOH = Molina

UNH = UnitedHealth Group

Refer to important disclosures on page 8 to 10.

MA rate roughly in line

CMS expects to cut MA rates -0.16% as a result of the methodology proposed in the advanced notice. CMS ultimately expects spending per member to increase +3.70%, since it believes that the industry will improve coding, but historically, this coding lift has only been mentioned in a footnote or separate line item, and is a factor CMS is estimating and which can vary significantly by company. Therefore, when comparing this rate to historical rate update, the -0.16% is the cleaner number. Meanwhile, although we agree that plans can improve coding as an offset, each plan will have different levels of success, so using a standard 3.86% offset as misleading and we have historically assumed a 1-2% lift from coding.

Exhibit 1: Negative effective rate change at low end of expectations
2025 Medicare Advantage Advanced Notice rate components

Factor	Industry
Effective growth rate	2.44%
Rebasing/Re-pricing	TBD
Change in star ratings	-0.15%
MA coding intensity adjustment	0.00%
Risk model revision and normalization	-2.45%
Expected Rate Change	**-0.16%**
2025 FFS USPCC Cost Trend	*1.98%*
2025 Rate Spread vs. Trend	***-2.14%***
MA risk score trend	*3.86%*

Source: CMS, BofA Global Research

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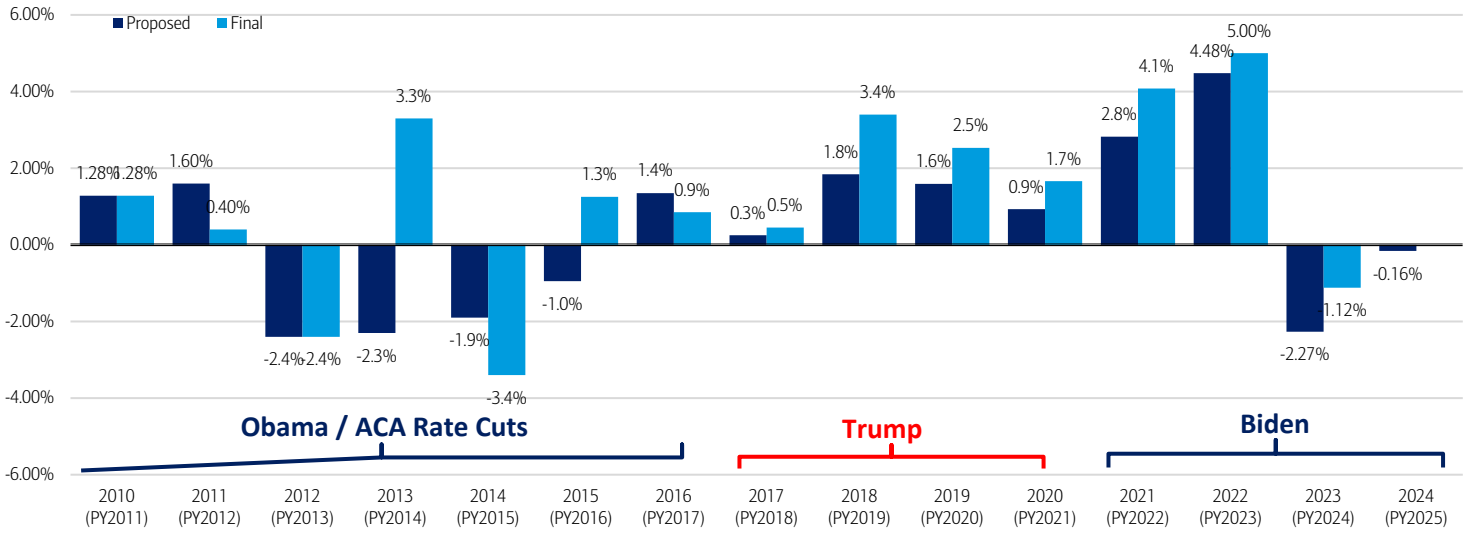
Final rate is usually better than proposal

While this -0.16% is at the low end of expectations, historically, the final rate has come in better than the proposal a majority (64%) of the time. In years where the final came in better, the average increase was 160bps. As a result, we think the final rate will be better and end up closer to the high end of expectations.

