Transcript

Independent/Provider-Sponsored Plan Administrative Cost Growth Accelerates in 2023

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<Title Page>

This call reports on the 22nd annual *Sherlock Benchmarks* for Independent/Provider-Sponsored plans, and the 27th *Sherlock Benchmarks* overall. Thank you all for participating in this call.

Last year, IPS plans increased their membership, did so especially in high cost-to-administer products, increased per member Sales and Marketing and increased their investment in their infrastructure while reducing their staffing ratios.

Before I start, as always, we owe a debt of gratitude to the plans that participated in the Benchmarks and our principal contacts in particular. Thank you for your considerable efforts to harmonize your classifications with your peer group while also honoring your other responsibilities to your plans.

Thank yous are also due to the most effective and efficient team in management consulting, Chris, Erin, John and Andrew. Thanks to their efforts, and the infrastructure that we've built, this cycle has gone well notwithstanding some unusual challenges.

We will be posting the slides and the transcript of this call 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 12 Independent/Provider-Sponsored plans that are the subject of this presentation serve approximately 9.9 million people in 21 states with comprehensive insurance. The median plan membership in Comprehensive products is 749,000.

It results in a robust data set, with strong indicators of validity. These plans collectively serve about 59% of the members served by Alliance of Community Health Plans excluding staff model plans, and 32% of the members by Health Plan Alliance health plans. We also have subjected plan survey information to validation procedures. Plus, the plans' practice effect contributes to accuracy: the average participation by this panel is 15.1 years, and three quarters of them have ten or more years of experience.

<Slide 2>

I am going to skip this slide except to note the appendices. The plans report expenses to us segmented in about 70 functions and subfunctions. They are listed in the appendices and shown how they roll up. Also, we provide some background on users and participants in the Benchmarks. Finally, the appendices show some cost information from last year's cycle.

<Slide 3>

As you can see from this slide, in 2023 cost growth continued to accelerate. Looking at the dark line, you can see that total administrative PMPM costs increased by 8.7%, up from 7.5% in the prior year or by 1.2 percentage points. It has never been that high during the past ten years.

Even more, the acceleration in the growth rate in 2023 for Account and Membership Administration was 3.6 percentage points, from 7.4% to 11.0%, shown in light blue. This cluster of expenses comprises more than 40% of the total and has the Enrollment, Customer Services, Claims and Information Systems functions. This rate is also without parallel over the past ten years.

<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. At the lower right side of the table, you can see where Total expense growth has accelerated from an increase 7.5% to 8.7%. This was expressed graphically in on the prior slide. Similarly, you see the acceleration in Account and Membership Administration from 7.4% in 2022 to 11.0% in 2023.

Each column shows rates of growth for the comprehensive products. We avoid distortion from changes in universes by using the same plans in both years of each comparison. We go one step further for the "constant mix" comparisons. Because the plans report to us administrative costs segmented by *product* as well as by function, we reweight the expense costs in the prior comparison year so that the product mix remains the same in both years.

It turns out that the membership growth pattern affected the apparent cost trends. Overall, membership increased at a median rate of 5.5%, but that growth emphasized higher cost-to-administer products. Commercial growth slightly exceeded Comprehensive at 5.6%. Within Commercial, insured grew faster than ASO, 5.6% versus 2.0%. MA grew faster at 6.2% while Medicaid increased by only 3.4%. Medicare Supplemental decreased by 1.7%, though only some of the continuous plans offer it.

This pattern of growth was responsible for the higher 10.5% percent *reported* growth compared with the constant mix growth of 8.7%. The effect of the resulting mix change was particularly apparent in the Sales and Marketing cluster. As reported, its costs increased by 13.9% but only 10.5% once mix changes have been eliminated: recall that per member Sales and Marketing are higher for the individuals and small groups that use MA and insured products.

I am stressing the changes in the fourth column since they represent the change in expenses after eliminating the effects of any changes in product mix. On a constant mix basis most clusters of functions accelerated in growth. The exception, Medical and Provider Management, which decelerated from 8.6% in 2022 to 5.2% in 2023 and was the second slowest among the clusters.

As noted earlier, Account and Membership Administration growth accelerated dramatically, by 3.6 percentage points to 11.0%. Medical and Provider Management grew far slower than Account and Membership Administration. Corporate Services growth increased from 1.0% to 3.3%, and was the slowest growing cluster.

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. Thanks to MA and Commercial Insured, as-reported expenses grew faster in total and in Sales and Marketing in particular.

<Slide 5>

Slide 5 is a more in-depth view of the Constant Mix changes posted 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 to the increase in the cluster's PMPM costs.

Account and Membership Administration had the most rapid increase at 11.0% but, because of its size, dominated overall cost trends. Customer Services was the fastest growing function. Information Systems costs increased a distant second, but its size dominated the increase in PMPM costs in this cluster and in total expenses. Growth in Application Maintenance and Security Administration and Enforcement was especially robust. While Claims processing grew slower than its cluster, Enrollment cost declined.

The Sales and Marketing cluster's growth was the second fastest with four of the five functions showing unambiguous growth. Surprisingly, Rating and Underwriting costs actually declined, including Risk Adjustment costs.

