



Transcript

Blue Cross Blue Shield Administrative Cost Growth Moderated in 2020

June 24, 2021

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<Title Page>

This call reports on the 24th annual *Sherlock Benchmarks* for Blue Cross Blue Shield plans. Thank you all for participating in this call. I also thank the Plans that participated and our principle contacts in particular. I know that has been a heavy lift because of the COVID-19 environment. Thanks to my colleagues for making this come together.

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

The 14 Blue Cross Blue Shield Plans that are the subject of this presentation serve approximately 41 million people in 22 states with comprehensive insurance. The median Plan membership was 2.1 million.

It is a robust data set, with strong indicators of validity. These Plans collectively serve about 61% of the membership of Blue plans that are not publicly traded. We have tested and validated the survey information, and 79% of the participants have 10 or more years of participation.

I want to mention the subject of the *Navigator* for early June, the effect of COVID-19. At the time of last year's Blue Cross Blue Shield presentation, policy initiatives to mute the spread of the disease had induced one of the sharpest declines in employment in US history. Since employees receive their health insurance through their employers, the potential for declines in plan membership and revenues, exacerbated by costs that are,



in the short run, fixed, could have led to extraordinary increases in administrative costs for these plans.

In response, we built budget models for participants informed by our economies of scale studies. A 30% decline in Commercial membership would have led to a 3% increase in per member administrative costs above normal cost increases *and only if rightsizing of long-term capacity was immediately executed.*

As we will develop in this presentation, this dire scenario did not happen: Blue Cross Blue Shield Plan membership did not collapse and cost growth was moderate in 2020. As developed in early June, the few plans reporting COVID-19 expense reported median costs of \$0.43 PMPM, primarily in Information Systems and Facilities.

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

<Slide 3>

This slide shows that per member cost growth continued its decline. Total Administrative expense growth accelerated its decline in growth from to 5.2% in 2020 from 6.6% in 2019. The decrease in growth was even sharper in the Account and Membership Administration which declined in growth to 2.7% in 2020 from 6.0% in 2019 and from 8.8% in 2018. Administrative cost growth in 2020 was the slowest since 2016, in total *and* for Account and Membership Administration.

The Plans participating in the Benchmarks provided us some anecdotes on how slow cost growth emerged from the COVID policy initiatives. In the first place, they adapted very rapidly and some began immediately tracking expenses including information systems support and extra facility cleaning expenses. In some cases, the Plans curtailed information systems investments which, because of their short accounting lives, led to modest growth in this function. When the sharpest declines in membership did not materialize, Plans appear not to have reversed course in their austerity. Interestingly, some Plans which began to track these expenses discontinued it as unnecessary.

<Slide 4>

This slide is a key summary. It shows the rates of growth in per member costs, as compared with that of the prior year. In calculating all of these rates of change, for all products and all periods, we include only Plans that participated in both periods. When, in the second and fourth columns, we refer to constant mix, we have reweighted



the expense costs to hold product mix the same in both measurement periods. (Yes, the plans actually report costs segmented by product as well as by function.)

At the bottom of the table, you can see where Total expense growth has declined from 6.6% to 5.2%. I noted this on the previous longitudinal graph. They are at the bottom of the chart identified through the *filled* blue arced arrow, the second and fourth columns. Similarly, in those columns, the decline in Account and Membership Administration from 6.0% in 2019 to 2.7% in 2020 is shown.

I highlighted the changes in the fourth column in slide 3 since they represent the change in expenses *unaffected* by the change in product mix. As it happens, the Plans shifted in favor of low cost products like ASO/ASC and Medicaid.

Total Commercial declined at a median rate of 1.5%. Since Commercial represents a median of 83.1% of the membership of these Plans, it dominates Plan product mix. Commercial *Insured* membership declined by a median of 3.9%, Commercial ASO/ASC increased by 4.1%. This shift in favor of self-insured is the most important driver of *mix-related* cost decreases.

Products that serve populations less subject to the economic shutdown showed growth. FEP, the product for US government employees, increased at a median rate of 1.1%. Medicare Advantage, whose members are usually retired, increased at a median rate 6.3%. While only four continuing plans offered Medicaid, membership increased at a median rate of 10.2%.

