



Transcript

# Blue Cross Blue Shield Administrative Cost Trends A Review of 2015 Results – Cost Optimization Continues

June 29, 2016

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<Title Page>

Thank you for participating in this year's review of the Sherlock Benchmarks for Blue Cross Blue Shield Plans.

I want to begin with an anecdote. Prior to the passage of the Affordable Care Act, I was invited to a meeting of congressional staffers for a conversation concerning administrative costs under the proposed law. At that point the, MLR rules were considered integral to the vision but details about calculations had not yet been worked out. The MLR rules require that revenues that are in excess of levels yielding a Medical Loss Ratio of 80 or 85% must be shared with the customer. In the emphatic view of one of the staffers, the denominator of the calculation should be premiums, *plus fees under ASO arrangements*. Setting aside the practical implications of that choice of denominators, this interchange highlights the focus on administrative costs that has since animated the law and regulations on health plans.

Let me offer additional data points. Nine Blue Cross Blue Shield Plans reported detailed individual segment information to us. Collectively, these nine plans served 3.3 million people with commercial individual products. On revenues of \$14 billion, they lost \$2.4 billion, or \$61 PMPM. Those reporting "grandfathered" products reported that their median losses were one-fourth that amount PMPM, Losses on Public Exchanges averaged \$42 PMPM, and compliant but off exchanges was \$61 PMPM. Meanwhile, the 25<sup>th</sup> percentile health benefit ratios for individual was 89% and the 75<sup>th</sup> percentile value was 104%. A recent *Investor's Business Daily* editorial tabulated the reported results of

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Blue Cross Blue Shield plans and losses in these products totals in the neighborhood of \$3 billion. Participation in the individual market has created a further impetus for cost management. Blue Cross Blue Shield plans, as we will see, have adapted to this by careful attention to their administrative expenses.

The 17 Blue Cross Blue Shield plans reflected here serve 45 million people with comprehensive insurance, higher than last year. These plans collectively serve about two-thirds of the membership of Blue plans that are not in plans that are publicly traded.

By way of introduction, I am Doug Sherlock, President of Sherlock Company. We offer what leading consultants call “the Gold Standard” for health plan benchmarks. Now in our 19<sup>th</sup> consecutive year of benchmarking health plans, we benefit from 740 health plan years of experience, comprised of definitions, systems for compilation and checking as well as processes for reporting and drill-downs. In addition to Blue plans, we also have other universes of Independent / Provider - Sponsored Plans, Medicaid Plans and Medicare Plans.

Before I begin though, I want to offer our thanks to the Plans that participated in this year’s benchmarking study and in particular our primary contacts. While Plans benefit from their participation, the rest of the industry does too via publicly available information such as this conference. You participants are not only setting a course for everyone, you are providing something of a roadmap as well.

<Slide 2>

I’m going to breeze through this slide. It shows the topics that I will address, and lists the appendices. Note that the appendices contain last year’s value and a list of all of the functions in each of the products offered by these Blue Plans. That means that administrative expenses are segmented into nearly 800 expense/product cells, each of which are separately analyzed. We only summarize broad trends here.

I will be posting the slides and the transcript of this within the next 24 hours. I very much welcome your questions at the end of this presentation and the audience will be muted during the presentation itself.

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For the second year in a row, the median administrative cost trends were quite modest at 1.2% per member versus 1.1% last year. Over the past 8 years, these two years are record setting in how low they are. This is shown in the dark blue bar.

The light blue bar is the cluster of Account and Membership Administration expenses. Here too, trends are at historic lows of 0.8% compared with 3.0% in 2014. Back in 2011, the median cost increase was 0.5% and back in 2008, it was 0.7%, but the rate of growth in costs in this cluster is very low compared to most years.

We have made these calculations as carefully as possible – in all comparisons, we have reweighted the product mix of the Blue Plans to eliminate the effect of product mix differences between the two years. Also, every comparison uses only health plans that participated in both comparison years. In short, we think that cost trends reflect, in part, the incentives that health plans now face for cost optimization.

<Slide 4>

The far right column of Figure 2 on Slide 4 shows 1.2% per member total administrative cost increase and the 0.8% Account and Membership Administration increase mentioned above. The arrow in the shape of an arc is to draw your attention to the comparison with prior year's values.

These comparisons, in the second and fourth columns, show the difference in greater detail. You can see that Account and Membership decelerated, as did Sales and Marketing from 2.0% to 1.0%. You can also see acceleration in Medical and Provider Management, and also a reversal from a decline in Corporate Services of 1.4% to an increase of 1.1%.

Columns 1 and 3 show the changes that the plans actually reported to us. Like columns 2 and 4 they hold the health plans constant. But their product mixes are not reweighted. That means that their changed mix of products has affected their reported rates of change.

