*Transcript*

# IPS Administrative Costs Declined in 2020

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<Title Page>

This call reports on the 19th annual *Sherlock Benchmarks* for Independent / Provider – Sponsored plans. Thank you all for participating in this call. I also thank the plans that participated and our principle contacts in particular. I know that has been a heavy lift because of the COVID-19 environment. Thanks to my colleagues for making this come together.

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

The 19 IPS plans that are the subject of this presentation serve approximately 9.6 million people in 20 states with comprehensive insurance. The median plan membership was 346,000.

It is a robust data set, with strong indicators of validity. These plans collectively serve about 38% of all members associated with the Health Plan Alliance and 52% of members in its plans that are not focused on government sponsored products. Our participation in this universe includes one-half the plans associated with the Alliance of Community Health Plans that are not staff model or plans focused on government sponsored programs. We have tested and validated the survey information, and 63% of the participants have eight or more years of participation.

The most notable environmental factor in 2020 was the effect of COVID-19. At the time of last year's IPS presentation, policy initiatives to mute the spread of the disease had induced one of the sharpest declines in employment in US history. Since employees receive their health insurance through their employers, the potential for declines in plan membership and revenues, exacerbated by costs that are, in the short run, fixed, could have led to extraordinary increases in administrative costs for these plans.

In response, we built budget models for participants informed by our economies of scale studies. A 30% decline in Commercial membership would have led to a 9% increase in per member administrative costs above normal cost increases *and only if rightsizing of long-term capacity was immediately executed.*

As we will develop in this presentation, this dire scenario did not happen: Independent / Provider - Sponsored membership did not collapse and per member costs declined in 2020. Our benchmarking surveys sought the identifiable costs associated with adaptation to COVID-19: four reported a median of $0.20 PMPM.

So, what actually did happen is the subject of this presentation.

<Slide 3>

This slide shows that costs per member per month declined sharply. We hold the comparison plans and product mixes constant for this slide, as well as others. Total Administrative expense flipped from growth of 7.6% in 2019 to a decline of 1.0% in 2020. The reversal was even greater for Account and Membership Administration which declined by 1.3% in 2020 from growth of 9.3% in 2019. Administrative cost growth in 2020 was the slowest since at least 2010, in total *and* for Account and Membership Administration.

<Slide 4>

This slide is a key summary. It shows the rates of growth in per member costs, as compared with that of the prior year. In calculating all of these rates of change, for all products and all periods, we include only plans that participated in both periods. When, in the second and fourth columns, we refer to constant mix, we have reweighted the expense costs to hold product mix the same in both measurement periods. (Yes, the plans actually report costs segmented by product as well as by function.)

At the bottom of the table, you can see where Total expense growth has declined from 7.6% to negative 1.0%. They are at the bottom of the chart identified through the *filled* blue arced arrow, the second and fourth columns. I noted this on the previous longitudinal graph. Similarly, in those columns, the decline in Account and Membership Administration from 9.3% in 2019 to negative 1.3% in 2020 is shown.

I highlighted the changes in the fourth column in slide 4 since they represent the change in expenses *unaffected* by the change in product mix. As it happens, the Plans shifted very slightly in favor of higher cost products like Medicare.

The continuous plans posted membership growth at a median rate of 1.8%. This is despite the fact that commercial membership declined by 0.1%. Commercial membership, representing 73% of the total  also shifted in favor of ASO products as Insured declined by 1.4% and ASO declined by 0.2. The median growth in Medicaid membership was 6.6% as MA increased by 1.5%. Medicare Supplemental typically declined.

The pattern of mix change is notable. The shift in favor of ASO and the government sponsored products illustrates that smaller private benefit sponsors were more affected by steps to combat COVID-19 transmission. Medicare Advantage, whose members are usually retired, increased, as did Medicaid. Importantly for the purposes of this presentation, the effects of this shift on costs are such that As-Reported costs understate the slightly less diminished actual cost trends shown in Total Constant Mix.

Considering the economic environment in 2020, it is no surprise that Sales and Marketing had an especially sharp decline in 2020 growth, 1.7% versus 7.9% in the prior year. Account and Membership declined by 1.3%, a 10.6 percentage point difference from the 9.3% increase in 2019. The reversal in Corporate Services was even sharper, by 11.2 percentage points from 9.6% growth to 0.6% decline.