Considering the economic environment in 2020, it is no surprise that Sales and Marketing had an especially sharp decline in 2020 growth, 3.8% versus 5.5% in the prior year. Account and Membership declined sharply as well, by 3.3 percentage points. The declines in Medical and Provider Management were far more modest. Corporate Services growth actually accelerated. I mentioned the anecdote of the decline in Information Systems investment as a key driver and this is corroborated by the data as we will develop later. Administrative activities for behavioral health and pharmacy benefits actually increased total cost growth by 0.2 percentage points.

The first and third columns are rate of change of Comprehensive expenses as the Plans *actually reported to us*, and these trends are affected by the change in the business mix. For example, if a Plan has most of its members in high cost Commercial Insured in one year and, in the second year, most of the members are in low cost ASO/ASC, then costs will seem to grow slower on account of this shift. This actually happened, which is why



the Constant Mix growth, reweighted to eliminate that effect, at 5.2% is higher than the 4.0% on an As-Reported basis.

For the most part, the real declines shown on the Constant Mix columns are similar to those of the As-Reported columns. Growth declined in total, and for most of the expense clusters. Like with the Constant Mix treatment, Corporate Services is the sole exception, which accelerates.

<Slide 5>

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

Account and Membership Administration had the sharpest decline in the growth rates among the clusters. Customer Services grew at by far the fastest pace. In fact, the growth in staff for this function explained about one-half of the overall staffing ratio increase for the Plans this year. Information systems growth was the lowest in at least five years but it is so large a function that its modest growth narrowly edged out much smaller Customer Services as the most important source of increase. Within that function, Operations and Support costs actually declined while Application Acquisition and Development sharply increased, especially in the Pre-Planning Project Cost area. Claims grew a bit above trend, and Enrollment costs actually declined. I suspect that the latter was affected by the decline in Commercial Membership.

The Sales and Marketing cluster's growth decline was also large. Marketing and Sales functions each had cost declines. The fastest growing function was Advertising and Promotion, which may well have resulted from media being the only available substitute for in-person communication during the COVID lockdown. The most important function to cost growth in this cluster was Broker Commissions, which exceeded all other function increases in this cluster combined. Rating and Underwriting grew modestly.

Medical and Provider Management growth declined but by three-tenths of one percentage point. The decline in the Medical Management / Quality Assurance / Wellness area was notable, and its growth was the slowest since 2016. There was substantial individual variation in how the Plans committed to this function but one general trend was the Nurse Information Line costs exploded. Notwithstanding



Medical Management's deceleration, because of its size, it dominated the trend of the cluster. On the other hand, Provider Network Management and Services had its sharpest growth since 2017. Growth was especially fast in Provider Contracting and Provider Audit / Billing Validation.

The Corporate Services cluster of functions uniquely accelerated its growth. While Actuarial is the second smallest of all functions, here and overall, it had by far the fastest growth, five percentage points faster than the next fastest. The Corporate Services function was the second fastest overall and in this cluster, but it is among the largest functions so was the important factor in this cluster's growth. The Legal subfunction, especially outside litigation, grew very rapidly, which may be legal fees associated with the resolution of the Multi-District Litigation. Risk Management also sharply increased, a trend that continued from the prior year.

The effect of the Legal expense growth was significant. If it had only grown as fast as it had in 2019, then the overall growth in this cluster would have been less than 8%, we estimate, and overall growth would have been 0.3 percentage points lower.

<Slide 6>

The as reported growth is similar to the previous slide's constant mix growth, except it is mostly slower. Since some of this slower growth is explained by a shift in favor of the lower cost products in the portfolio, the prior slide is more useful.

Because the two slides are so similar, I am going to focus on differences between them. In the previous slide, the most important contributor to Sales and Marketing growth was Broker Commissions whereas, in this one, the most important one is Advertising and Promotion. As we noted earlier, the shift in favor of self-insured from fully insured has meant that, while there is no indications that commissions have declined by product, the shift in favor of self insured, with its lower commission products, has reduced what commissions brokers collect. In fact, on an as-reported basis, broker commissions actually declined slightly. While this way of looking at trend is less useful from a health plan perspective, the as reported trend may be meaningful to the brokers.

By contrast, Media and Advertising growth is sharply higher on an as reported basis, also meaningful to the media and advertising organizations that are also Blue Cross Blue Shield business partners.



