



Transcript

Independent / Provider - Sponsored Administrative Cost Growth Accelerated in 2022

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<Title Page>

This call reports on the 21st annual *Sherlock Benchmarks* for Independent / Provider - Sponsored plans, the latest set of 26th annual *Sherlock Benchmarks*. Thank you all for participating in this call. This has proven to be a very interesting year. I have a few intro remarks prior to getting in the meat of this: that is, thank you's, background on process and a description of the panel.

I thank the plans that participated in the Benchmarks and our principle contacts in particular. Every single plan that participated in the 2022 cycle participated again in 2023 except those that were precluded by a business combination.

Our respondents put considerable effort into participation to assure comparability and that the results are actionable. In summary, they reclassify their internally reflected costs and staffing to be comparable with those of the panel of participants, they coordinate the reporting of non-financial metrics of the various function activities, they engage in the validation process and often make presentations of the Benchmark results to their senior management. Communication with us, with line managers and with senior plan officers requires technical skill, tact and a sense of humor, which our principle contacts have in abundance. By the way, they participate in the Sherlock Benchmarks while executing their responsibilities of external reporting, targeted cost management projects, other FP&A activities and strategic planning.

I also thank my colleagues for making this study come together. Each classification challenge for each plan has a counterpart at Sherlock Company since we are responsible to the panel for uniformity of reporting. In addition, our team has developed systems

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for receiving surveys, compiling them, performing several automated validations, summarizing the results and then publishing. I am blessed with the best.

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

The 11 Independent / Provider - Sponsored plans that are the subject of this presentation serve approximately 8.3 million people in 22 states with comprehensive insurance. The median plan membership in Comprehensive products is 673,000 million. Growth, both internal and external, had a significant effect on this year's survey. As we discuss later, membership growth was rapid, relating to constant mix growth in Sales and Marketing. The effect of external growth was on survey participation which affected a remarkably high proportion participants in the 2023 cycle.

This year's Benchmarks are a robust data set, with strong indicators of validity. Participants in this year's study serve about 36% of all Independent / Provider - Sponsored members in the Health Plan Alliance. Besides staff-model plans, most members served by Alliance of Community Health Plans participated in the 2023 *Sherlock Benchmarks*. We have tested and subjected the survey information to validation procedures. Besides these procedures, the plans' practice effect contributes to accuracy: the average participation by this panel is 12.2 years.

<Slide 3>

As you can see from this slide, 2022 was a year of accelerating growth. Looking at the navy-blue line, you can see that total administrative costs PMPM increased by 7.5%. In 2021, total administrative costs increased by 4.2%. The rates of total cost increase was barely exceeded by that of 2019, the highest over the past 10 years. In 2020, PMPM costs declined.

The growth in 2022 for Account and Membership Administration is shown as the light blue line. It is important since this cluster represents just over 38% of the total, a plurality. This cluster's growth, at 7.4%, was the third highest in the past 10 years, and compares with 3.2% last year and a decline of 1.3% the year before. It encompasses the Enrollment, Customer Services, Claims and Information Systems functions.

<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 constant in both measurement periods. (The plans report to us administrative 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 accelerated from an increase 4.2% to an increase of 7.5%. I reflected this on the graph on the previous slide. To highlight this, these two values and their component clusters are identified through both ends of the *filled* blue arced arrow, the second and fourth columns. Similarly, in those columns, we show the acceleration in Account and Membership Administration from 3.2% in 2021 to 7.4% in 2022. I emphasize the changes in the fourth column in slide 4 since they represent the change in expenses *after eliminating the effects of any changes in product mix*. That is, we reweighted last year’s product costs so that they reflect the same product mix and 2022, then calculated changes on this basis.

The unfilled arrow shows the comparison between the as reported comparisons in 2022 versus 2021. Ostensible growth is less in 2022 reflecting a shift to lower cost products. The 1.6% membership median growth in continuously participating plans was in large part due to a 14.8% growth in Medicaid HMO. This product has administrative costs that are half that of commercial insured products: this shift in favor of low cost products resulted in as-reported cost growth of 6.7% being 0.8 percentage points lower than the constant mix growth.

