Transcript

Blue Cross Blue Shield Administrative Costs Experienced Flat Trends in 2019

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<Title Page>

Thank you for participating in this year's review of the *Sherlock Benchmarks* for Blue Cross Blue Shield Plans. I am Doug Sherlock, President of Sherlock Company. Today, I would like to speak about the administrative cost trends of Blue Cross Blue Shield Plans in 2019. 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 this, the audience will be muted during the presentation itself.

The nineteen Blue Cross Blue Shield plans that are the subject of this presentation serve approximately million people with comprehensive insurance. The median Plan membership for those participating in the Sherlock Benchmarks this year was 1.8 million. The Plans were geographically disbursed, serving nearly 30 states. These Plans collectively serve about 74% of the membership of Blue plans that are not publicly traded. We have tested and validated the survey information, further enhanced by the fact that 74% of them, 14, have 10 or more years of participation. The slides that show PMPM or percents of premiums are based on these 19 Plans.

About two-thirds of these Plans participated in 2018 as well as 2019. The rate of change discussion is based solely on these thirteen continuously participating Plans. To get an even stronger read on trends, we reweight these Plans' 2018 costs for the 2019 product mix. So, by assuring the same plans at the same mix, we improve comparability.

To be clear, the two-thirds of the Plans that are continuing are similar to the Blue universe a whole. Local cost of living was similar. The continuous Plans served an average of 2.9 million members and had a median membership of 1.8 million, similar to the universe as a whole. The product mixes were also similar: while they had somewhat lower exposure to higher cost Medicare and commercial insured and somewhat lower exposure to low cost commercial ASO/ASC, once we adjusted to exclude mix differences, these continuously participating Plans had costs that similar to the universe as a whole.

There is a theme in this year's trends. The trends in the functions and in the composition of costs seem to reflect an emphasis on long-term strategic focus in 2019.

Corporate Executive and Governance soared. The number of FTEs increased sharply, compensation per FTE fell and non-labor costs sharply increased. Non-labor costs in this functional area often has to do with enterprise, strategic consulting.

Marketing expenses are also forward looking and these expenses increased as well. Interestingly, their components increased similar to Corporate Executive. Non-labor cost increases and staffing ratios were higher, though compensation also bested inflation.

Finance and Accounting also increased sharply. While compensation increased, the key driver was non-labor costs as well. This is said to be due to the adoption of software packages, which presumably will enhance the ability of plans to manage their costs as they execute their strategies.

Finally, some of the cost drivers in Information Systems growth are attributable to the recognition of previously capitalized software expenses. The effects of this investment is found in our subfunction of Application Amortization and Licensing Expenses. Reflecting how capitalized and non-capitalized expenses pass through Information Systems, staffing ratios and compensation (including those outsourced) declined here.

<Slide 2>

This slide is how the presentation is organized and I'm going to breeze through it. It shows the topics that I will address and lists the Appendices. Note that the Appendices contain last year's values. It also lists of all the functions in each of the products offered by these Blue Plans. By the way, that particular Appendix means that administrative expenses are segmented into nearly 800 expense/product cells, each of which are separately analyzed.

<Slide 3>

This slide summarizes long term administrative cost trends for Blue Cross Blue Shield Plans. The percent changes that you see here, and elsewhere in this presentation, are in *per member* values. All comparisons and the actual values we present later exclude the effect of Miscellaneous Business Taxes: these taxes include ACA taxes which have proven volatile.

In 2019, Blue Cross Blue Shield Plans had a *real* administrative cost increase of 6.6%, a shade lower than the increase of 6.7% last year. This is the dark blue line. By "real", I mean the growth in expenses within the constant set of Plans, standardized by members, after having reweighted the 2018 results to exactly match the product mix offered by those plans in 2019. You can see trend jumped in 2017, then continued to grow in 2018 and 2019.

By contrast, in Account and Membership Administration, the growth sharply decelerated, 2.4% versus an 8.8% spike in 2018. While this cluster represents 40% of administrative costs, the much smaller Corporate Services cluster was the key driver of overall growth.

As we'll develop later, the Plans *reported* per member administrative cost trends of 7.1%, up from 5.5% in the previous year. The higher reported growth in 2019 results from a mix shift in favor of higher cost Medicare Advantage.

<Slide 4>

This slide shows the growth of the various clusters and overall. The comparisons on the prior slide are detailed in this one, in the second and fourth columns. I have circled in blue the 6.6% and 2.4% increases from Slide 3, and the blue-*filled* arced arrow illustrates the changes in the growth rates from the prior year, on a constant mix basis. In other words, the second and fourth columns reflect the thirteen continuous plans, whose cost values have been reweighted to eliminate differences due to product mix.