So, first, see how the as-reported costs increased by only 0.3%, as against 1.2% when the effect of product mix is removed. That difference occurs because the continuously participating Plans' customers are embracing lower cost to administer products. These



emphasized products include ASO and Medicaid. Many of the same comparisons are evident in the as reported changes as they were in the constant mix comparisons. You can see the same thing happened in 2014 as well when the constant mix values were well below the as reported values, 1.1% versus 3.5%.

Notably, the highest rates of change for 2015 are that of Medical and Provider Management. At 3.6% and 3.8% for as-reported and constant mix respectively, this cluster's growth was far higher than any other.

<Slide 5>

The administrative expense cluster growth was driven by the speed of their increase and the size of the function making that increase. We've captured this in the "Greatest Change" meaning speed, column and in the "Highest Weight", meaning the dollar value of the increase. Size, of course, is measured in dollars. This slide pertains to as reported results.

The largest single factor in the Sales and Marketing cluster of expenses was the surge in Rating and Underwriting. This area matches premium rates with population health characteristics. Accordingly, the growth of HCC (or Risk Adjustment Expenses) in Medicare, Medicaid and individual products has been the fastest growing and the greatest single change.

However, Sales and Marketing expenses actually declined. The reason for this is that external broker Commission growth, the largest function, was effectively flat, and Advertising and Promotion declined sharply. Sales growth was modest but Marketing, containing Product Development and Market Research, grew relatively rapidly.

The Medical and Provider Management cluster increased faster than any other function, by 3.6%. Both functions increased but Provider Network Management and Services increased at mid-single digit rates. Medical Management grew only moderately but since it is much larger than Provider Network Management and Services, its impact on trend was greater, diminishing growth.

Account and Membership administration increased very modestly. Enrollment cost growth was effectively flat and Claim and Encounter Capture and Adjudication was down. Reflecting the continued turmoil among consumers, Customer Services costs was



the fastest growing function. Information Systems growth was nearly as rapid as Customer Services, and may in part be due to increasing automation of Enrollment and Claims activities.

The Corporate Services cluster showed relatively modest growth, at 0.5% per member. Both Actuarial and Association Dues and License / Filing Fees posted declines for the second year in a row. The Corporate Services function increased at a low single digit rate. However, the Finance and Accounting and Corporate Executive and Governance areas increased at high single digit rates. Staffing ratios in these functions did not increase. We don't know the reason for the increase but, based on flat staffing, it is possible that these higher expenses were associated with enterprise consulting. I offer this comment only as conjecture though.

<Slide 6>

Slide 6 shows the rates of change and the most important reasons for the changes for the group, after eliminating the effect of product mix differences. Overall, of course, the cost increases are greater since the effect of the move to less expensive to administer products has been eliminated.

Slide 6 shows many of the same trends as are evident in Slide 5. However, I would like to highlight a few differences.

Note that broker Commissions are now an important source of increase. Put a different way, the lack of an increase in broker Commissions on an as reported basis was largely due to the shift away from products that brokers sell, such as Medicaid and ASO products. Sales also was faster after eliminating the effect of mix.

Provider Network Management and Services was even more important and faster growing than on an as-reported basis. This means that the efforts in this function are occurring within the historic product portfolio. Anecdotally, forming new contractual relationships can be central to adaptation to the new environment, and staffing indeed grew in Provider Contracting.

While Information Systems remains the most important factor in Account and Membership administration growth, it is even more important and growth is even faster. Likewise the growth in Customer Services is faster as well. The decline in Claims



was even more rapid without the effect of product mix differences. The growth in Enrollment, while still modest, was less so.

All functions in the Corporate Services cluster grew faster and had a greater dollar impact on trend. But perhaps the most notable difference is that Corporate Services increased in its importance. The decline in Actuarial was less precipitous. The effect of the changes in mental health costs, pharmaceutical costs and ICD-10 muted the rate of growth in expenses on a constant mix and an as reported basis.

The as-reported increase in Information Systems exceeded the change for expenses as a whole, and the increase in Information Systems dominated the increase on a constant mix basis. It is almost as though the plans are taking a portfolio approach to their expenses - reducing Advertising and Promotion, Actuarial and investing in Customer Services, Provider Network, Rating and Underwriting and Information Systems.

<Slide 7>

Up until now, I have focused solely on the administrative expenses that managers can control. For instance, I have excluded from the discussion capital costs such as interest and dividends because they are the result of financing decisions made at the board level.

For the same reason, we have excluded Miscellaneous Business Taxes. These taxes, which are primarily associated with the Affordable Care Act, layer in additional costs. With the exception of corporate restructuring to consolidate government business in one non-profit, these taxes are unaffected by management, especially operational management. From an operating perspective, perhaps the central attribute of such taxes is to amplify the need to manage administrative costs.