Other Sales and Marketing functions whose growth is significantly less include Risk Adjustment, Other Marketing and Other Sales. Outside of this cluster, the growth in Credit Card Fees, while very rapid, was slower than on a constant mix basis: The shift in favor of self insured diminished its very high growth.

A few areas other than Advertising reflected a higher commitment to functions notwithstanding a shift in favor of self-insured. That is, they grew faster on an as reported versus a constant mix basis. These areas include Medical Informatics, Health and Wellness and Quality Components.

What we glean from the cost trends that they are consistent with the Plans adapting to the COVID-19 environment. Blue Cross Blue Shield Plans committed much greater resources to enhancing communication with customers and prospective customers. Examples included (a) Employer Group Reporting, (a) Media and Advertising and Credit Card Fees. They also enhanced communications with their membership by surging Customer Services and assisted in management of the care in this virtual care environment by increasing Nurse Information Line and Case Management. Risk Management, with its insurance purchasing and business continuity planning, may also have been positively affected.

Nevertheless, the Plans had an eye on the future with heightened expenses in Actuarial, Provider Contracting and IS Application Acquisition and Development. The most notable source of internal financing of these activities was diminished growth in Information Systems, with actual declines in Operations and Support.

This adaptation is also reflected in some of the operational levers employed by the Plans to implement their cost optimization strategies. For the continuously reporting plans, staffing ratios increased by 5.3% to approximately 23 FTEs per 10,000 for Commercial Insured members. This fully includes staffing that is outsourced. Customer Services had very high increases in staffing ratios and represented most of the staffing ratio increase. Surprisingly, Information Systems was the second greatest contributor to staffing increase. Actuarial is among the smallest functional areas but it was also the third largest source of staffing increase.

The median and mean proportions of FTEs that were outsourced are 12.3% and 11.4%, respectively, similar to last year among continuously participating Plans. Areas that are heavily outsourced included Risk Adjustment, Nurse Information Line, Health and Wellness, Applications Acquisition and Development and Imaging.



Median Compensation, including all benefits except OPEB, increased by 3.2%, to a median of \$110,000. Compensation growth was notable in Other Provider Contracting, Nurse Information Line, Enrollment / Membership / Billing, Customer Services, Legal, Audit, Risk Management and Corporate Executive. With the decline in commercial membership, Sales and Marketing functions sometimes had compensation declines, such as in the Other Sales areas.

<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 three 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 2020 which have a different set of Plans from 2019, and even continuing plans have different product mixes so there are some important limitations.

Total Expenses of \$41.36 PMPM were 1.1% lower than last year's costs of \$41.82. The largest cluster, Account and Membership Administration, cost \$18.74, 5.8% higher than last year's.

Sometimes the changes in expenses loosely correspond with the actual trends noted earlier. Sales and Marketing costs grew very modestly per Slide 4 and, at a median of \$9.38 PMPM, was 11.3% lower than last year's value. The Corporate Service Cluster was the fastest growing in the Slide 4 analysis and had the greatest increase, 7.2%, between 2019 and 2020, to \$6.73 PMPM. Medical and Provider growth was somewhat higher than the total cost growth in Slide 4 and the change in annual values was up by 1.7% to \$5.75.

<Slide 8>

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



This slide of the product values illustrates this. If you recall from the previous slide, the comprehensive per member per month costs are \$41.36. The blue circled value near the bottom of this chart is that value. It can be thought of as each of the listed products such as Indemnity and PPO or Medicare Advantage, weighted by their product mix.

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/ASC, with insured nearly twice the cost of ASO / ASC. This explains that, even if there was no change in the per product expense, a change in the mix would show an apparent change in costs: more insured would increase costs and more ASO / ASC would reduce it.

As you can see, there are 14 products shown here of which 11 are Comprehensive. They vary greatly in costs, from FEP at \$30.13 PMPM to \$144.42 for Medicare Advantage sold to individuals. While this universe excludes SNP from Comprehensive, others do include it, and its costs are \$194.17, more than six times higher than the FEP product. So, product mix makes a difference in costs and trends of those costs.

Looking at Commercial, ASO/ASC products are always much lower than their insured counterparts, mostly due to far lower Sales and Marketing, but also lower enrollment, Credit Card fees, Actuarial, Legal and, accordingly, Facilities.

