Transcript

Blue Cross Blue Shield Administrative Costs: A Review of 2013 Results

July 9, 2014

Douglas B. Sherlock, CFA
sherlock@sherlockco.com
(215) 628-2289

<Slide 1>

Welcome to our annual summary of the results of the Blue Cross Blue Shield benchmarking study. This is the first of a series of presentations on trends in health plan performance metrics reflecting 2013 results.

<Slide 3>

As we'll develop, the expenses surged, and the specific sources of increase are consistent with two likely reasons. First, health plans incurred costs relating to implementation of the Affordable Care Act. For instance, since health plan customers had products that differed from what they had been accustomed to, health plans had costs that temporarily "bulge" to communicate through Customer Services, Advertising and Promotion and perhaps broker Commissions. In addition, health plans faced the costs of membership churning between products, and Enrollment costs increased.

Second, they incurred costs that were, in effect, investments in the newly reformed health care system. The included increases in Product Development (which we group with Marketing), Information Systems and Actuarial.

However, as I mentioned last year at this time, the secular trend for health plans is for cost optimization. Among pressures, the express intent of the MLR rules is to "create incentives for" health plans "to become more efficient" in the execution of their administrative activities. Plus, self-insurance, also incentivized under ACA, indirectly creates similar incentives in that segment of the insurance market.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

So, because of the (hopefully) unique cost requirements in 2013 and the continuing pressures to reduce costs, we think we may look back on 2013 as an inflection year. In other words, 2013 will be the baseline year for which costs for health plans will be compared in future years.

This presentation concerns Blue Cross Blue Shield Plan administrative cost trends. Many thanks to the 19 Plans that participated in this year's benchmarking study: This web conference is a happy side-effect of your efforts benefiting the industry as a whole.

A few 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. All of these presentations, including this one, will be posted on our web site.

<Slide 4>

The PMPM cost increase in 2013 was the highest we've recorded in the past six years. You can see from this slide that the increase in Total costs (the dark Blue Bar) was the highest over that period and at 6.2%, a rate that was 63% higher than last year's rate of 3.8% and almost 50% higher than the prior year's rate of 4.2%.

The surge in Account and Membership Administration expenses is even more pronounced. These costs increased by 8.5% compared with 5.3% in the prior year. The next highest year was 2009 when these costs increased by 4.2%. This cost acceleration is without recent precedent.

<Slide 5>

This slide shows the changes for this year and the prior year. As an aside, the rate of growth shown in the previous side corresponds to the fourth and second columns of this table, and like this table, by reweighting, eliminate the effect of any changes in product mix between the comparison periods. Of course, all comparisons in these slides hold the universe itself constant. The cost increases reported by the continuing plans are in columns one and three, and are "as reported" since the calculations don't adjust for product mix.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

The takeaway from this slide is how broad the cost acceleration was. All eight of the expense cluster values under the 2013 Data Columns are greater than all eight of the values under the 2012 data columns.

For the next couple of slides, I want to drill into the sources of the increases.

<Slide 6>

For those of you who may not be familiar with our benchmarks, costs are segmented in a highly granular way to make them actionable. For Blue Cross Blue Shield Plans, administrative costs are segmented into nearly 60 functional areas, summarized as shown in Appendix C into the four expense clusters. (We don't show the sub-functions there.) That provides me the basis for commenting on trends in a highly granular way. I want to begin by tracing the components of the cost trends, based on the data as the plans reported them to us.

Overall, they reported administrative expenses that increased by 7.3%, sharply higher than the 5.1% increase in 2012. The fastest increase of all of the functions was in Advertising and Promotion, which increased at high double-digit rates. This is an example of what we earlier called "bulge" expenses, since we think that this could stem in part from the need to reach out to consumers in the more tumultuous than usual market.

Information Systems growth was the most important increase though. We say that it is more important because, of the total increase in PMPM costs, it was responsible for the single largest share of the difference in dollars. It too grew at double-digit rates but less than four other functions. I earlier characterized this as "investment" and dollars committed to Information Systems is typically expensed.