Exhibit 2: In the past 14 years, the final rate has come in better than the proposal 64% of the time
Medicare Advantage rate increases over time (excluding risk score trend) vs proposal



Source: CMS, BofA Global Research

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HUM had set an expectation of a negative rate update

To be fair however, HUM (the largest 'pure play' Medicare Advantage company) recently said it expected a negative rate update. While this -0.16% rate is below the 0-1% range we expected, the company had been bracing for this.

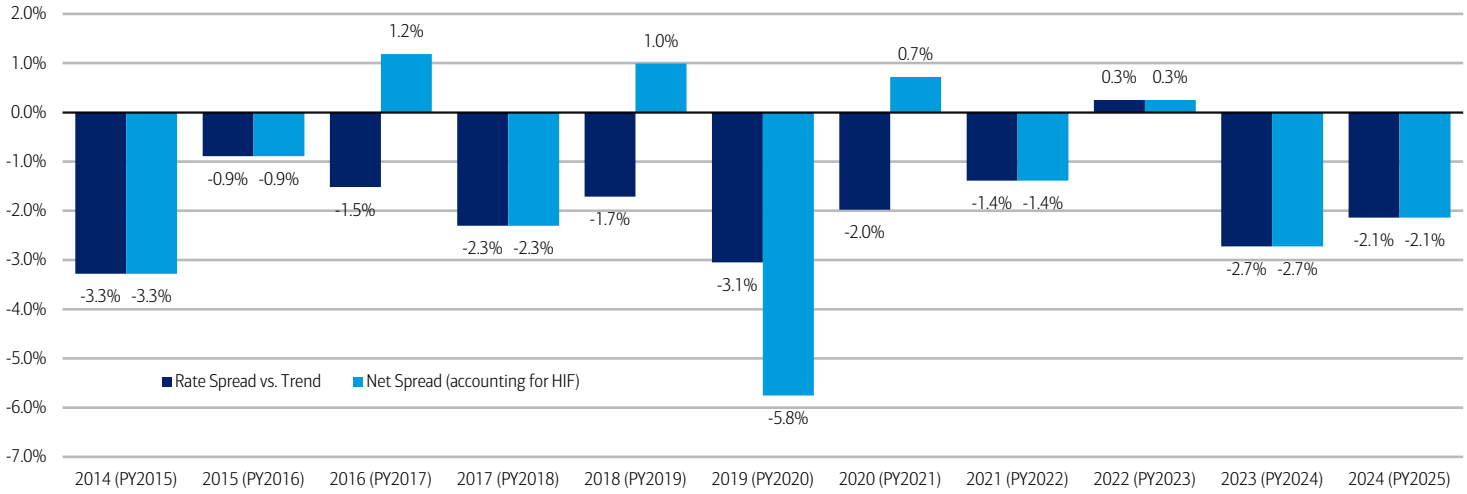
"And right now, we are assuming that the '25 Rate Notice will look similar to 2024, in that it will be negative given we have another one-third of the V-28 Model implementation." **– HUM, 4Q23 earnings call**

Ultimately MA rates should bracket trend over time

Another way to think about MA rates is to compare the aggregate, fully adjusted MA rate, against what CMS expects cost trend to be on the Medicare FFS population (FFS USPCC trend). When looking at rates this way, MA usually screens 1-2% lower than FFS. While 2023 was an unusually strong year on both an aggregate and relative basis, we see no reason to believe why MA plans should have any issues with a potentially weaker aggregate rate increase if that aggregate rate is accompanied by lower expected trend, because costs would be lower as an offset.

Meanwhile, it is the role of MA plans to come up with cost savings each year (reductions in trend from medical management, shift to value based care, shift in site of care to lower cost settings, G&A savings from efficiencies and growth, improved coding and quality scores). As a result, MA plans have grown membership in the mid/high single digits over the past decade with rates that on average have been about 2% below trend.

