Transcript

Independent / Provider – Sponsored Plan Administrative Cost Growth Accelerates in 2021

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

<Title Page>

This call reports on the 20th annual *Sherlock Benchmarks* for Independent / Provider - Sponsored plans, and the 25th *Sherlock Benchmarks* overall. Thank you all for participating in this call. I also thank the plans that participated and our principle contacts in particular. I know this has been a heavy lift because of their other commitments. Their responsibilities range from external reporting, targeted cost management projects, more general FP&A and strategic planning. Also, while we seem to be out of the woods on Covid, translating the activities within the plans to the Benchmark classifications may remain more cumbersome because of operation function leadership working remotely.

I also thank my colleagues for making this come together. Each translation challenge for each plan has a counterpart at Sherlock Company since the panel tasks us to assure uniformity of reporting, key to the reliability of the Benchmarks. Also, our team develops systems for receiving surveys, compiling them, performing some automated validation, summarizing and then publishing. Plus validation has some manual components too. I have a great team.

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 15 Independent / Provider – Sponsored plans that are the subject of this presentation serve approximately 10.6 million people in 24 states with comprehensive insurance. The median plan membership in Comprehensive products is 555,000.

It is a robust data set, with strong indicators of validity. These plans collectively serve about 52% of all membership in plans served by non-staff model plans of the Alliance of Community Health Plans and 35% of all membership served by commercial members of the Health Plan Alliance. We have tested and validated the survey information and the continuity of their participation suggests participant contribution to the quality of the results: 87% of the participants have five or more years of participation.

I want to address Covid-19 adaptation up front as it helps to understand this year's results. Last year, reflecting 2020 costs, we had feared that plans would be negatively impacted by sharp membership declines as customers laid off employees, and that plans would incur direct, identifiable costs for their own adaptation in such areas as facilities, information systems and customer services. Happily, the effect on enrollment was relatively modest, and the direct costs were about $0.20-$0.25 PMPM. There was no clear pattern of expenses but HR, Facilities, Marketing and Information Systems seemed central among the four reporting plans. This year, the amounts were so modest that, in the 2021 cycle, the Plans elected not to poll for this. As we will touch on later, the absence of COVID may have impacted Marketing costs.

So, what actually did happen in 2021 is the subject of this presentation. In short, it reflected trends in membership, the effects of cost management and a redeployment of expenses. IPS plans experienced an increase in PMPM costs.

<Slide 3>

This slide shows that per member cost growth reversed its unusual decline in 2020 and increased. The Account and Membership Administration cost increase of 3.2% PMPM was the second lowest since 2015. This is shown in the light blue line.

The Total increase of 4.2% was less than 2019 and 2017. This is shown in the Navy-blue line.

<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 those 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 lower right side of the table, you can see where Total expense growth has accelerate from a decline of 1.0% to an increase of 4.2%. I reflected this on the graph on the previous slide. To highlight this, these two values and their component functions are identified through both ends of the *filled* blue arced arrow, the second and fourth columns. Similarly, in those columns we show the change in the trend in Account and Membership Administration from a decline of 1.3% PMPM in 2020 to an increase of 3.2% in 2021.

I emphasize 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 in favor of lower cost products like Medicaid. You can infer that this shift to lower cost products must have occurred since the constant mix growth is greater than the as reported growth, 4.2% versus 1.9%.

The reason for the difference between the constant mix trends and the as reported trends was a shift by the continuously participating plans in favor of lower cost products. So, while membership increased at a median rate of 1.2%, low-cost Medicaid membership soared by 15.9%. Within commercial, low cost ASO decreased by 2.0% while the more expensive to administer insured product decreased by 6.7%. Medicare also declined at a median rate of 0.7%

On a constant mix basis clusters of functions trends were split. Account and Membership Administration had a 4.5 percentage point reversal from a 1.3% decline to a 3.2% increase. The increase in per member costs in Information Systems expenses was the chief reason for the increase in this cluster. Corporate Services growth sharply accelerated, an increase of 1.6% versus a decline of 0.6% in the prior year.

By contrast Medical and Provider Management decelerated from 5.9% growth in 2020 to 3.8% in 2021. Growth in Sales and Marketing growth declined from 1.7% in 2020 but, at 1.6% in 2021, was the most modest decline in growth among the clusters.

The first and third columns are rates of change of Comprehensive expenses that the plans *actually reported to us*, and these trends are affected by the change in the business mix. For example, if a plan has a decline in Commercial Insured and growth in Medicaid, then costs will seem to grow slower on account of this shift. This actually happened, which is why the Constant Mix growth, reweighted to eliminate that effect, is faster than on an As-Reported basis.