Sales grew fastest, at low double digits, but the most important reason for this cluster's growth was Broker Commissions. Broker Commissions are a much greater share of total Sales and Marketing expenses. Marketing and Advertising and Promotion posted more modest growth.

Medical and Provider Management increased by 5.2%. Provider Network Management and Services exceeded the growth in Medical Management / Quality Assurance / Wellness. The much greater expense in Medical Management, made this the more important function in cost growth. Subfunctions notably contributing to growth included Provider Configuration, Nurse Information Line and Health and Wellness.

The costs of the Corporate Services *cluster* grew slowest at 3.3%. Finance and Accounting actually declined. Corporate Executive and Governance was by far the fastest growing function. While compensation was flat, staffing and non-labor expenses grew rapidly as outsourcing increased. Actuarial grew second fastest in this cluster. Legal, especially Fraud, Waste and Abuse grew faster than the cluster, as did the Audit subfunction.

Regarding the total trends, the very rapid growth in Corporate Executive even outstripped growth in Customer Services. Information Systems was the most important source of growth, followed by Corporate Executive and broker Commissions. It is notable that this set of plans grew at a fast clip in 2023.

<Slide 6>

The as-reported growth is similar to constant mix with the exception that I have circled. Marketing costs became the most rapid growing function on an as reported basis. This contains the subfunctions of Product Development and Market Research, Member and Group Communication and Other Marketing. The shift was significant enough to have displaced Sales as a fastest growing in its cluster. Sales and Marketing increased by 13.9%, 3.4 percentage points greater than the constant mix growth. This cluster replaced Account and Membership Administration as the fastest growing cluster. All other orders of trends were the same as constant mix.

As an aside, the cost trends also reflected changes in some of the key drivers. For the continuously reporting plans, staffing ratios for Commercial Insured decreased by low single digits to 27 FTEs per 10,000. The median Staffing Ratio for all plans was 23 FTEs per 10,000 for Comprehensive.

Areas with high staff increases included Corporate Executive, Provider Network and Actuarial. Staffing ratio declines were notable in Sales, Information Systems, Claim and Encounter Capture and Adjudication and Customer Services.

The staffing ratios include the effects of outsourced staffing. The median proportions of FTEs that were outsourced are 13.2% for all plans and 13.5 for the continuously participating plans. The percent of FTEs outsourced increased by 1.6 percentage points among the continuously participating plans.

Areas that are more than 20% outsourced include Nurse Information Line, Payment Integrity, Information Systems, including Operations and Support Services and Security Administration and Enforcement, all Other Legal, Audit and Purchasing. Median Compensation for combined employees, including all benefits, increased at low single digits to a median of $104,000. Among all plans, median compensation was $109,000.

<Slide 7>

The *Sherlock Benchmarks* present the administrative expenses in high granularity, by more than 70 functional areas for each of up to nine Comprehensive products for a total of more than 600 product/expense cells. Because this is a summary presentation, we can only touch on very high-level aspects of expenses and their totals.

This slide shows median costs of each cluster, summarizing the functions of the 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 2023 which have a different set of plans from 2022, and even the continuing plans have different product mixes so there are some important limitations.

Total Expenses of $45.70 PMPM were 11.0% higher than last year's costs of $41.16. This approximates the as-reported increase. But the order of the increase in costs of clusters is different to the order of the growth, shown in Slides 4 through 6. The Corporate Services, at $6.94, is the largest difference, 31.6% but was the lowest growing cluster among continuing plans.

While the Sales and Marketing cluster, at $12.43, was 2.1% less than last year, growth on an as-reported basis was the fastest growing function. Account and Membership Administration and Medical and Provider Management showed a better correspondence. Medical and Provider, at $7.79, was 2.9% lower than last year's values and its continuous plan increase was among the slower growing functions. Account and Membership Administration was the first or second fastest growing cluster and, at $18.77, was higher than last year's values by 18.6%.

<Slide 8>

I earlier observed that any changes in product mix will affect cost changes: Medicare Advantage and Commercial Insured growth amplified expense increases in 2023 by 1.2 percentage points. Since the differing needs of populations are separable from trends in actual operating costs, we give greater weight to the constant mix changes when we look at trends.

This slide of the administrative costs of various products illustrates the merits of this. Recall that the comprehensive per member per month costs have a median value of $45.70. The red circled value near the bottom of this chart is that value. But the comprehensive products range from $27.23 to $229.50.

There are two reasons for the range of administrative costs for comprehensive products: the characteristics of the benefit plan sponsor and the characteristics of the population served.

By benefit plan sponsor, I mean who is ultimately financing the benefits. It can be an employer, an individual purchasing the product or a government. If a benefit plan sponsor is a larger group, then the distribution costs are less. For instance, the ASO product costs $27.23 to administer while its insured counterparts cost $59.48, roughly twice that. ASO products are generally sold to large groups with the ability to bear health care cost variances. So, Rating and Underwriting borne by the plan will be less, and so will Medical Management unless the sponsor requests it. But the distribution system expenses are even more important. The main cost difference between the two sets of products is broker Commissions, Sales and so forth because, with size, there are fewer decision points per covered person.