The decline in the rates of change in Medical and Provider Management were more modest, and remained high at 5.9%growth PMPM. Overall, Provider Network Management and Services growth was down sharply due to activities related to provider report cards and education but actually increased by double digits in Provider Relations Services.

Corporate Services actually declined in per member costs, by 0.6%. Every function declined in cost increases but paradoxically all but Association Dues and License and filing fees actually increased. I attribute this to our use of medians for expressing trends and that each of the plans achieved its declines differently. Corporate Executive and Governance was however a common source of growth as staffing increased.

The Account and Membership Administration decline was most important factor in the overall decline in costs. Every function in the cluster declined except Information

Systems. However, Information Systems had its slowest growth since at least before 2015. To put this in some perspective, administrative activities for behavioral health and pharmacy benefits actually increased by 6.4%. We include these activities in the Cluster for *Navigator* purposes.

The first and third columns are rate of change of Comprehensive expenses as the plans *actually reported to us*, and these trends are affected by the change in the business mix. For example, if a plan has most of its members in high cost Commercial Insured in one year and, in the second year, most of the members are in low cost ASO/ASC, then costs will seem to grow slower on account of this shift. Similarly, a relative shift in favor of Medicaid would drive trend down and Medicare would increase it.

These shifts actually occurred so that the overall growth rates were substantially identical in the as-reported as they were to the constant mix. I would like to offer a couple of comments.

Note that the Medical and Provider Management cost increase is lower on an as-reported basis than a constant mix basis. This may reflect that, in any given product, there was greater commitment to these functions than it would appear. Remember, a shift in favor of ASO from Insured would itself lead to a decline in the growth of Medical Management.

Also note that Corporate Services increased on an as-reported basis, rather than declining. The differences in Finance and Accounting and Corporate Services appeared especially notable. It is possible that this reflects the growth in Medicare.

<Slide 5>

Slide 5 is a more in-depth view of the Constant Mix changes in the previous slide, also identifying contribution to trends. It identifies the fastest growing functions and also ones that contributed most to the increase, that is, the per member increase in that activity's cost.

Account and Membership Administration had the sharpest decline in the growth rates among the clusters, and actually declined. Claim and Encounter Capture and Adjudication, and Enrollment / Membership / Billing both declined, at low to mid single digit rates. The decline in Claims was the fastest in the cluster and was also the source of greatest decline. It is possible that the decline in utilization as well as the increasing automation of this function were responsible. Customer Services also declined at about the same pace, remarkable for reasons that we develop later. Information Systems, by far the largest function in this cluster, grew very slightly. For simplicity of presentation, in *Navigator* we group the administrative expenses of Pharmacy and Behavioral Health with this cluster – the growth in these expenses was higher than any function in this cluster and was more similar to the pace of Medical and Provider Management. The effect was to reduce the magnitude of the decline both in this cluster and overall expenses.

The Corporate Services cluster of functions also declined in per member costs but individual variation makes it difficult to summarize the source of these trends. This is exemplified by the fact that median changes were growth, not declines, for every function other than Miscellaneous Business Taxes. Take the function of Corporate Services, the most important source of cost change: Costs increased but, of the eleven plans participating in both comparison periods, five posted declines. Several of the sub-functions mostly had declines such as HR, Facilities, Audit, Imaging and Printing and Mailroom.

Similarly, five plans reported declines in Finance and Accounting and four reported declines in Actuarial and Corporate Executive and Governance. Corporate Executive and Governance was by far the fastest growing function, not only in this cluster but overall. So, while overall expenses declined in this cluster, it was achieved in ways that reflected individual plan approaches and defy easy summary.

The Sales and Marketing cluster's growth decline was also substantial but it continued to grow. The rate of increase in per member cost growth most sharply declined in the Marketing function. Its subfunction of Member and Group Communication sharply increased however. Costs actually declined in the Sales function and this was most evident in Sales Commissions which fell in eight plans and by double digits in five of them. Advertising and Promotion also increased slightly less than in 2019, especially Media and Advertising. External Broker Commissions grew at a somewhat declining pace during 2020 compared with 2019 but that growth was greater than that of the cluster. Its size and only slightly diminished growth rate made it by far the most important source of increase.