For most expenses, the declines shown on the Constant Mix columns are similar to those of the As-Reported columns. One exception is that Medical and Provider Management cost growth declined on a Constant Mix basis, but they accelerated on an as-reported basis. Also the growth in Corporate Services declined on an As-Reported basis but accelerated on a Constant mix basis. The much larger Sales and Marketing and Account and Membership Administration were directionally similar and drove the overall trends.

Let me digress for a moment and provide two examples that help explain the idea of constant mix, which eliminate the effects of any changes in mix. Suppose you are looking at trends in a health plan's administrative costs solely as user of financial statements. The context might be that you are studying a competitor, or a potential acquisition candidate. Once you have same-sized a couple of years of financials by expressing them as PMPMs, you are intrigued when you notice that PMPM expenses in certain functions have increased, and some have decreased. So, is this the result of a change in the strategy of the company? You aren't a fly on the wall so you can't really know but you may be able to rule out product mix as a source.

As you know, some administrative activities of health plans parallel their health needs. So, if you can largely exclude changing demographics, you can be confident of a strategic change. Suppose you calculate that per member Medical Management costs increased. If you know that the Medicare membership grew faster than the membership as a whole, you can infer that there was not a strategic shift. In Benchmark-speak, as-reported Medical Management expenses increased as constant mix expenses remained the same.

It goes the other way too. Some administrative activities depend on the distribution of the health plan's products: ASO products serve larger groups and Sales and Marketing expenses are less than in insured products because they can spread distribution over the members in the group. So, suppose you notice essentially flat enterprise per member Sales and Marketing expenses. But then you learn that ASO membership is growing considerably faster than fully insured products. Therefore, if you held the product mix constant, Sales and Marketing expenses would not be flat as, but would be increasing.

<Slide 5>

Slide 5 is a more in-depth view of the Constant Mix changes in the previous slides, but also identifying contributions 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.

The acceleration in the costs of the Account and Membership Administration cluster of functions was the sharpest change in growth rates and was also the cluster most responsible for the increase in overall costs. The increase in Claims was the sharpest, narrowly followed by Information Systems. Since Information Systems is such a large functional area, it was the most important reason for the increase in costs, not only in this cluster but overall.

Medical and Provider Management was the fastest growing cluster of functions though, at 3.8%, it declined from 5.9% last year. Despite the fact that it is dwarfed by Medical Management / Quality Assurance / Wellness, Provider Network Management and Services was the most important source of cost increase because it grew at a double digit rate. Increases in Provider Relations Services seemed to be central on an increase in staffing ratios. By contrast, in the Medical Management area, Case Management, Nurse Information Line, Medical Informatics and Other Medical Management (housing the medical directors) all declined. By contrast, Precertification, Disease Management, Health and Wellness, Quality Components and Utilization Review increased.

The Sales and Marketing cluster's growth was the third ranked cluster in its contribution to growth. The most important reason for growth was Advertising and Promotion and it also grew far and away the fastest at double digit rates. Its growth was the fastest in the past five years. Broker Commissions was second fastest but far slower. Its size made it the second greatest contributor to Sales and Marketing cluster growth. While Rating and Underwriting and Sales grew, Marketing declined, as we will return to in a moment.

The Corporate Services cluster contributed least to growth in 2021. It grew at effectively the same pace as did Sales and Marketing but is far smaller. The modest decline in the extremely large Corporate Services *function* mitigated cost growth in all other functions. Notable areas of per member cost decline included Legal, Facilities, Audit, Imaging, Printing and Mailroom and Risk Adjustment. The relatively small Corporate Executive and Governance function was the fastest growing function in double digits but its rate of increase made it also the most important source of cost increase. The small Finance and Accounting function grew at near double digit rates and was the second largest contributor to growth. Growth was evident in the true Finance and Accounting areas but also credit card fees.

<Slide 6>

The as reported growth is similar to the previous slide's constant mix growth, except it is mostly lower. Since some of this slower growth is explained by a shift in favor of the lower cost products in their portfolios, such as Medicaid and ASO, the prior slide is more useful in understanding the underlying cost trends.

So, I am going to focus on differences between them. In the previous slide, the Sales and Marketing costs reflected a slight deceleration, whereas on an as-reported basis they sharply decelerated. From 30,000 feet this makes sense since ASO and Medicaid have modest Sales and Marketing expenses and they are of increased importance in the plans' product portfolios. Rating and Underwriting grew faster in this rendering. Marketing is here the greatest source of cost change and most rapidly changing function. Member and Group Communication, its subfunction declined notably especially due to non-labor. This may partly have had to do with the decline of COVID. Advertising and Promotion increased nearly as rapidly as Marketing declined.