We have spoken about the decrease in growth in Account and Membership Administration, which went from 8.8% to 2.4%, far lower than the trend for total costs. Sales and Marketing and Medical and Provider Management growth also declined, though less precipitously. The Corporate Services Cluster was the only cluster to experience an acceleration in growth, and its growth was impressive.

The first and third columns reflect the as-reported values, that is, before the effect of reweighting to eliminate year-over-year product mix differences. The blue *outlined* arced arrow shows the growth rates of the continuous Plans without that reweighting.

On an as-reported basis, the overall cost trends were similar to the constant mix growth. Corporate Services was the fastest growing cluster, followed by Medical and Provider Management. Account and Membership Administration sharply declined in growth and Sales and Marketing did also, but less dramatically.

The reason for the faster as-reported expense growth was that Medicare Advantage increased as a share of the product mix of these Plans. This may stem from the higher health care requirements of the senior population which leads to higher associated administrative expenses. For instance, growth in Customer Services expenses was higher on an as-reported than on a constant mix basis. Medicare Advantage was the fastest growing product, growing by 6.2%. For the Blue universe as a whole, it is only 3.0% of membership, but is 10% of revenues of comprehensive products.

Commercial represents 80.6% of the total comprehensive membership of these Plans and dominates the product mix. Commercial *Insured* membership declined by 1.3%, commercial ASO / ASC increased by 1.5%. Self-insured relationships typically represent about 55-60% of commercial members. Medicaid also increased, though it was only offered by four of the Plans.

The shift away from individual products likely dampened Commercial Insured growth. Of the thirteen continuously participating plans, ten segmented their commercial membership into individual and group, and of those, seven reported declines in the proportion of members that were individual.

<Slide 5>

This shows the rates of change and the most important reasons for the changes, after eliminating the effect of product mix differences. These are the "real" rates of increase so I will spend considerable time on this.

While Account and Membership Administration was not the most rapidly growing function, because it represents the single largest cluster, it was the greatest source of increase.

Information Systems was by far the fastest growing function in the Account and Membership Administration cluster, which cluster increased by 2.4%. Growth was extremely broad: of the thirteen continuously participating Plans only four had decreasing growth rates in this function.

Applications Amortization and Licensing Expenses grew especially rapidly but Operations and Support and Application Maintenance were also extremely rapidly growing. One Plan noted that a new core system led to an internally developed software capitalization increase. Another Plan has been depreciating previously capitalized expenses in the development of an Enterprise Data Warehouse. That Plan also built out its analytic capabilities.

In 2019, all of the other functional areas in the Account and Membership Administration cluster actually declined in costs. Enrollment / Membership / Billing reported its first cost decline in the past eight years. Customer Services and Claims reported cost decreases after last year's gains. The decline in Claims was by less than half a percent. Outsourcing declined in this cluster of expenses.

The Sales and Marketing cluster increased by 4.1%, half the pace of last year. Rating and Underwriting costs were this cluster's most rapidly growing function. Much of the growth is centered on the subfunction Risk Adjustment. Staffing ratios were higher, though focused on a few Plans with an increased commitment. Compensation growth exceeded inflation. Outsourcing decreased and non-labor costs surged. One of the Plans noted increased investment (vendors and internal staffing) to assist in Risk Adjustment calculations while another cited trends in pricing for vendor that conduct chart reviews for Medicare Advantage.

Marketing also increased at near double-digit rates after posting its fastest growth in a decade last year. Staffing ratios were higher and, while outsourcing was slightly higher, compensation was up greater than inflation. Non-labor costs were much higher, whether calculated PMPM or per FTE. This function can have a significant strategic component, paralleling that of Corporate Executive in some organizations.

For the fourth year in a row, broker Commissions grew more slowly than for the cluster as a whole. But because it is the largest function in the cluster, it was narrowly the highest contributor to the cluster's cost trend.

Over the years, high growth in Information Systems and Marketing have sometimes occurred together. We saw this in 2012, 2013, 2018 and this year too. This may relate to the need to invest to support new products.

The cluster of Medical and Provider Management grew by 8.0%, a slight decline compared from 2018. Growth in the past three years was nearly double that of any of the previous eight years, suggesting a continuing high commitment these activities.

Medical Management growth was slowest since 2016. Since Medical Management / Quality Assurance / Wellness is by far the larger of the two functions, the lower growth for this functional area lowered this cluster's growth. The still impressive growth was paralleled by higher staffing. Higher staffing was especially notable in Disease Management and Health and Wellness. Medical Informatics also experienced high growth in staffing ratios.