FEP is low since this product is actually a subcontract with the Association which performs most of the Sales and Marketing. Medicaid is a relatively new product to Blue Plans and only five in our set offer it. There are few marketing costs in that product, and members are often young so its low health care costs give rise to low administrative costs.

By contrast, Medicare Advantage products are highest cost in part because of the high service requirements of seniors stemming from their high health needs. This also pertains to Medicare SNP. Sales and Marketing costs may have increased for this product in 2020, associated with the stronger than average growth we outlined earlier.

Stand-Alone Medicare Part D and Stand-Alone Dental are very low administrative cost specialty, non-comprehensive products. The benefits scope is limited but the Sales and Marketing costs run high here.



<Slide 9>

Another way of looking at expenses is as a percent of premium equivalents. There are a number of disadvantages to this since dollars are actionable but percents are not. Moreover, the denominator of the ratio is the premium rate for that product: this depends on forces beyond your control – the pricing strategies of your competitors.

Nevertheless, a comparison between the PMPMs and percents of premiums shows greater clustering. While MA is over twice the PMPM of Commercial HMO Insured, it is only 35% greater expressed as a percent of premium equivalents.

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.

Stand-alone Dental is similar in its high burden of admin relative to premiums but low costs. In this case, the Sales and Marketing costs are a major contributor to this relationship.

<Slide 10>

I said earlier that the percents of premium sometimes track along with health care trends and administrative cost trends. This slide shows that this is true even between years. On Slide 7, we reported modestly lower PMPM costs in 2020 versus 2019, by 1.1%. The percent of premium ratios are also slightly lower, in total by 0.1% to 9.5%. Recall that Sales and Marketing cost *growth* was lower: at 2.1% of premium equivalents, it was 0.3 percentage points lower. The modest growth in Account and Membership Administration in the Slide 4 presentation was paralleled by 10th of a percent decline in its percent of premium ratio. The relatively fast growing and high PMPM increase Corporate Services corresponded by this 0.1 percentage point increase as a percent of premium equivalent. Finally, modestly growing and modest changing Medical and Provider Management was unchanged relative to the premium equivalents.

<Slide 11>

Generally speaking, when we analyze the companies that participate in the *Sherlock Benchmarks*, our focus is on actual outcomes rather than expressed strategies.

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Comparing costs from 2020 with 2019, we have seen trends that suggest adaptation to the COVID-19 environment and also to their future competitive advantage.

Costs increased in 2020, but generally at a lower rate than during 2019. The only cluster that increased its rate of growth was Corporate Services.

Sales and Marketing growth sharply declined possibly due to the fears for the economic environment for employers, and also their actual consequences. Advertising and Employer Group Reporting were important exceptions stemming from the need to serve socially distant clients.

Another response to social distancing was a sharp increase in Customer Services costs and in the Nurse Information Line.

A discipline of austerity, again reflecting concerns over the economy, was apparent in the modest growth in Information Systems overall and in Operations and Support Services, which actually declined.

On the other hand, it appeared that Plans made a serious focus on their long term competitive position with sharp increases in Pre-Planning Project Costs and Actuarial costs.

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

Thank you for your participation in our presentation. This year marks the 24th year of the Sherlock Benchmarks, and the 23rd for the Blue universe. Cumulatively, by year end, our cumulative experience will be approximately 929 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.

I also want to thank the participating Plans for their efforts during this most difficult of survey cycles. Our primary contacts all have other responsibilities to honor and they



completed the survey forms, participated in conference calls, and fielded our follow up calls with good humor and wise insights. Since the subject matter of this web conference is free of charge and beneficial to health plans that do not or cannot participate in the study, I hope you share my gratitude.

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

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Questions and Answers

Q. You mentioned the Multi-District Litigation as a factor in Corporate Services increase. Is that the cost of the settlement of those claims?

A. No, this reflects only the legal expenses associated with this settlement.

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

A. Only a few of the plans supplied this to us, and the median was \$0.43 PMPM, roughly 1% of administration and 0.1% of premium. We suspect that this may well be the results of plans for which this is high cost.

Q. Is there any further breakout of Information Systems.

A. Yes, we have costs and staffing eight subfunctions for each of the 14 products, and also a segmentation by natural accounting categories including internal employees, outsourced employees and contractors, consultants, hardware depreciation, software amortization and so forth. We also have information systems “platform” information for data center, engineering, helpdesk, storage and capacity management and so forth.

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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 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 23rd 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.