Account and Membership Administration, shown on the third row, was up by 8.9%. Information Systems costs, which falls into this expense cluster, was second fastest in growth to Customer Services which was very sharply higher than last year and also over at least the past five years. Enrollment costs were also higher than trend, as you might imagine.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

Sales and Marketing was the second fastest growing cluster, at 8.1%. Naturally, it was led by Advertising and Promotion. Indeed, every function in this cluster of expenses accelerated compared with the prior year. In addition, both Marketing (including Product Development) and Rating and Underwriting, grew at double digit rates. We suspect that these all relate to adaption to the new reformed health care environment, though overall economic improvements may also contribute. Interestingly, while each of the function's accelerated or remained at high rates of growth, broker Commissions growth rates actually declined. Yet you see that broker Commissions was the greatest source of cost increase for the cluster. The cost of broker Commissions dwarfs the others in this cluster.

Medical and Provider Management growth accelerated over the prior year, 5.7% versus 4.2%. Provider Network Management and Services grew faster but the larger Medical Management / Quality Assurance / Wellness function dominated the trend in the cluster.

The effects of adaptation are also evident in the Corporate Services cluster of functions. Actuarial costs surged at double-digit rates, higher than at any year over the past five. This again may stem from the demands to reanalyze the environment in which health plans operate. More slowly increasing, but of much greater importance, was the Corporate Services function, comprised of HR, Legal, Mailroom and so forth. But even here, cost growth was higher than any during the past five years. While Finance and Accounting and Corporate Executive and Governance were higher than last year, the growth in Corporate Executive and Governance was extremely modest.

<Slide 7>

This slide reflects what I would call "real" increases in expenses. In other words, it eliminates any effects of changes in product mixes between the plans being compared over the two year period. There was an effect, as you could see earlier – this shows a total increase of 6.2% compared with a 7.3% increase without holding the mix constant.

And there were some mix changes. Medicare was a larger share of this year's overall business mix than last year, Medicaid and Medicare Supplemental diminished.

Notwithstanding, by and large the same observations that applied to the as-reported values also apply to the constant mix comparisons as well. In fact, there is only one

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

major change between the two charts: Note that the fastest growing area in Account and Membership Administration is the function of Information Systems, rather than Customer Services. The real rate of increase for Information Systems was greater than its as-reported value and Customer Services remained substantially unchanged but at a very high level.

Let me touch on staffing since, as a people business, it can be the driver of cost changes in health plans. If I simply compare the staffing ratios for all reporting Plans, including the staff that the Plans believe to be outsourced, there is an indications of slightly *lower* levels of staffing to 18.5 FTEs per 10,000 members and for 24.5 for commercial insured. Areas of high growth in staffing include Rating and Underwriting, Sales, Advertising and Promotion, Information Systems, especially Application Maintenance and Acquisition and Development. Pre-planning and Project Costs were particularly strong. Audit staff climbed as well.

By contrast, Provider Network declined, as did Medical Management, Claims, Finance, HR and most Legal. Within Medical Management, Case Management and Precertification increased while Disease Management and Quality Components decreased.

While the overall trend is for lower staffing, note that some of the staffing increases comport with the bulge and adaptation expenses earlier discussed.

<Slide 8>

The costs to administer comprehensive products for Blue Cross Blue Shield Plans was $30.53, 4.3% higher than last year's reported costs of $29.25. Last year's values are shown in Appendix A. The numbers are not perfectly comparable; while both universes contain 19 plans, three of the Plans turned over, so that 84% of the plans were the same as last year.

Because of the high comparability, some of the earlier comments are paralleled when the comparing the respective universe values over the two years. Thus, the sharp increase in Sales and Marketing compares with the 12% increase to $8.09 PMPM. Similarly, Account and Membership costs increased, as did the values for 2013 compared with the values for 2012. The relationships are less close in the other clusters. The moderate growth in Medical and Provider Management compares with the slight

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

decline to $4.05 PMPM in 2013. The similarly moderate growth in Corporate Services also compares with the slight decline to $4.44.