In contrast to the other Sales and Marketing functions, Rating and Underwriting growth was in mid double digits, the highest since 2015. Seven of the 11 plans reported this growth and it was focused on the sub-function of Risk Adjustment.

The rate of Medical and Provider Management growth declined, but less so, and grew far more rapidly than any other cluster of functions. Medical Management was both the fastest growing function and the most important one because of its sheer size. Subfunctions with rapid growth included Case Management, Medical Informatics and Other Medical Management. This last subfunction is not the miscellaneous category that one might think: it is medical policy and where medical directors are placed. Finally, among the fastest growing subfunctions was Nurse Information Line which may reflect COVID-19 adaptation.

<Slide 6>

The as reported growth is similar to the previous slide's constant mix growth, except it is in aggregate slightly higher. The move to higher cost products is very slight since the rate of expense decline is less pronounced if the mix is not corrected for. Let me emphasize how slight: the as reported change is negative 1.00% while the constant mix change is negative 1.05%.

The two slides are very similar. The only difference in the table is that, without adjusting for mix, Enrollment / Membership / Billing is the greatest percent change in Account and Membership Administration, displacing Claims. And rather than declining, it increased. The cost increase may have stemmed from a movement towards Medicare Advantage, largely an individual product, from Commercial Products.

The other aspect that I see as notable is that Medical and Provider Management and Services doesn't grow quite so quickly as reported, when compared with constant mix. When I look at the increase in costs for that cluster for the universes as a whole, costs increased for the commercial insured products, the dominant product offered by this universe. This was not the case for ASO, which appeared to decline, and also Medicaid, and was flat for Medicare. I offer that this is not a true apples to apples comparison though.

So, what you are seeing in the difference between the two is, in the case the as reported values, the effect of shift in favor of lower cost commercial and government products, along with, as evidenced by the very slightly higher growth on a constant mix basis, a greater commitment to the Medical and Provider Management cluster for the plurality of this membership.

Incidentally, this universe appeared to have a pretty sharp decline in health care costs. It appeared greatest in Medicare Supplement and Medicaid, followed by commercial insured. Medicare Advantage was not especially affected. The combination of health care cost declines and higher commitment to this cluster meant that the ratios of this cluster to health care almost always increased for each product.

Let me reiterate a few of the functions and subfunctions that had some significant growth, rather than the decline posted overall. They included Member and Group Communication, Media and Advertising, Provider Relations Services and Nurse Information Line. This growth could well have stemmed from the needs of the membership under COVID-19 for communication of important information in a confusing environment under severe limitations.

We don't know for certain why Customer Services was absent from these cost increases though the plans did not see the same surge as Blue plans for this function.

We surmise several possible factors. First, the universes had different product mixes: IPS plans have more Medicaid and more Medicare Advantage, insulating IPS plans from the effects of the economic disruption on the private sector. Second, it is possible that there were different industry mixes in markets served. Probably, the provider-sponsored plans had a higher health care employer component. This sector was less impacted than was manufacturing or hospitality industry sectors. Third, based on admittedly incomplete 2019 data, Blue members may be somewhat younger thus more vulnerable to the layoffs. Fourth, customer service inquiries can be linked to claims: while claims expenses grew for Blue plans, they declined for IPS plans.

I mentioned Customer Services staffing trends in both this and last month's *Navigator*. There is an operating leverage aspect to staffing ratios and overall membership grew for IPS but declined for Blues. Since staff can be sticky, Blue staffing increased while IPS staffing ratios declined.

But Customer Services appears to be an exception to what are somewhat expected changes, reflected in some of the operational levers employed by the Plans to implement their cost optimization strategies. For the continuously reporting plans, staffing ratios decreased by 4% to approximately 26 FTEs per 10,000 for Commercial Insured members. This fully includes staffing that is outsourced. Medical Management and Sales seemed to be especially prominent in this decline. Staffing ratios increased for Provider Relations Services, Precert, Other Medical Management, Fraud, Waste and Abuse, Risk Management and Corporate Executive and Governance.