The Medical and Provider Management cluster accelerated on an as reported basis compared the slowing growth on a constant mix basis. The Provider Network Management Services function dominated both growth rates and importance.

Corporate Executive was again the greatest contributor to cost growth in the Corporate Services cluster, and it also grew much faster than any other function. Unlike on a constant mix basis, this cluster decelerated.

The Account and Membership Administration cluster closely matched trends on a constant mix basis. Claims and Information Systems were the fastest growing functions, in that order. The order was reversed in their contribution to overall trends.

As I see it, the ten continuously participating IPS plans appear to be committing heavily to Medicaid, investing in Information Systems and strengthening an infrastructure of Finance and Accounting and Corporate Executive and Governance. Marketing showed declines and Member and Group Communication appeared to be central. At the same time, they are committing more heavily to Advertising and Promotion – it is as though, having already helped their existing members navigate in the more insular Covid environment, they redirected their communication to include those they hope to attract as members.

These plans have a median membership of 683,000. This compares with median total membership of 346,000 in the prior cycle and 555,000 in the current cycle. But the change in mix favoring Medicaid at the expense of Medicare and Commercial seem to be a consistent pattern in both complete universes as well as in the continuing plans.

The cost trends also reflected changes in some of the key drivers. For the continuously reporting plans, staffing ratios increased at a median rate of 3.8% to approximately 21.7 FTEs per 10,000. For Commercial Insured members this ratio was 28.9. This includes the effects of outsourced staffing. The median proportions of FTEs that were outsourced are 5.0% up at a median percentage point of 0.6. Median Compensation, including all benefits, basically unchanged, was a median of $101,000 among continuing plans and $106,000 among all plans. Total and Commercial staffing ratios among all plans was 24.3 and 28.3.

<Slide 7>

The *Sherlock Benchmarks* present the administrative expenses in high granularity, by more than 70 functional areas for each of up to 11 Comprehensive products plus four other products for a total of about a thousand 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 2021 which have a different set of plans from 2020, and even continuing plans have different product mixes so there are some important limitations.

Total Expenses of $45.65 PMPM were 8.7% higher than last year's costs of $41.99. The largest cluster, Account and Membership Administration, cost $16.41, 4.5% higher than last year's.

Sometimes the changes in expenses loosely correspond with the actual trends noted earlier. Sales and Marketing costs had modest growth and a decline on a constant mix basis per Slide 4 and, at a median of $11.09 PMPM, was 5.9% lower than last year's value. The Corporate Service Cluster was also slow growing, and was lower by 8.2% to $6.36.

Medical and Provider growth was most rapid in Slide 4 and the change in annual values was higher by 27.2% to $9.23.

I am skipping the list of the functions and subfunctions in the presentation but it is included as an exhibit in the Appendix F of this presentation.

<Slide 8>

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

This slide of the product values illustrates the merits of this. If you recall from the previous slide, the comprehensive per member per month costs have a median value of $45.65. The red circled value near the bottom of this chart is that value. It can be thought of as the median of each of the listed products of each plan, such as HMO or Medicaid, which plan's values are each weighted by that plan's product mix.

If you look further up the chart, you'll see that there is a significant difference between the median costs of Commercial Insured and Commercial ASO, with insured more than 80% greater than the cost of ASO. 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 cost and more ASO would reduce it.

As you can see, there are ten products shown here of which 9 are Comprehensive. They vary greatly in costs, from CHIP at $24.75 PMPM to $191.28 for Medicare SNP. SNP is nearly eight times that of CHIP so product mix makes a difference in costs and trends in costs.

ASO products are always much lower than their insured counterparts, mostly due to far lower Sales and Marketing, but also lower Enrollment, Member Services, Credit Card fees and Actuarial expenses.

Medicaid and CHIP has low Account and Membership Administrative costs compared to commercial products. CHIP costs likely benefit from the young demographics of that population. There are few marketing costs in those products.

By contrast, Medicare Advantage and Medicare SNP are high cost in part because of the high service requirements of seniors stemming from their high health needs.

I don't think we have reported on this previously but please note MLTSS, or Managed Long Term Services and Support. This costs are $141.62 PMPM to administer. We don't include it in Comprehensive products, it is unusual for plans to offer it. Members using this product have complex healthcare needs and chronic illnesses often making them eligible for care in nursing homes. They resemble Medicare Advantage SNP products in some ways.

<Slide 9>

Another way of looking at expenses is as a percent of premium equivalents. There are a number of disadvantages to this approach: 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. While MA is more than double Commercial Insured PMPM, it has percent ratios of 12.0%, 21% greater than Commercial Insured.