Exhibit 3: MA rates are generally always below FFS trend, but screen better than last year
Medicare Advantage rate increases over time vs FFS USPCC, and net spread inclusive of HIF



Source: CMS, BofA Global Research

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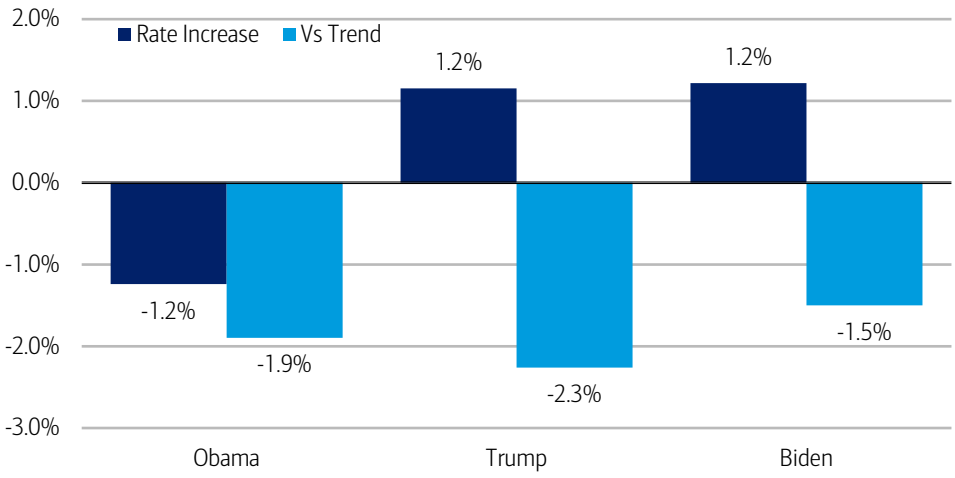
-2% rate vs trend holds across administrations and political parties

Another interesting way of slicing the data is looking at the average rate vs trend during various administrations. Notably, using the data we have available (only covering the majority of the second term of the Obama administration due to data limitations), every Administration ends up bracketing -2% rate vs trend over time, and in that time the MA program has grown successfully.

Exhibit 4: Over multiple administrations, -2% rate vs trend has held over time
Medicare Advantage rate increases over time vs FFS USPCC under various administrations



Source: CMS, BofA Global Research
Note: Data for the Obama Administration only covers his second term, due to limitations in getting older data

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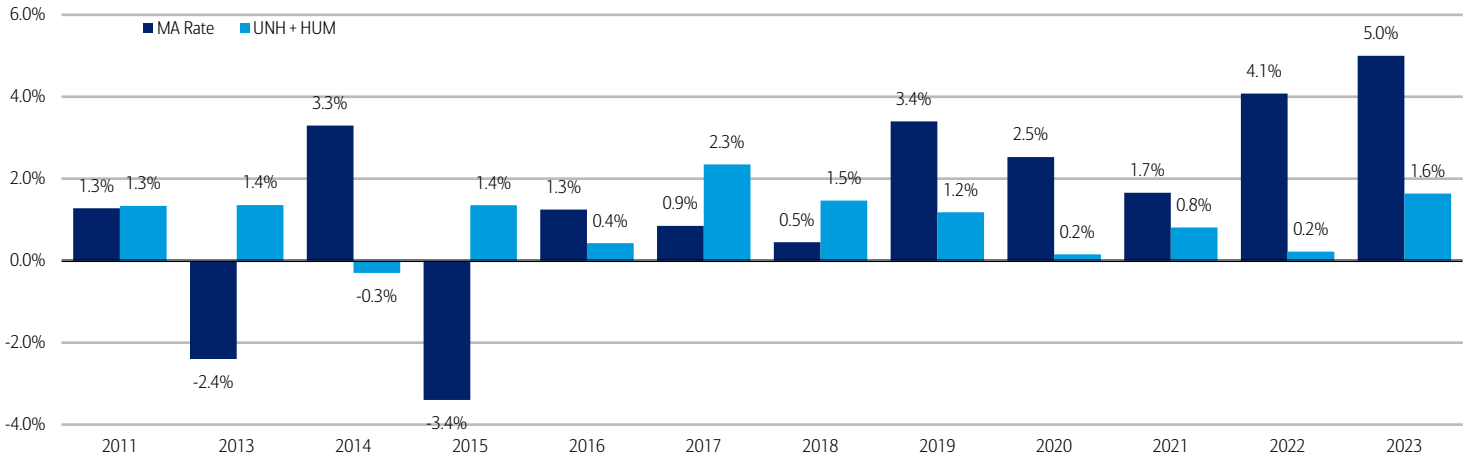
'Weaker' rate could benefit plans like UNH/HUM

There is an argument to be made that an overly generous aggregate rate update is actually a bad thing for incumbent plans like UNH/HUM because it gives smaller competitors the ability to cover fixed costs more easily and incrementally compete on benefits. If rates do end up more closely mirroring expected costs, only the plans with the largest and most efficient platforms will be able to cover trend while expanding benefits. There is some evidence to support this. Looking back to 2011, we have found a -36% correlation (excel CORREL function) between MA rates and share gains at the two largest MA platforms (UNH + HUM) collectively, which have grown from 33% of all MA membership in 2010 to 47% today.

