Transcript

Blue Cross Blue Shield Administrative Cost Growth Declined Slightly in 2021

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<Title Page>

This call reports on the 24th annual *Sherlock Benchmarks* for Blue Cross Blue Shield plans, and the 25th *Sherlock Benchmarks* overall. Thank you all for participating in this call. I also thank the Plans that participated and our principle contacts in particular. I know that has been a heavy lift because of their other commitments. Their responsibilities range from external reporting, targeted cost management projects, more general FP&A and strategic planning. Also, while we seem to be out of the woods on Covid, translating the activities within the Plans to the Benchmark classifications may remain more cumbersome because of operation function leadership working remotely.

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

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

The 16 Blue Cross Blue Shield Plans that are the subject of this presentation serve approximately 49.1 million people in 24 states with comprehensive insurance. The median Plan membership in Comprehensive products is 2.2 million.

It is a robust data set, with strong indicators of validity. These Plans collectively serve about 71% of the membership of Blue plans that are not publicly traded. We have tested and validated the survey information, and 74% of the participants have seven or more years of participation.

I want to address Covid-19 adaptation up front as it helps to understand this year's results. Last year, reflecting 2020 costs, we had feared that Plans would be negatively impacted by sharp membership declines as customers laid off employees, and that Plans would incur direct, identifiable costs for their own adaptation in such areas as facilities, information systems and customer services. Happily, the effect on enrollment was relatively modest, and the direct costs were about $0.30-$0.40 PMPM. In 2021, those direct costs appear to be one-fourth of the prior year, $0.08-0.10, with customer services costs representing a plurality of those expenses. Few Plans actually reported these to us raising the possibility that the costs that are reported are only from Plans that considered their expenses high enough to merit the effort, thus overstating direct costs.

So, what actually did happen in 2021 is the subject of this presentation. In short, it reflected trends in membership, the effects of cost management and a redeployment of expenses. Blues experienced a modest decline in costs, the first since 2015.

<Slide 3>

This slide shows that per member cost growth continued its decline, and for the first time since 2015, PMPM costs actually declined. Total Administrative expenses declined by 0.4 percent in 2021 from 5.2% in 2020. This is the third year in a row in which cost growth has declined. This is shown in the Navy-blue line.

It is also the third year in a row in which costs declined in Account and Membership Administration. Growth rates fell to 1.7%, down from 2.7% in the prior year. This is shown in the light blue line. You can see that the cost increase is the lowest since 2016.

<Slide 4>

This slide is a key summary. It shows the rates of growth in per member costs, as compared with that of the prior year. In calculating all of these rates of change, for all products and all periods, we include only those Plans that participated in both periods. When, in the second and fourth columns, we refer to "constant mix", we have reweighted the expense costs to hold product mix the same in both measurement periods. (Yes, the Plans actually report costs segmented by product as well as by function.)

At the lower right side of the table, you can see where Total expense growth has declined from growth of 5.2% to a decline of 0.4%. I reflected this on the graph on the previous slide. To highlight this, these two values and their component functions are identified through both ends of the *filled* blue arced arrow, the second and fourth columns. Similarly, in those columns we show the decline in Account and Membership Administration from 2.7% in 2020 to 1.7% in 2021.

I emphasize the changes in the fourth column in slide 4 since they represent the change in expenses *unaffected* by the change in product mix. As it happens, the Plans shifted in favor of higher cost products like Medicare Advantage. You can infer that this shift to higher cost products must have occurred since the constant mix growth is less than the as reported growth, minus 0.4% versus 0.0%.

Total Commercial declined at a median rate of 1.5%. Since Commercial represents a median of 84.0% of the membership of continuously participating Plans, it dominates Plan product mix. Commercial *Insured* membership declined by a median of 3.0%, Commercial *ASO /ASC* was typically unchanged.

Products that serve populations less subject to the economic shutdown showed growth. Medicare Advantage, whose members are usually retired, increased at a median rate 2.0%. This product costs nearly three times the cost to administer commercial insured products so this, plus the effect of the decline in commercial insured, accelerated apparent cost trends among continuing Plans. FEP, the product for US government employees, increased at a median rate of 0.6%. While only four continuing plans offered Medicaid, membership increased at a median rate of 16.4%.