Of the 14 functions with staffing, non-labor expenses increased in eight of them and overall by approximately 10%.

The median and mean proportions of FTEs that were outsourced are 5.0% and 5.5%, respectively, similar to last year among continuously participating Plans. Areas that are heavily outsourced included Risk Adjustment, Nurse Information Line, Actuarial, Purchasing and Risk Management.

Median Compensation, including all benefits, increased by 1.1%, to a median of $101,000. Compensation growth was notable in Provider Relations Services and Legal, especially its subfunctions of Government Affairs and All Other Legal.

Compensation tended to decline in the Sales subfunctons of Account Services and Media and Advertising, Other Claim and Encounter Capture and Adjudication, Facilities and Printing and Mailroom. Compensation also fell in Corporate Executive and Governance.

<Slide 7>

The *Sherlock Benchmarks* present the administrative expenses in high granularity, by more than 70 functional areas for each of up to 9 Comprehensive products plus MLTSS for approximately 700 product/expense cells. Because this is a summary presentation, we can only touch on very high-level aspects of Comprehensive expenses and totals of each of the Comprehensive products.

This slide shows median costs of each cluster in Comprehensive products. I'd like to make some comments on the year-over-year changes in the values of these. Of course, these are costs for 2020 which have a different set of Plans from 2019, and even continuing plans have different product mixes so there are some important limitations.

Total Expenses of $41.99 PMPM were 1.0% lower than last year's costs of $42.43. The largest cluster, Account and Membership Administration, cost $15.70, 10.6% lower than last year's.

Sales and Marketing costs, at a median of $11.79 PMPM, was 2.9% greater than last year's value. The Corporate Service Cluster had the greatest increase, 7.6%, between 2019 and 2020, to $6.92 PMPM. Medical and Provider's change in annual values was a decline of 5.5% to $7.25.

<Slide 8>

A core analytical premise that we used in slides 3 and 4 is that the product mix makes a difference. Accordingly, we think it makes sense to correct for differences in product mix between years in determining the annual rates of growth.

This slide of the product values illustrates this. If you recall from the previous slide, the comprehensive per member per month costs are $41.99. The red circled value near the bottom of this chart is that value. It can be thought of as each of the listed products, such as Indemnity and PPO or Medicare Advantage, weighted by their product mix.

As you can see, there are 9 Comprehensive products shown here. They vary greatly in costs, from ASO at $20.48 PMPM to $267.73 for Medicare SNP. So, product mix makes a difference in costs and trends of those costs.

You'll see that there is a significant difference between the median costs of Commercial Insured and Commercial ASO, with insured nearly twice the cost of ASO. This is indicated by the blue arrow. This explains that, even if there was no change in the per product expense, a change in the mix would show an apparent change in costs: more insured would increase costs and more ASO would reduce it.

ASO is usually much lower than their insured counterparts, mostly due to far lower Sales and Marketing, but also lower enrollment, Credit Card fees, Actuarial, Legal and, accordingly, Facilities.

Medicaid is offered by 11 of the 19 plans. There are few marketing costs in that product, and members are often young so its low health care costs give rise to low administrative costs.

By contrast, Medicare Advantage, shown relative to insured products using the red arrow, are highest cost in part because of the high service requirements of seniors stemming from their high health needs. This also pertains to Medicare SNP. Sales and Marketing costs appear to have increased for both products in 2020, perhaps associated with the stronger than average growth we outlined earlier.

<Slide 9>

Another way of looking at expenses is as a percent of premium equivalents. There are a number of disadvantages to this since dollars are actionable but percents are not.

Moreover, the denominator of the ratio is the premium rate for that product: this depends on forces beyond your control – the pricing strategies of your competitors.

Nevertheless, a comparison between the PMPMs and percents of premiums shows greater clustering. Like PMPMs, insured commercial products are more expensive to deliver, per member, than ASO.

While MA is over twice the PMPM of Commercial HMO Insured, it is similar (0.6 percentage points lower) when expressed as a percent of premium equivalents. And while SNP is five times greater than Commercial Insured, is much closer when expressed on a percent basis.