On a constant-mix basis, per member Miscellaneous Business Tax costs increased by 17.5% down from the surge of 369.1% last year. These taxes grew at approximately 4-5% annually prior to the ACA implementation.

These taxes, largely the result of ACA, comprise approximately 17% of total administration. Such costs are essentially nil for ASO/ASC products and range from \$11.00 to \$15.00 for commercial insured products. The median PMPM cost of this in 2015 is \$6.96 compared with \$0.84 in 2013.



<Slide 8>

A very rough gauge of trend is difference in the raw numbers between last year's values and this year's. The median PMPM value of \$31.00, 7.1% less than the median value of \$33.37 last year. The "real" growth was 1.2% however and the change in the product mix caused the reported growth to be muted to 0.3%. We don't know what the plans that didn't participate actually did but it seems to me that costs in this year's universe operated at lower costs than its peers.

The prior year values are shown in Appendix A. Because we are using median values, while the total medians are lower, each component is higher. Nevertheless, there is some correspondence with the overall administrative cost trends on Slide 4 and the increases shown here. Recall that growth in the Sales and Marketing cluster was modest - here it increased by 0.3% to a median value of \$8.22 PMPM. Medical and Provider Management was the fastest growing cluster and the values were 3.6% higher than last year's at \$4.07. Account and Membership Administration increased only modestly and was higher by 1.0% to \$14.89. Corporate Services does not fit the pattern so much, having increased by 2.9% to \$4.76.

Interestingly, the cluster values are slightly more clustered. The differences between 25<sup>th</sup> and 75<sup>th</sup> percentile values are less, and the coefficients of variation tend to be less as well.

<Slide 9>

I have been emphasizing the effect of product mix changes on trend and this slide shows what I mean. Note that the ASO/ASC products have costs that are about half of that of the insured commercial products. The overwhelming reason for the differences stem from Sales and Marketing cost differences.

Median ASO/ASC PMPM costs range from \$21.36 in the Commercial POS product to \$23.58 in the Indemnity and PPO. The latter is the single largest product offered by the Plans, comprising 39% of the comprehensive membership, on average. (Last year it was 36%.) Insured product costs ranged from \$41.02 for Indemnity and PPO to \$44.09 for POS.



Other low cost products included FEP at \$22.68, Medicare Supplemental at \$28.06 and Medicaid at \$32.88. The highest cost in Blue Comprehensive products is Medicare Advantage at \$84.06. This panel has elected not to include Medicare SNP as a comprehensive product but it costs \$198.93. The specialty insurance products, Medicare Part D and Stand Alone Dental are low cost products at \$13.94 and \$3.34, respectively.

Medicare Advantage increased from 3.0% of membership to 3.4%, as Medicare Supplemental decreased from 5.6% to 5.0%. Medicaid increased from 1.0% to 2.7% of membership on average.

<Slide 10>

The median administrative expense relative to premiums was 8.6% while the equivalent value for last year was 9.0%. (By the way, we are using premium equivalents here.) There were a number of factors that contributed to this decline. There has been a shift in favor of relatively low ratio businesses, such as ASO/ ASC and Medicaid. That effect seems small probably tenths of percents. Another effect is the decline in the percents for each product. Moreover, six of the ten comprehensive products had declines in percents. This shows this year's percents. Please look at last July's *Navigator* for last year's ratios. Of course, the universe was different as well.

In many respects, the relationships between the costs of various products measured in percents parallel those measured in PMPM values. The ASO/ ASC products range from 5.2% to 6.5% for HMO and POS, respectively. These values are substantially lower than the ratios for insured products that go from 8.9% for HMO to 10.9% for Indemnity and PPO.

Other low ratio products include FEP, at 4.6% and Medicaid at 7.3%. The highest ratio product, Medicare Supplemental at 14.2% is also among the lowest values measured on a PMPM basis. That this product is secondary to Medicare while many of the claims paying activities of Medicare are borne by this product likely explains this paradox.

<Slide 11>

This slide shows the administrative expenses by cluster of functions. As in the previous page overall costs were at 8.6% of premium equivalents, lower than the 9.0% last year. The median values for three of the clusters, Sales and Marketing, Medical and Provider



Management and Account and Membership Administration, all declined in comparison to the 2014 values shown in Appendix B. Only Corporate Services increased.

As noted earlier, these differences won't track with the values shown in Slide 4 because the universe and mix has changed.

<Slide 12>

The overall cost trends were modest, which was certainly a contributor to the fact that the administrative expenses PMPM were lower than last year's universe.

Once you eliminate the effects of product mix and universe changes, the growth was roughly the same as last year, just over 1%.

There was a tendency to emphasize Medical and Provider Management, while Sales and Marketing and Account and Membership Administration growth was modest. If you look at specific functions you see a continued emphasis on Rating and Underwriting, Customer Services, Information Systems and a renewed emphasis on Provider Network Management and Services. It is as though, through the constraint of low overall cost trends, Plans funded these cost commitments through declines in Claims, Advertising and modest growth in Medical Management.