Exhibit 5: There has generally been an inverse correlation between MA rates and share gains at the top MA plans
Final MA rates vs share gains at UNH and HUM collectively



Source: CMS, BofA Global Research

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Breaking down the components of rates

Below we walk through each of the core rate components, bridging to how the administration reached -0.16% and what each component represents.

+2.44% effective growth rate (+0.16% better than PY24). CMS estimates that the combined effect of the MA growth percentage and the FFS growth percentage (that determine MA payment rates) will be +2.44% in 2025 vs 2.28% in 2024. Included in the

2025 growth rate estimate is a continued technical adjustment to the per capita cost calculations related to indirect and direct medical education costs associated with services furnished to MA enrollees. This technical adjustment is being phased in over three years, and will be applied at 33% of the adjustment in CY 2025 (year 2).

-0.15% impact from Star bonus degradation (+1.09% better than 2024). CMS expects to see a -0.15% industry impact from changes in Star quality ratings. However, the impact to each MCO is different since Star ratings are determined at the contract level.

0% impact from risk coding intensity (in-line with 2024). Historically, CMS adjusted MA risk scores to reflect differences in coding patterns between plans and FFS providers in Part A and B. Since Medicare Advantage companies receive higher reimbursement for sicker beneficiaries, they are incentivized to code efficiently to reflect accurate acuity. As a result, CMS has observed higher disease coding patters in Medicare Advantage versus FFS. Importantly, CMS adjusts for coding based on the intensity and not the accuracy of coding. For example, even if MA codes more frequently only because the industry is more efficient, CMS still considers coding adjustments as necessary. The industry saw minimum incremental coding adjustments of 0.25% each year form 2015-2018, but for 2019, the MA coding intensity adjustment was actually a very modest tailwind (+0.01%) and is 0% for 2020 through 2025.

-2.45% from Risk model revision and normalization (-0.29% vs 2024). This line contains two components and it's worth breaking them out separately. We note this is worse than 2024, which was a -2.16% impact.

- **Normalization factor changes (+1.99%).** This adjustment reflects that the overall Medicare population risk score tends to drift above 1.0, and the normalization factor would be applied to bring it back to 1.0.

- **Risk Model revisions (-4.44%).** CMS will periodically make adjustments to the coding system, with the most recent change a result of moving to the Encounter Data System (EDS) to directly collect the data for creating risk scores (instead of having plans calculate their own risk scores). CMS didn't make any changes to the new model, but is continuing to phase in that model (now 2/3 new model and 1/3 old model). As a reminder, the new model includes shifting from using ICD-9 data to ICD-10 data to create risk scores (International Classification of Diseases, Tenth Revision, or ICD-10 is the current standard for fee for service claims and is much more detailed than ICD-9). The potentially more impactful shift that CMS is making involves a periodic review of codes that MA plans submit and review if certain claims still are good predictors for the average cost of a patient. During these reviews, CMS often finds that some codes are disproportionately found in the MA population vs FFS and therefore CMS believes that their presence skews the average rate paid to MA plans upwards, purely because it is better documented. In the CY 2024 rule, CMS dropped 2,236 codes from the prior model, added in 209 new codes, and decided to phase in the new model over three years, starting in 2024. CMS blended the CY 2024 risk scores using 67% of the risk scores under the old 2020 risk adjustment model and 33% of the risk scores under the finalized 2024 risk adjustment model. CMS will phase in the rates to be 67% the new model in 2025 and 100% of the new model in 2026.

All in, industry rates -0.16% vs. 1.98% projected trend. Overall, we estimate plans will see a -2.14% rate spread which is better than the -2.72% rate spread in 2024, but is slightly below the historical average of around -2%.