Another notable change between the two years is the increased clustering of values. The total coefficient of variation is 24% down from 25% last year. This is underscored by the fact that the Corporate Services cluster's coefficient of variation declined 20 percentage points to 31%. The coefficients of variation in the other clusters declined or remained effectively the same. It is possible that increased clustering captures increasing adoption of best practices by participating plans.

<Slide 9>

This slide shows the costs for each of the products offered by the 19 participating plans. In general, the relationships are fairly similar to the patterns we've seen before in prior years, and across universes. In short, insured products cost much more than administer than their ASO/ASC counterparts. Medicare Advantage costs much more to administer than do the equivalent commercial products.

But if you compare this slide with the equivalent slides for last year (they are available on our website), you'll notice a sharp change in the differences between the costs of Insured versus ASO/ASC products. While last year, the difference ranged from $12-16, this year they are in the $18-19 range. There's always been a difference and for the most part, those differences come from lower Sales and Marketing expenses for ASO/ASC. The individual business segment (another cut of the data in the Blue benchmarking study), which is always insured, provides a hint of the reason for this year's expansion to $46.93: costs increased by 16% and nearly all of those costs related to Information Systems or the Sales costs. We expect that if employers capable of self-insurance increasingly elect to do so, the cost differences will increase further.

<Slide 10>

As you can see, this slide is similar to the previous, except that we've expressed administration relative to premiums or equivalents. In some respects, the relative values are similar: ASO/ASC percents are considerably lower than their insured counterparts. And the differences are similar as well. For the central Indemnity & PPO product, median PMPM costs of ASO are 58% of the insured costs, and the similar ratio for percents of premium is 61%.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

But they do differ in the products for seniors. Medicare Supplemental, at $32.44 PMPM, is a relatively low cost product. But at 17.1% of premiums, it is among the highest cost products when calculated in this way. This stems from the fact that many administrative activities for this population are incurred for events in which Medicare Supplemental is the secondary payer.

But Medicare Advantage cost ratios are exactly reversed. On a PMPM basis, they are the highest cost product but lower than all of the commercial insured products when expressed as a percent of premium. The health benefit per claim is considerably higher for MA members, giving rise to the low percent.

Note that the overall costs are 8.7%. This is lower than the 8.9% reported last year. The higher PMPM costs combined with the lower percent raises the question of whether a product mix shift might have affected this. The answer is that it did not; we reweighted the respective annual values by each year's product mix and the improvement remains. Please do note that the rates of change reflect a constant universe but this table is a one-year snapshot. While 84% of the plans in this year's universe participated in the prior year, there was some turnover. The equivalent tables for last year are found on our website at the link for *Navigator* July 2013.

<Slide 11>

Once again, administrative costs for Blue Cross Blue Shield Plans were 8.7% of premiums. The comparable values for the prior year are shown in Appendix B. Plans' sharp increase in the percent of premiums devoted to Sales and Marketing were more than offset by declines in the percents committed to Medical and Provider Management, Account and Membership Administration and Corporate Services.

This somewhat comports with the trends discussed earlier. On a constant mix basis, Sales and Marketing costs surged in 2013. The declines in Corporate Services and Medical and Provider Management increases seem to follow the somewhat slower growth in their PMPM expenses compared with the total in 2013.

More puzzling is the 0.1 percentage point decline in Account and Membership Administration considering the sharp growth of this cluster. It is important to recognize that this is a snapshot of all Plans while the rate of growth figures hold

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

constant the universe and sometimes product mix. As it happens, each of the three plans that left the panel were replaced by others that had lower ratios for Account and Membership Administration. Also, several continuous participants posted declines in their ratios.

Reducing the percent of expenses devoted to administration even as costs increase suggests that there is continuing focus on cost management by the Plans.

<Slide 12>

The most recent year saw administrative costs that, in their rate of growth, were much higher than in recent years. In fact, Account and Membership Administration growth was more than 60% higher than last year.

Information Systems was, far and away, the most important factor in overall cost growth. But it was followed in its contributions by fast growth in such key areas as Commissions, Customer Services and Advertising and Promotion. Actuarial costs, which are not especially large, grew sharply as well.