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 reflecting that it is a secondary payer to Medicare. At least some of the administrative work for Med Sup members has to be performed even when the plan is not bearing the risk of health care cost variance.

MLTSS has relatively modest Sales and Marketing and heavy Medical Management. Overall its costs are low on a percent basis.

<Slide 10>

This slide reinforces some earlier themes we identified, though somewhat obscured by the change in the plans and the changes in the product mix of those plans.

To review, slides 4 through 7 reflect that the plans' results told us that they had three notable cost trends. They had modest Sales and Marketing growth, mainly due to a decline in Marketing, especially their Member and Group Communications, but offset by sharply higher Advertising and Promotion. They had an increase in Medical and

Provider Management, with the relatively small Provider and Medical Management area chiefly responsible. Finally, Account and Membership Administration increased, most sharply in Claims but most heavily weighted by Information Systems.

These three general themes seem supported by an increase in Finance and Accounting and Corporate Executive infrastructures.

The membership shift in favor of Medicaid obscures these trends since the simplicity of its benefit design makes fewer demands on information systems and distribution costs than commercial products. Despite this, you can nevertheless see in this slide indications of those same trends.

Sales and Marketing cost *growth* declined and, on an as-reported basis, declined in actual dollars: similarly, at 2.3% of premium equivalents, it was 0.3 percentage points lower. Medical and Provider Management was the fastest growing cluster, accelerating on an as-reported basis and accordingly increased by 0.1 percentage points relative to the premium equivalents to 1.7%. The growth in Medicaid, with its relatively modest Account and Membership Administration requirements, led to both faster constant mix than as reported growth and yet two-tenths of a percent decline in its percent of premium ratio.

The relatively slow growing PMPM costs for Corporate Services corresponded with this 0.2 percentage point decrease as a percent of premium equivalent. Recall that the very large Corporate Services function declined in such areas as Legal and Facilities while much smaller Corporate Executive and Finance and Accounting tended to increase.

In total, there was a modest decline in the percent of premium ratio, by 0.1% to 8.7%.

<Slide 11>

When we analyze the companies that participate in the *Sherlock Benchmarks*, our focus is on actual outcomes rather than expressed strategies. For IPS plans, 2021 reflected growth in Medicaid which, because of its more modest distribution system and infrastructure requirements, obscured growth in advertising, information systems and claims, provider network, finance and corporate executive. The Sales and Marketing emphasis seems to me more outward facing as does the emphasis on Provider Network Management and Services.

Costs, totaling $45.65 PMPM, increased in 2021 from $41.99 last year.

The real increase in expenses for continuously participating plans was 4.2%, a reversal from a decline of 1.0% in the prior year. The ostensible increase was only 1.9%, illustrating the importance of product mix in evaluating cost trends. Medicaid increased from 25.4% of membership in 2020 to 28.5% in 2021.

PMPM cost growth was elevated compared with last year, with Account and Membership Administration growth as the key driver. Information Systems and Corporate Executive and Governance were prominent in cost growth in 2021.

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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 25th year of the *Sherlock Benchmarks*, and the 20th for the IPS universe. Cumulatively, by year end, our cumulative experience will be approximately 963 health plan years and will include, in addition to the Independent / Provider – Sponsored Plans, Blue Cross Blue Shield Plans, Medicaid Plans and Medicare Plans.

We have already published on the Blue 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.

Once again, I thank the participating plans and our contacts in those plans for their efforts. I appreciate your participation under circumstances in which it is challenging to access any siloed information, and as you meet other company obligations. We truly appreciate your implied compliment that we meet your high "insight to effort." requirements.

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

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Questions and Answers

Q. Do you think moving away from Covid-19 adaptation affected cost trends?

A. We think so but cannot know directly. Recall that last year only a few of the plans reported direct expenses so the panel of participants elected not to ask for them this year. But the declines in facilities costs, HR costs, member and group communications costs, maybe even legal costs, are plausibly associated with a post-Covid environment.

Q. Can you reiterate why you think Finance and Accounting increased?

A. Finance and Accounting increased due to growth in staffing. Independent / Provider – Sponsored plans are heavily more committed to their provider networks. These organizations are highly localized and have a well-developed provider network. When they choose to go into other states, it seems that they ramp up the Finance and Accounting area.

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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. We have already posted transcripts and slides on the results of the Blue Cross Blue Shield Plans. We try to make our research accessible so please let me know if I can help you find our materials on our website.

Once again I want to thank everyone involved in the 20th annual edition of the Independent / Provider -Sponsored benchmarks for their insights and hard work. Participation pays off in optimizing costs for the plans but we hope that the results benefits the industry as a whole.

This is Douglas Sherlock of Sherlock Company.