Medicare Advantage also grew by 3.6%, a slower pace than Medicaid. It was 7.0% of continuous IPS participant members. Total Commercial represents a median of 48.4% of members, down from 50.8% in the prior year. Commercial *Insured* membership declined by a median of 5.5%, Commercial *ASO* also decreased at a median rate of 0.9%.

On a constant mix basis every cluster of functions accelerated in growth except for Corporate Services. Medical and Provider Management grew at the fastest rate, by 8.6%. The rapid growth in Provider Network overcame modest growth in Medical Management.

Sales and Marketing growth accelerated from 1.6% in 2021 to 8.5% and was the second fastest among the clusters. Note also the sharp difference between as-reported and



constant mix growth. The shift in favor of Medicaid is especially important to that difference because Sales and Marketing costs are minor in that product, so reweighting eliminates the apparent modest growth on an as-reported basis.

As noted earlier, Account and Membership Administration growth accelerated from 3.2% to 7.4%. Claims increased sharply, and fastest, and Information Systems was the largest factor in overall cost increases.

Uniquely, Corporate Services growth rates declined, from 1.6% to 1.0%. As the smallest of the clusters its effect on cost trend was modest.

The first and third columns are rates of change of Comprehensive expenses that the continuously reporting Plans *actually reported to us* and these trends are affected by the change in the business mix. They are less than the Constant Mix growth because the low cost products of Medicaid, grew rapidly while commercial declined.

<Slide 5>

Slide 5 is a more in-depth view of the Constant Mix changes in the previous slides, but also identifies contributions to trends. The middle column shows the fastest growing functions. The right column shows the functions that contributed the most dollars PMPM to the increase in the cluster's costs.

Medical and Provider Management increased by 8.6%, the fastest among the clusters. Growth was through the rapid growth in Provider Network Management and Services. Slower but still rapid was the Medical Management / Quality Assurance / Wellness area. The Provider Contracting subfunction was key to the Provider Network cost increase because of its increase and underlying costs. Medical Management also grew rapidly, and since it is much larger had a greater impact. Health and Wellness, Medical Informatics and Utilization Review each increased at or near double digits.

The Sales and Marketing cluster's growth was the second fastest among the clusters. The effect of Medicaid growth on ostensible growth is overcome by the reweighting implicit in the constant mix presentation. Advertising and Promotion growth was the fastest in this cluster in 2022 and, for that matter, greatly exceeded the growth in each of the prior four years. While it is not the largest function, it was the largest source of growth. Broker Commissions increased with inflation and was nearly as great a contributor to the cost increase.



The Account and Membership Administration's increase of 7.4% approximated the total cost increase. But this cluster of expenses was most responsible for the Total increase. Claim and Encounter Capture and Adjudication grew at a significant double-digit rate and, in fact, was the fastest growing function in this cluster and in Total. Information Systems costs increased just faster than inflation but, because of its size, its increase was responsible for most of the increase for this cluster and in Total. The Application Acquisition and Development subfunction grew especially rapidly, though Operations and Support grew as well. Enrollment and Customer Services grew by less than inflation.

The costs of the Corporate Services grew far slower than any other cluster of functions, by 1.0%. While Association Dues and License and Filing Fees made the fastest change, a sharp decline, the Actuarial function increased fastest, exceeding inflation. This was followed by growth in Finance and Accounting, which alone could explain the dollar increase in its cluster.

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The as-reported growth of 6.7% is slower than the constant mix growth of 7.5%. Slower growth is also evident in the clusters that compose 85-90% of all expenses. This stems from the mix shift in favor of Medicaid, and away from more expensive to administer commercial insured products. While the prior slide is more useful in understanding the underlying cost trends, this slide can help illuminate how costs are distributed between plan's products.

Nothing better illustrates this than Sales and Marketing, with its reported per member costs of 1.2%, sharply lower compared with the 8.5% on a constant mix basis. Here is what that difference means. Imagine an alternative world in 2022. In this alternative world, each product for these health plans grew at the exact same pace. Given the differing Sales and Marketing required of these products, the per member costs for this cluster for the companies as a group would increase by the 8.5% shown on the previous slide.