Provider Network Management and Services is a much smaller function and its cost growth was effectively the same as last year. Growth was evident in all subfunctions but was especially rapid in Provider Configuration. Staffing ratios increased in this function.

The Corporate Services cluster of costs increased by 9.9%, a surge from the 1.8% pace in 2018. The most important source of growth was the Corporate Executive and Governance function which increased at its fastest pace in at least five years. Staffing in the Corporate Executive and Governance function appear to be sharply up while average compensation fell. Notably, non-labor costs PMPM increased sharply. This function includes strategic planning and similar direct reports to the CEO, as well as the CEO and COO themselves. Based on the changes in composition of costs in this function, we think Plans made decisions in this function that are focused planning for their long-term competitiveness.

Finance and Accounting was the fastest growing functional area and a prominent source of cost increase in the Corporate Services Cluster. It grew at low double-digit rates. This function was the second largest contributor to cost growth in this cluster in six Plans, and the first in two Plans. While the sub-function of Credit Card Fees had an indifferent effect on trend, the other sub-function, Other Finance and Accounting growth was rapid. In ten Plans, the cost trend was 8% or higher. Staffing ratios increased modestly, and compensation increased at rate greater than inflation. As with Corporate Executive, non-labor costs sharply increased. Some Plans reported increases in vendor costs, including new scopes of efforts and the cost of new software packages.

<Slide 6>

This slide shows the *reported* rates of change, that is, the values with no adjustments for changes in product mix. These trends, again, are based on continuous plans. Because there is a correspondence between the relative rates of growth and their importance between the constant mix and as-reported renderings, I won't spend a lot of time on this slide.

Again, growth was faster in 2019 on an as-reported basis, 7.1% compared with 6.6% when adjusted to eliminate mix effects. This higher rate apparently stems from Medicare Advantage growth.

In the Sales and Marketing cluster, on an as-reported basis, Marketing grew more rapidly and broker Commissions grew less rapidly, making Marketing the most important factor in cost growth. Rating and Underwriting grew faster without mix adjustment, likely due to the effect of Risk Adjustment of Medicare Advantage. Advertising and Promotion declined less precipitously when mix is not taken into account.

Medical and Provider Management trends were higher without mix adjustment. Account and Membership Administration grew more rapidly, as Customer Services posted an increase in 2019, unlike on a mix-adjusted basis.

Corporate Services Cluster cost growth were mostly less on an as-reported basis. But Actuarial was an important exception, increasing much faster. Association Dues and

License / Filing Fees also grew faster on an as-reported basis than on a constant mix basis.

Let me close this part of my presentation with a few summary observations. Overall, it appears that staffing ratios remained about the same among continuing plans. Overall participating plans, Blue Cross Blue Shield Plans have approximately 20 FTEs per 10,000 members, though we believe that it differs between products and market segments: we estimate that there are 21 FTEs per 10,000 members in the commercial products.

Functions in which many Plans increased staffing ratios include Rating and Underwriting, Marketing, Medical Management / Quality Assurance / Wellness, Actuarial, Finance and Accounting and Corporate Executive and Governance. On the other hand, Sales, Advertising and Promotion, Enrollment, Claim and Encounter Capture and Adjudication, Information Systems all had staffing ratio declines.

Compensation was typically higher to $112,000, up by about 1.7%. Compensation growth was notable in Sales, Advertising and Promotion and Provider Network Management and Services. Compensation declined in Corporate Executive, and Information Systems. None of these trends consider the effect of changes in the types of employees included within each function, though it is notable that the declines are in relatively highly compensated functions.

We estimate that non-labor costs per FTE increased at approximately 8% and per member increased at approximately 10%. Areas with especially high growth in non-labor costs included Rating and Underwriting, Marketing, Provider Network Management and Services, Finance and Accounting and Corporate Executive & Governance.

Overall, the median proportion of FTEs that were outsourced decreased by less than one percentage point but Sales and Information Systems functions declined more rapidly than this.

<Slide 7>

To this point, we have focused on rates of change rather than the underlying values of the components of administrative costs. They were based on a constant set of plans over two-year comparison periods.

The next few slides speak to the values of these activities for the entire set of Plans: six Plans joined this universe and one Plan withdrew, bringing us to 19 Plans. Because of the difference between the two sets of Plans, and their product mixes differ, changes between the values is a weak gauge of trend. The median PMPM value of $41.82, 10.7% greater than the median value of $37.77 last year. The prior year values are shown in Appendix A of this slide deck and are also excerpted on this page. The total medians are higher, and the cost mixes differ.