Company-specific items can vary the rate

Usually, some items in the reg are applied uniformly to all plans, while others are applied on a plan by plan basis based upon plan specific characteristics (local geography, stars

performance, etc.). CMS does not disclose the county rebasing until the final rule, so we don't have all the data needed to calculate the ultimate update.

Exhibit 6: Company specific rates determined by a number of factors, so far the only known being Stars
Preliminary estimated 2025 Medicare Advantage Rates by company per Advance Notice

Factor	Industry	ALHC	CLOV	CNC	CI	CVS	ELV	HUM	MOH	UNH
Effective growth rate	2.44%	2.44%	2.44%	2.44%	2.44%	2.44%	2.44%	2.44%	2.44%	2.44%
Rebasing/Re-pricing	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Change in star ratings	-0.15%	-0.15%	-1.50%	-0.03%	-0.11%	3.30%	-1.69%	-0.27%	0.00%	-0.25%
MA coding intensity adjustment	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Risk model revision and normalization	-2.45%	-2.45%	-2.45%	-2.45%	-2.45%	-2.45%	-2.45%	-2.45%	-2.45%	-2.45%
Expected Rate Change	-0.16%	-0.16%	-1.51%	-0.04%	-0.12%	3.29%	-1.70%	-0.28%	-0.01%	-0.26%
2025 FFS USPCC Cost Trend	*1.98%*	*4.25%*	*4.25%*	*4.25%*	*4.25%*	*4.25%*	*4.25%*	*4.25%*	*4.25%*	*4.25%*
2025 Rate Spread vs. Trend	*-2.14%*	*-4.41%*	*-5.76%*	*-4.29%*	*-4.37%*	*-0.96%*	*-5.95%*	*-4.53%*	*-4.26%*	*-4.51%*
MA risk score trend	*3.86%*	*3.86%*	*3.86%*	*3.86%*	*3.86%*	*3.86%*	*3.86%*	*3.86%*	*3.86%*	*3.86%*

Source: CMS, BofA Global Research

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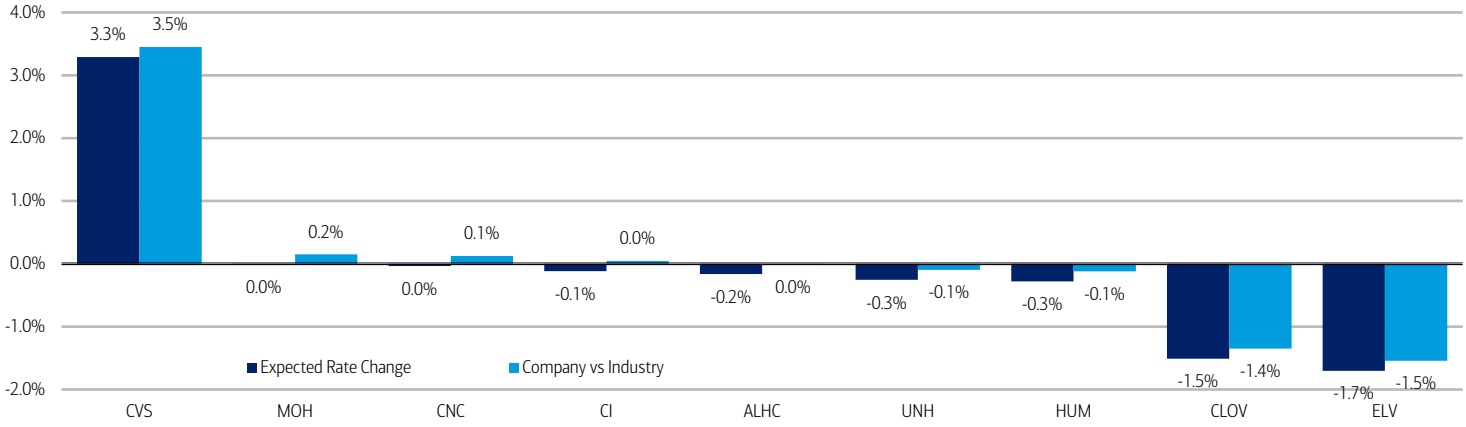
Of larger MCOs, CVS best positioned while HUM, ELV least

Based upon what data is available (changes in Stars scores), we expect CVS, MOH (PF BHG), and CNC to see better y/y rate changes vs the industry. Meanwhile, ALHC, UNH, HUM, CLOV, and ELV will see worse than average rates due to stars pressure.