What really happened was Medicaid and CHIP increased from 38.9% of the portfolios of these companies to 42.4% between those periods. Sales and Marketing expenses are 10-15% of those of Commercial Insured products. So the combination of the expansion of Medicaid and the very low costs gave rise to the huge difference in trends for this function and, to a lesser extent, trends overall.



If you compare the trend summaries in this chart with those of the prior, you notice very little difference. The prominence of Advertising and Promotion is the same in both charts. Let me offer a couple of additional comments.

Rating and Underwriting is faster on an as-reported basis probably reflecting the greater Risk Adjustment costs of Medicare, which also grew. Commissions and Enrollment cost growth are far slower because the costs of these functions is non-existent or modest for Medicaid. The Corporate Services cluster and Finance and Accounting grew faster as reported probably owing to higher compliance and reporting requirements for Medicaid.

The cost trends also reflected changes in some of the key drivers. For the continuously reporting plans, staffing ratios increased by 4.7%. This excludes the effects of mix differences. Overall, it was 25.9 FTEs per 10,000 for both continuing and all plans. For Commercial Insured members the staffing ratios were 28.3 for all plans and for continuous plans. Areas with high staff increases included Advertising and Promotion, Provider Network Management and Services, Claim and Encounter Capture and Adjudication, Actuarial.

The staffing ratios include the effects of outsourced staffing. The median proportions of FTEs that were outsourced are 11.5% for all plans and for the continuously participating plans. The percent of FTEs outsourced increased by 1.2 percentage points among the continuously participating Plans. Areas that are heavily outsourced include Claim and Encounter Capture and Adjudication, Information Systems and Actuarial. Outsourced Subfunctions include Nurse Information Line and Information Systems Operations and Support.

Median Compensation, including all benefits, increased by 5.6%, to a median of \$101,000 among continuous plans and was \$95,000 among all plans.

The product of the 4.7% increase in staffing ratios and compensation growth of 5.6% exceed that of the constant mix cost growth of 7.5% shown in the prior slide. Non-labor costs per FTE declined in 2022.

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The *Sherlock Benchmarks* present the administrative expenses in high granularity, by more than 70 functional areas for each of up to 9 Comprehensive products equate to over 600 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. Of course, these are costs for 2022 which have a different set of plans from 2021, and even continuing plans have different product mixes so there are some important limitations.

Total Expenses of \$41.16 PMPM were 9.8% lower than last year's costs of \$45.65. This is different from the 7.5% or 6.7% *increase* noted previously. The increase in Sales and Marketing costs, at a median of \$12.69 PMPM, was 14.4% higher than last year's value. The Medical and Provider cluster decreased by 13.0% to \$8.03. The largest cluster, Account and Membership Administration, cost \$15.83, 3.5% lower than last year's. The Corporate Service Cluster, the smallest had 17.0% lower costs to \$5.27, PMPM.

<Slide 8>

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

This slide of the product costs illustrates the merits of this. If you recall from the previous slide, the comprehensive per member per month costs have a median value of \$41.16. The red circled value near the bottom of this chart is that value. Because we are using medians here, this is not exactly accurate but, if we were using mean values you could think of the total as the product values, such as Indemnity & PPO or Medicaid, each weighted by their mix, and then summed.

As you can see, there are 9 products shown here. They vary greatly in costs, from ASO at \$26.03 PMPM to \$182.10 for Medicare SNP, a seven fold difference. 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 Medicare would increase apparent cost trends and more Medicaid would reduce it.

The median costs of Commercial Insured are \$56.42, double that of Commercial ASO at \$26.03. This is mostly due to far lower Sales and Marketing, but also other areas including Enrollment, Member Services, Credit Card fees and Actuarial expenses.



Medicaid has few marketing costs and generally low Account and Membership Administrative costs. On the other hand, Medical Management is slightly higher in Medicaid versus Commercial Insured. Their costs are quite low, as we discussed earlier.