Despite the cost growth, administrative costs declined as a percent of premiums. This suggests that cost consciousness remained a priority for plans even as costs increased since health costs grew faster.

The cost increases seem to us to reflect "bulge" communications costs, for example, Customer Services and adaptation costs, for example, Information Systems. From a measurement perspective, 2013 was notable because every health plan was exposed to these kinds of costs and, it is to be hoped, these were largely one-time events. That would make 2013 important as the baseline year for future health plan administration cost comparisons. Going forward, cost optimization is a central priority for health plans.

Today we've gone through a lot of numbers and if you're like me, this is very hard to digest at one sitting. So you should know that this presentation, the transcript and the slides are available on our web site, right now. Please feel free to call us at any time. If I am not there, my colleagues Chris, Erin and John will be able to help at least as well. Those of you who have called in the past know I normally pick up our telephone personally but my colleagues say that that is because I am the one whose actual analytical work would be least missed.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

There are 19 Blue Cross Blue Shield plans that participated in this year's benchmarking study, and the overwhelming proportion of them have at least one representative on this call today. So let me take this opportunity to thank you all for the hard work that goes into the 16th annual edition of the Blue benchmarks. We know, because we measure this, that participation pays off in lower costs. But the "bi-product" is something that benefits the industry as a whole. Thank You!

Finally, before we go into questions, let me "plug" a free application of these benchmarks on our calculator. The application allows you to compare your, or your client's if you're a consultant, health plan results to the Sherlock Benchmarks. This works regardless of your mix of comprehensive health benefits products. Plus, it works even if you only know your total administrative costs and you don't segment your administrative activities by product.

Because a picture is worth a thousand words, I'm going to switch screens to provide an illustration. This is the Sherlock Company website, www.sherlockco.com. Then, you click on the Benchmark Calculator link.

First put in your annual administrative expenses. By the way, this should include all medical management and broker commissions since that's what the Blue panel includes. Leave out taxes and capital costs. I'll put in, for this example, $36 million.

Then you put the average number of members. Ok, 40,000 for HMO Insured, 20,000 for HMO ASO, 35,000 for Indemnity and PPO ASO and finally 5,000 for Medicare Advantage.

Then review the results. All in, you have a 100,000 members on average. Note that it says that the benchmark value for this plan is $33.65 PMPM. That's different than the $30.53 found on Figure 3 of the *Navigator* because it reflects the product mix of the plan that you're analyzing rather than the average product mix of the Blue Cross Blue Shield plans.

Note too that your PMPM costs are $30.00. That's the 36 million divided by the member months or 100,000 times 12.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

Since $30 is less than $33.65, there is a favorable variance of $3.65, shown as a negative value since that the amount the subject plan is less than the benchmark. Negatives are good here. $30 is also 10.85% less than the benchmark value of $33.65.

By design the benchmark value is highly sensitive to the products that you offer.

<Examples 2 and 3>

Note that we've focused on Blue Cross Blue Shield plan universe values in this example. You can pick from the universe you consider most applicable.

<Example 4>

Here's what happens when we use the Independent/Provider-Sponsored universe for HMO Insured. Note, though, that this has not yet been updated. We'll update when we publish the respective Navigators which should be in about 10 days.

Many thanks for your attention to this dry, but I hope informative presentation on a matter of critical importance to your organization. I have attached to the end of this presentation some appendices in support of this presentation. They include 2012's costs and the functions found in the clusters we have been speaking.

Additional information on the benchmarks themselves are found on the website. Call me if we can elaborate.

Now I would like to open this for questions.

• • •

Questions and Answers

• • •

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.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.

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.

Again, thank you who participate in our various benchmarking studies. While participating plans realize a return on their investment in the benchmarking process, it is nevertheless the case that the summary benchmarks that we discussed today benefit consumers and the health plan industry as a whole.

This is Douglas Sherlock of Sherlock Company.

COPYRIGHT © 2014 SHERLOCK COMPANY. ALL RIGHTS RESERVED.