There is little correspondence with the overall administrative cost trends on Slide 4 and increases that resulted in the values shown here. The growth in Corporate Services Cluster values to $6.28 was 7.6% higher, below the growth reported earlier. The 11.6% increase in Account and Membership Administration to $17.70 PMPM is far higher than the actual acceleration in this cluster. The 15.3% increase in Sales and Marketing, to $10.58 PMPM sharply exceeds the actual growth. Medical and Provider Management showed the greatest increase, at 14.4%, to $5.66.

The values appeared more scattered in 2019 versus 2018, as measured by the coefficient of variation. Overall and in every cluster except for Account and Membership Administration, coefficients of variation were higher in 2019.

By contrast, dispersion measured by the differences between the 75th and 25th percentile values were narrower. In total, this difference narrowed by $1.86 and sharply narrowed in Account and Membership Administration by $5.54. The other clusters expanded, most notably Sales and Marketing, which expanded by $2.24.

<Slide 8>

I have noted the effect of product mix changes on trend and this slide shows the cost differences that give rise to this. Note that the ASO/ASC products have costs that are about 54% of that of the insured commercial products, $29 versus $54. I have circled this, and there are further differences within the funding mechanisms based on benefit design. The main reason for the differences between ASO and Insured stems from Sales and Marketing cost differences, distantly followed by Enrollment. What this means is that, when there is a shift in favor of these products, reported cost trends decline.

Other low-cost products included FEP at $27.96, Medicare Supplemental at $38.76 and Medicaid (relative to other insured products) at $39.02. The highest cost in Blue Comprehensive products is Medicare Advantage at $121.80. Note that, within Medicare Advantage, Individual runs higher than Group, $121.80 PMPM versus $111.69 PMPM. As with commercial products, some Sales and Marketing and Enrollment costs are lower for the Group Medicare Advantage business.

This panel doesn't include Medicare SNP as a comprehensive product, but it costs $228.89 PMPM. This population has health benefit costs that are more than 60% higher than those of Medicare Advantage for Individuals. We believe these are primarily dual-eligible members though I-SNP, PACE and similar products with exposure to long-term care is not included by the Blue Plans in SNP. The specialty insurance products, Medicare Part D and Stand Alone Dental, are low cost products at $15.76 and $3.23, respectively.

For continuously participating plans, membership grew overall at a median rate of 0.2% and an average decline of 0.2%. Six of these 13 posted declines. Commercial membership declined at a median rate of 0.2% - the 1.3% decline in commercial insured was offset by the 1.5% increase in commercial ASO/ASC. Medicare Advantage was the fastest growing product at 6.2%, while Medicare Supplemental declined by 0.4%. Medicaid increased by 0.8% as FEP grew by 0.9%.

<Slide 9>

This is similar to the previous slide, only expressed in percents. The median administrative expense relative to premiums was 9.6% higher value than last year's 8.8%. (By the way, we are using premium equivalents here.) In many respects, the relationships between the costs of various products measured in percents parallel those measured in PMPM values. For instance, the ASO/ASC products tend to be less than the ratios for insured products, and FEP is low cost under either metric.

However, the highest percent ratio product, Medicare Supplemental at 18.7%, is also among the lowest values measured on a PMPM basis. That this product is secondary to

Medicare Fee for Service while many of the claims paying and other activities of Medicare are still borne by the Plans likely explains this.

The specialty products, with very low PMPM costs, also had high percents. Administrative costs for Stand-alone Part D was 18.4% of premiums and Stand-alone Dental was 18.7%.

The Medicare products are much more similar to commercial products on a percent than on a PMPM basis. This is consistent with administrative requirements of insured people tending to track their health needs.

<Slide 10>

This slide shows the administrative expenses by cluster of functions. Overall costs were 9.6% of premium equivalents, higher than the 8.8% last year.

Except for Corporate Services Cluster, the median values for all of the clusters grew in comparison to the 2018 values.

<Slide 11>

The Plans that participated in this year's study had costs that were $41.82 PMPM versus $37.77 last year. In this presentation, I've emphasized growth holding the universe constant but changes in participation plus changes in product mix also made a difference. Again, the universe increased from 14 Plans to 19 in 2020.

The as-reported cost trends increased by 7.1%, higher than last year's increase of 5.5%. Once we back out the effect of product mix differences that emphasized Medicare Advantage, the trend was 6.6%, a shade lower than 6.7% in the prior year.