The reason for this closer relationship is that administrative expenses somewhat track medical expenses. Med Sup is a notable exception: its PMPM costs are quite low but its percent of premiums are quite high at 17.7% reflecting that it is a secondary payer to fee for service Medicare. At least some of the administrative work for Med Sup members has to be performed even when the Plan is not bearing the full risk of health care cost variance.

<Slide 10>

The percents of premium increased for Independent / Provider – Sponsored Plans, unlike the decline in the PMPM values, by 0.4 percentage points to 8.7%. There are some similarities though. The decline in Account and Membership Administration in the Slide 4 and Slide 7 presentations was paralleled by 10th of a percent decline in its percent of premium ratio, to 3.5%. Also, all other clusters that increased their PMPM costs on an as reported basis also increased as percents of premium.

Sales and Marketing at 2.6% was 0.4 percentage points higher. Corporate Services also increased by 0.2 percentage points to 1.5% of premium equivalent. Finally, Medical and Provider Management increased by 0.1 percentage points to 1.5% of premium equivalents.

<Slide 11>

Generally, when we analyze the companies that participate in the *Sherlock Benchmarks*, our focus is on actual outcomes rather than expressed strategies. Comparing costs from 2020 with 2019, we have seen trends that suggest adaptation to the COVID-19 environment as well as continued focus on cost control and competitive advantage.

Costs decreased in 2020, compared with an increase during 2019. The reversal in trend was very sharp. The growth was slowest since at least before 2010.

The driver of this was a sharp decline in Account and Membership Administration. On a constant mix basis, all functions declined, except information systems. Both IS and Account and Membership Administration grew at historic lows. Claims declined sharply also.

All clusters declined in growth. Sales and Marketing sharply declined possibly due to the fears for the economic environment for employers, and also their actual consequences. For instance, internal Sales commissions plummeted. Corporate Services also declined but there was high variability between the plans on how this was achieved.

Medical and Provider Management increased faster than all other clusters, especially in Medical Management. It appeared that, for most products, there was a heightened commitment to Medical and Provider Management, notwithstanding a decline in health care costs.

Apparent COVID-19 adaptation was reflected in high growth in Nurse Information Line,  Member and Group Communication, Media and Advertising. The increase in membership in Medicaid and Medicare meant that overall membership trends were stable to positive. Customer Services growth cost growth was not present unlike for Blue Plans.

Long term positioning was evident in greater Risk Adjustment, Medical Management and IS Operations and Support Services.

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This presentation, (transcript and slides) will be posted on our web site, hopefully later today. In addition to the slides presented so far, the deck includes last year's values and some descriptive materials about our benchmarking process.

Thank you for your participation in our presentation. This year marks the 24th year of the *Sherlock Benchmarks*, and the 19th for the IPS universe. Cumulatively, by year end, our cumulative experience will be approximately 929 health plan years, and will include Blue Cross Blue Shield Plans, Medicaid Plans and Medicare Plans. Our presentation on the Blue plans is already on the web site, and we expect to host similar web conferences for Medicare and Medicaid plans later this summer. Additional information, including tables of contents of the Benchmarks themselves are found on the website. Call me if we can elaborate.

I also want to thank the participating Plans for their efforts during this most difficult of survey cycles. Our primary contacts all have other responsibilities to honor and they completed the survey forms, participated in conference calls, and fielded our follow up calls with good humor and wise insights. Since the subject matter of this web conference is free of charge and beneficial to health plans that do not or cannot participate in the study, I hope you share my gratitude.

Now I would like answer, as best as I can, any questions you may have on the trends or the execution of this analysis.

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*Questions and Answers*

Q. What was the effect of unusual COVID-19 expenses?

A. Only a few of the plans supplied this to us, and the median was $0.20 PMPM. We suspect that this may well be the results of plans for which this is high cost.

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I want to close by hoping that you are all returning to your pre-COVID lives and that you and yours were not too severely affected. If you were, it is our hope that you or they made a speedy and complete recovery.

Thank you again for your participation in this web conference. 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.

Once again I want to thank everyone involved in the 19th annual edition of the IPS benchmarks for their insights and hard work. Participation pays off in lower costs for the Plans but we hope that the results benefits the industry as a whole.

This is Douglas Sherlock of Sherlock Company.