By contrast, Medicare Advantage and Medicare SNP products, at \$120.43 and \$182.10 are highest cost in part because of the high service requirements of seniors stemming from their high health needs. For instance, those two products have 3 and 6 times the Medical Management costs of Commercial Insured.

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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 – including the pricing strategies of your competitors.

Nevertheless, a comparison between the PMPMs and percents of premiums shows the latter are more clustered. While MA is more than twice the PMPM of Commercial Insured, it is only 15% greater expressed as a percent of premium equivalents. The reason for this closer relationship is that administrative expenses somewhat track medical expenses. There are activities that create exceptions to this: the low ASO and Medicaid costs stem in part from low distribution costs of the large group and Medicaid market segments respectively.

Med Sup is an especially quirky exception: its PMPM costs are below average 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.

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The percents of premium ratios in this slide declined and, while this is not the whole explanation, can make sense in light of the discussion above. Recall Medicaid grew rapidly, giving rise to rapid growth on a constant mix basis and slow growth on an as-reported basis. In this chart you can see that administrative costs fell by 0.4 percentage points between 2021 and 2022 to 8.3% of premiums. On a percent basis, the Medicaid HMO product, at 7.3% was a below average cost for the participating plans so, as it grows, the overall costs are less as a percent of the revenues.



The main reason for the decline was the lower values for Sales and Marketing. Percents of premium fell from 2.3% to 2.1% or by 0.2 percentage points, which corresponds with the sharp growth in Medicaid plus the near absence of Sales and Marketing costs associated with the product. This also corresponds to our observation of much faster growth in this cluster on an as reported basis than on a constant mix basis.

Medical and Provider Management declined 0.1 percentage points to 1.6%, possibly reflecting the younger demographics of Medicaid. Corporate Services declined by 0.1 percentage points to 1.2%. Account and Membership Administration was unchanged at 3.3% of premiums.

<Slide 11>

In closing, it was a very interesting year for the Independent/Provider-Sponsored health plans. While a remarkable number of such plans were precluded from participation in the 2023 cycle, the continuing plans posted a 7.5% PMPM increase. This was sharply higher than the 4.2% growth last year. It was only 0.1 percentage points less than the highest level in 2019, which was the highest in the past ten years.

2022 also saw a significant shift in product mix as the typical plan increased its participation in Medicaid. This affected cost trends in several ways. The rate of cost growth was more rapid on a constant mix basis than on an as-reported basis. This was especially the case in Sales and Marketing which had a 7.3 percentage point difference between the costs as reported and costs as they would have been had not the mix changed.

Similarly, the median total administrative expenses declined by nearly 10%, from \$45.65 to \$41.16. That this occurred despite record cost increases shows the importance of the mix change.

There were also indications of heightened commitment to building their businesses. While there was a great difference between overall Sales and Marketing trends between as-reported and constant mix, Advertising growth was quite rapid any way it is calculated. Similarly, cost growth in Claims and Information systems were very prominent. In accordance with their traditional commitments to managed care forms of health insurance, the Medical and Provider Management cluster grew fastest, with the Provider Contracting area of Provider Management being especially important. Also of



note is that Finance and Accounting were especially important contributors to the growth of Corporate Services.

Staffing ratios increased, compensation grew and outsourcing was more prevalent.

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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 26th year of the *Sherlock Benchmarks*, and the 21st for the IPS universe. Cumulatively, by year end, our cumulative experience will be roughly 1,000 health plan years, and will include Medicaid Plans and Medicare Plans, as well as Independent / Provider – Sponsored plans discussed today and Blue Cross Blue Shield plans discussed last month. 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. Since the Benchmarks are 1,300 pages in length, please call me if we can elaborate on our descriptions.

Once again, I thank the participating plans and our contacts in those plans for their efforts. I appreciate your participation under what, under the circumstances of some business combinations, appear to be a fluid environment. 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 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

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I want to close by hoping that you are fully back 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. *You will be among good company.*

Once again I want to thank everyone involved in the 21st 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.