While the growth in most clusters of expenses declined, Corporate Services Cluster accelerated. This was driven by Corporate Executive and Governance but, Finance and Accounting was also a prominent source of cost increase in the Corporate Services Cluster.

While Account and Membership Administration cost growth declined overall from 2018 to 2019, Information Systems surged and the single most important reason for administrative expense increase in 2019.

The growth in Corporate Executive, Marketing and Information Systems suggests the effects of investment in adaptation to the future.

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. I will open this for questions, but before I do, I want to offer some general comments.

First, this year marks the 23rd year of the Sherlock Benchmarks, and the 22nd for the Blue universe. Cumulatively, I estimate that by year end our cumulative experience will be approximately 893 health plan years, and will include Independent / Provider – Sponsored Plans, Medicaid Plans and Medicare Plans. In early July, we will summarize the Independent / Provider - Sponsored plan universe results, and we expect to host similar web conferences for Medicare and Medicaid plans later this summer. Additional information, including tables of contents on the Benchmarks themselves are found on the website. Call me if we can elaborate.

Second, I should say that our comments are inferences from the surveys of the Plans. We don't ask about their strategic plans.

Third, on a personal note, we at Sherlock Company have sincerely missed you. It has been a difficult few months for all of us and you owing to adaptation to COVID-19, and while we have spoken and emailed some of you while working from our homes, this process is not seamless. So we are happy to be back in an environment that allows us all to communicate with fewer frictions.

Fourth, 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 with the happy sounds of domestic life in the background. 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.

Fifth, I also thank my very talented colleagues for their hard work and professionalism, especially at this difficult time. Some of our team welcomed new babies, making their efforts especially heroic.

Finally, I would like to remember Sherlock Company's great debt to Randall Allen Edwards, whose vision was the catalyst for the *Sherlock Benchmarks*. Before his retirement, Randy was the Chief Financial Officer of Blue Cross and Blue Shield of Georgia. Randy passed away two weeks ago. Let light perpetual shine upon him.

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

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Questions and Answers

Q. Have you noticed the effect of Economies of Scale on these Plans?

A. We run regression models on this topic and think they exist. Scale appears to have a limited effect overall, is confined to a few functional areas and, to the degree that scale affects staffing ratios, higher compensation mutes it.

This is an important consideration in the wake of COVID-19 because shutting down some of the economy may affect the number of members that you serve and also your product mix. We made a budgeting model that takes these two factors into account. If you are among the 2019 licensees or participants and have not seen this model, please let us know and we will make sure to get it to you.

Q. Can you provide the percent of plans that used the Sherlock-provided values for total costs FTEs versus those plans that provided their own FTEs/Costs for Outsourced activities?

A. We don't know but we think that participants tend to use the Sherlock-provided values to convert invoices to FTEs. That is because, unless the outsourcer is physically present say in the case of an information system, the vendor may be unable or unwilling to provide the Plan with this information in a way that can be validated.

Q. How do the new plans compare to the returning 13 plans? Are the results of the four clusters markedly different?

A. I think that the differences are small. Without diving too deeply into it, based on the rates of change and the median PMPM costs, the 2020 universe plans as a whole are less than a dollar higher PMPM what would be indicated from last year's results. Sales and Marketing and Account and Membership Administration are lower in last years set but are higher in the Medical and Provider Management and Corporate Services. But the product mix also changed, notably the expensive Medicare Advantage is more prominent.

Q. Is there any adjustment made for cost of living differences, or is there anything that could be provided to Plans to consider this in their internal analysis?

A. We don't make any adjustment for cost of living differences because we can't get comfortable with a reliable process for doing it. The biggest complexity are that plans have service centers in differing cost regions and that outsourcing takes that complexity to a whole new level. This is compounded by these same factors in each of the plans.

Yes, we can provide a cost of living adjustment to participants, acknowledging the limitations I mentioned. Let me know.

Q. Can you share the average contract size, members to employee ratio?

A. The median group size for commercial insured is 34 members and is 2,003 for ASO. If you are asking about the ratio of beneficiaries to employee, we don't capture this.

The overall staffing ratio, including outsourced FTEs is 19.93 per 10,000 members. The members per employee ratio is about 503.

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I want to close by hoping that none of you and yours were directly affected by the coronavirus but, if you were, I hope that you or they made a speedy and complete recovery.

Thank you again for your participation in this web conference. In July, we will have a similar web conference on the results of the Independent / Provider - Sponsored plans. In late summer, we will have similar web conferences on the results of the Medicare and Medicaid plans. We hope that you will consider participating in those web conferences as well.

Once again I want to thank everyone involved in the 22nd annual edition of the Blue 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.