I had mentioned that the MLR rules and competition has led to a focus on administrative expense optimization. Miscellaneous Business Taxes, which are overwhelmingly associated with the Affordable Care Act, are an additional impetus since they now comprise 17% of total administrative costs.

Many thanks for your attention to this dry, but I hope informative, presentation on a matter of critical importance to your organization. Again, this presentation, (transcript and slides) will be posted on our web site in the next few hours. Please feel free to call us at any time. Those of you who have called in the past know I normally pick up our telephone personally but if I am not there, my colleagues Chris, Erin and John will be able to help.

A two weeks from now we will summarize the Independent / Provider - Sponsored plan universe results, and we expect to host similar web conferences for Medicare and



Medicaid plans later this summer. Additional information, including tables of contents on the benchmarks themselves are found on the website. Call me if we can elaborate.

Now I would like to open this for questions.

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*Questions and Answers*

Q1. Do you know whether Blues Plans are outsourcing a greater portion of their back office functions?

A. I haven't tracked this holding the universes constant but I suspect that the tendency is going in the opposite direction. Overall, approximately 10% of all Blue FTEs are outsourced, lower than it has been in the past. Areas that decreased include Account and Membership Administration such as Information Systems. On the other hand, Provider Contracting and Customer Services increased from very low levels of outsourcing.

	2014 Median	2015 Median
Total	13.3%	9.9%
A&M	14.5%	9.5%
IS	26.2%	16.9%
CS	2.2%	4.3%
Provider Contracting	0.6%	2.3%

Q2. Do you publish staffing ratios and so forth?

A. Yes. I'm going to speak to commercial insured which has been a cornerstone product. This has a median of over 22 FTEs per 10,000 compared with about 24 FTEs last year.

Customer Services was higher, as was Rating and Underwriting and Provider Network Management and Services. Information System was lower as was the staff in Advertising and Promotion.



These staffing ratios reflect two adjustments. The first is that they include estimates of the staff equivalents of outsourced arrangements. Also, we are expressing the staffing by using one product commercial insured. So we adjust the values to infer commercial insured staffing.

You didn't ask this but the median compensation was \$99,889, 2.2% higher than last year's values of \$97,736. This varies from over hundreds of thousands in Corporate Executive and Governance. Employees in Actuarial, Government Affairs, Other Legal and Other Medical Management all make greater than \$150,000. Customer Services employees make \$67,935 while claim and encounter capture and adjudication people make 74,381.

Q3. What were the costs in the Segments?

A. For the individual market, costs were \$42.71, more or less in line with insured products as a whole. Grandfathered individual was only \$35.18, while compliant on exchange and compliant off exchange were \$41.71 and \$40.04, respectively. This is before Miscellaneous business taxes which for instance, are \$16.60 for On Public Exchanges.

Small groups were \$46.57, Middle Market was \$46.26, Large Groups were \$24.14. Broker commissions was an important reason why small groups' costs were greater than individual. We have other segmentations

Small: 2 - 50 eligible employees, Middle: 51 - 99 eligible employees, Large: 100 or more eligible employees. Individual Membership was 12.6% in 2015 compared with 10.5% in 2014.

Q4. Are these product cost values posted somewhere?

A. They are posted on the website as slides, and in the Plan Management Navigator.

Also, they are posted in an especially useful way as a sort of application, called the "Benchmark Calculator." You can actually see how you are doing relative to your peers by providing your business mix and total administrative expenses. What the calculator does is permit a quick analysis of your costs, after eliminating the effect of product mix



differences. Incidentally, no we don't look at your results any way. It's pretty straightforward but call me if you have any questions on how to work this.

Q5. What happened to enrollment among Blues?

A. Among continuously participating Plans, enrollment rose at a median rate of 0.4%. Commercial Insured declined by 0.5%, Commercial ASO/ASC rose by 1.6% and overall commercial declined by 0.3%. Medicaid increased and Medicare Advantage surged by 13.0%

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I want to again thank you for your participation in this web conference. More in depth and actionable information is available in the Sherlock Benchmarks themselves, which anyone can license. Please contact me directly if you are considering licensing these materials.

In late July, in two weeks actually, we will have a similar web conference on the results of the Independent / Provider - Sponsored plans. In late summer, we will have similar web conferences on the results of the Medicare and Medicaid plans. We hope that you will consider participating in those web conferences as well.

Let me thank you all for the hard work that goes into the 18th annual edition of the Blue benchmarks. We know, because we measure this, that participation pays off in lower costs. But the "by-product" is something that benefits the industry as a whole. Thank you!

This is Douglas Sherlock of Sherlock Company.