Exhibit 7: Of larger MCOs, CVS best positioned while HUM, ELV to see biggest cuts
Preliminary estimated 2025 Medicare Advantage Rates by company per Advance Notice



Source: CMS, BofA Global Research

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MCOs have levers to pull to respond to rate changes

Below we walk through how an MCO could respond to rate changes, regardless of the industry averages.

1.5% trend benders. HUM has said that it can achieve annual savings versus FFS of ~200bps by way of medical management initiatives and provider contracting, for example.

1-2% coding improvements. CMS estimated for 2025 MCOs will see an average 3.86% increase in revenue from coding improvements. Interestingly, in the past few years, CMS included the estimate within the overall summary table instead of as a footnote, making the headline number look larger than it is. However, every year MCOs have a trend factor related to their ability to improve risk coding. The 3.86% CMS gave this year is an expected industry average but each company is likely to see risk coding trend vary dramatically. Historically, we have viewed 1-2% as a reasonable assumption for coding offsets.

4.5%-5.5% adjust bids. MCOs that generate significant savings could reduce extra benefits to members by about $30 per month, assuming the benefit design remains

attractive versus open network FFS. This implies bids could be raised by $45-$55, since plans keep ~60% of the difference between their bids and the benchmark for extra benefits. PPOs and PFFS do not offer as many extra benefits to cut. We note that plans generally do not want to cut benefits, for fear it could lead to membership losses, but will do so as a last resort if rates are negative or they need to reprice for margin.

SG&A leverage. MA membership has consistently grown as a share of the Medicare population. On top of this HMOs that take significant market share at the expense of inefficient PPOs and PFFS could use operating leverage to offset rate cuts.

Company-specific Star ratings. In early October, CMS released their Star ratings which determine quality bonus payments for Medicare Advantage plans in 2025. Based on these Stars, CVS was the only profitable MCO to see a net rate tailwind from Stars improvement (see report). At the other end of the spectrum, ELV saw material y/y declines to Stars and rates.

Exhibit 8: Stars rate impact varies by MCO
Weighted average bonuses and rebates by MCO

	Weighted average bonus			Rebate advantage*			Combined benefit advantage		
	2024	2025	y/y	2024	2025	y/y	2024	2025	y/y
ALHC	4.7%	4.6%	-0.1%	1.5%	1.5%	-0.1%	6.2%	6.1%	-0.2%
CNC	0.1%	0.0%	-0.1%	0.2%	0.3%	0.1%	0.3%	0.3%	0.0%
CI	3.3%	3.3%	0.0%	1.3%	1.2%	-0.1%	4.6%	4.5%	-0.1%
CLOV	0.0%	0.0%	0.0%	1.5%	0.0%	-1.5%	1.5%	0.0%	-1.5%
CVS	1.1%	4.4%	3.3%	1.5%	1.5%	0.0%	2.6%	5.9%	3.3%
ELV	3.3%	1.7%	-1.6%	1.4%	1.3%	-0.1%	4.7%	3.0%	-1.7%
HUM	4.9%	4.7%	-0.2%	1.8%	1.8%	0.0%	6.7%	6.5%	-0.3%
MOH	0.0%	0.0%	0.0%	0.1%	0.2%	0.1%	0.1%	0.2%	0.1%
MOH PF BHG	0.0%	0.0%	0.0%	-5.0%	-5.0%	0.0%	-5.0%	-5.0%	0.0%
OSCR	0.0%	0.0%	0.0%	-5.0%	-5.0%	0.0%	-5.0%	-5.0%	0.0%
UNH	4.1%	3.9%	-0.3%	1.7%	1.8%	0.0%	5.8%	5.6%	-0.2%
Industry	**3.7%**	**3.7%**	**0.0%**	**1.6%**	**1.6%**	**-0.1%**	**5.3%**	**5.2%**	**-0.1%**

Source: CMS, BofA Global Research
*Assuming bids 10% below the benchmark

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Underperform	N/A	≥ 20%

[R1]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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