The second reason for administrative expense differences is the characteristics of the population that purchases the product. Since Medicare Advantage members are typically 65 or older, they have more health care needs. That means they also have a greater need for claims adjudication, customer services, medical management and the information systems supporting them. So, Medicare Advantage with administrative costs of $118.57 PMPM is twice that of Commercial HMO Insured of $59.51.

Medicaid reflects a combination of those two factors. Moms and babies, with relatively modest health needs, dominate the demographics of this population, plus it is also government sponsored with that effect on distribution system costs.

So, when we speak of reweighting the product cost values to hold mix constant, it is values like these that we are weighting.

<Slide 9>

Here we are expressing percents of premium equivalents, that is, for ASO, fees plus health benefit costs. When you express Comprehensive administrative expenses as percents of premium equivalents, the main thing is you reduce the effects of the health characteristics of the population while retaining the differences between the products due to the benefit plan sponsor. That's because the PMPMs have members as the denominator while the premium equivalent denominator *implicitly includes* health benefits.

To elaborate, Medicare Advantage members require much more health care than Commercial members and this fact is reflected in much higher PMPM revenues. At 90% health benefit ratios, health care dwarfs administrative costs. However, because some administration is associated with health care costs, more administrative support such as claims processing is required for this population.

The actual costs are reflected in higher administrative expenses as seen in the previous slide. When we expressed administrative costs PMPM, Medicare Advantage was twice its closest comparable, Commercial HMO Insured. When we are expressing administrative costs as a percent, the revenue numerator is already taking the higher health and administrative expenses into account. Therefore, expressed as a percent, the reduced population effect drops the Medicare Advantage to HMO difference to only 1.1 times.

By contrast, there is more modest difference between health care required for Insured and ASO populations. So, the higher costs of Commercial Insured versus ASO are reduced between the PMPM and the percent approaches but not by quite as much. On a PMPM basis, administrative costs for Commercial Insured were 2.2 times that of ASO, but 1.7 times on a percent basis.

I tend to focus on PMPMs because you can manage dollars through staffing ratios, compensation and non-labor. Percents will give you a starting place but you still need to translate them into actual expenses to manage it. Plus, the percent approach has a denominator of revenues so you complicate matters with the additional factor of competitors helping establish your market prices and, therefore, your revenue denominator.

<Slide 10>

Recall that Slide 7 had the clusters' PMPMs. While the total costs increase resembled the trends, the differences in costs between the years and the order of cluster cost increase only loosely related to the actual trends.

To begin with, administrative costs as a percent of premium equivalents increased by 0.3 percentage points to 8.6%.

On a percent of premium equivalent basis, the changes in the clusters are more similar to the trends. Recall that Sales and Marketing and Account and Membership Administration were alternately first and second in trend low double digits depending on whether product mix is eliminated. On a percent of premium equivalents basis, they both increased. Sales and Marketing increased by 0.2 percentages points to 2.3% of premium equivalents. Account and Membership Administration increased by 0.1 percentage points to 3.4%.

Corporate Services had the slowest trends in growth and its percent of premium equivalents was unchanged. Medical and Provider, whose trends were less than the total cost increases, actually declined as a percent of premium equivalents, 0.1 percentage point, to 1.5%.

<Slide 11>

The 10.5% PMPM as-reported increase was a sharp acceleration from last year when it was 6.7%. But the constant mix increase to 8.7% from 7.5% in the prior year was also sharp. Costs, totaling $45.70 PMPM for the 12 participating plans, was higher than for those that participated in 2022, $41.16. The increase of 11% in PMPM loosely corresponded with as reported trends from continuously reporting plans.

Reported comparisons were affected by a shift towards high cost Medicare Advantage and commercial insured. Reported growth conflates population needs with purely technical needs, which is why we emphasize the constant mix comparisons.

Expenses increased to 8.6% of premium equivalents. Sales and Marketing expenses percents increased and so also did Account and Membership administration, to a lesser degree.

Sales and Marketing and Account and Membership Administration expenses both increased. Sales, Customer Services, Information Systems and Corporate Executive were all important sources of increase because they grew rapidly, contributed greatly to the dollar increase, or both.

Staffing ratios decreased, compensation growth was modest and there was a slight increase in outsourcing.

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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 the *Sherlock Benchmarks*.

Thank you for your participation in our presentation. This year marks the 27th year of the *Sherlock Benchmarks*, and the 22nd for the IPS universe. Cumulatively, our cumulative experience exceeds 1,000 health plan years, and includes Independent / Provider – Sponsored Plans, Medicaid Plans and Medicare Plans.

In mid-June, we summarized trends in the Blue Cross Blue Shield universe, 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. Since the Benchmarks are more than 1,000 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 especially recognizing the challenges of accessing 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 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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Once again, thank you again for your participation in this web conference. Please stay in touch for announcements for similar web conferences on the results of the Medicare and Medicaid plans.

Once again I want to thank everyone involved in the 22nd 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 benefit the industry as a whole.

This is Douglas Sherlock of Sherlock Company.