On a constant mix basis every cluster of functions decreased or declined in growth. Corporate Services growth sharply decelerated, a decline of 6.6 versus growth of 9.7% in the prior year. The 16.3 percentage point change is the most notable one in 2021. Account and Membership Administration growth declined less dramatically, by 0.9 percentage points, but because of its size, its growth nearly offset the entire reduction in Corporate Services costs. The actual per member decline in Information Systems expenses muted growth in this cluster.

The decline in Medical and Provider Management was the first such in five years and, at an 9.7 percentage point change from growth in 2020, was the second most dramatic shift in cost trends. Sales and Marketing growth declined from 3.8% in 2020 but its growth, at 2.4%, was the fastest among the clusters.

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

For the most part, the declines shown on the Constant Mix columns are similar to those of the As-Reported columns. Sales and Marketing in the as-reported comparisons is the sole exception in the eight cluster comparisons shown here, which accelerates very slightly.

<Slide 5>

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

The decline in the costs of Corporate Services cluster of functions was the sharpest change and was also the cluster most responsible for the decline in overall costs. The sharp declines compensated for the fact that this is one of the two smallest clusters. The decline in the Corporate Services *function* was most responsible for this, plus its decline was sharpest within the cluster and in total. The subfunction Legal's decline was especially notable. Recall that in the prior year, Blue Cross Blue Shield Plans incurred expenses related to their own and Association-assessed Multi-District Litigation. Other subfunction declines included Facilities, OPEB and Purchasing, though Risk Management increased.

Other functions in this cluster with cost declines were Finance and Accounting and Association Dues and License and Filing Fees. Finance and Accounting declined despite a surge in Credit Card fees. Actuarial and Corporate Executive, the two smallest functions in the cluster, showed growth.

Account and Membership Administration had an increase and, because of its size, nearly overcame the decline in Corporate Services. Surprisingly, the growth in Claim and Encounter Capture and Adjudication was responsible. This function was the fastest growing in the cluster and among all functions. Information Systems costs declined slightly due to declines in the subfunction of Operations and Support Services. Enrollment and Customer Services typically increased.

After Account and Membership Administration, the Sales and Marketing cluster's growth was the most important offset to the Corporate Services Cluster decline. The most important reason for growth was Broker Commissions. Marketing expense growth followed in importance, but it had the fastest growth stemming from the increase in Product Development and Market Research. While Rating and Underwriting and Sales grew, Advertising and Promotion declined.

Medical and Provider Management declined by 2.0%, a remarkable 9.7 percentage point reversal from the prior year. The Medical Management / Quality Assurance / Wellness area was the key reason for the decline, with the fastest rate of change. Its costs are far greater than the Provider Network Management function. That function, incidentally increased, due to increases in Provider Relations Services. In the Medical Management area, Care Management, Medical Informatics, Utilization Review and Other Medical Management all declined.

<Slide 6>

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

So, I am going to focus on differences between them. In the previous slide, the Sales and Marketing costs reflected a deceleration, whereas on an as-reported basis they very slightly accelerated. Marketing continued to be the fastest growing function but here it was the largest contributor to cost increase. Sales, which grew slightly on a constant mix basis, declined on an as-reported basis. Also, the Sales and Marketing cluster displaced Account and Membership Administration as the key offset to the Corporate Service decline.

The Corporate Services cluster was again the most important source of cost change, with the underlying *function* of Corporate Services being by far the most important contributor to cluster and total cost change. The decline in this function remained faster than any other.

The Provider Network Management Services area exhibited the same pattern on a as-reported basis as it did on a constant mix basis, though it decreased slightly less. Paradoxically, both functions, Medical Management and Provider Network Management and Services, declined in their median trends. Medical Management was both a larger contributor and had a greater rate of change than Provider Network.

The Account and Membership Administration cluster was far less important to the overall trend and grew more slowly on an as-reported basis. Enrollment actually declined rather than increasing though all of the other relationships were the same. Claim and Encounter Capture and Adjudication was both the fastest and the most important cost driver for this function.

Our approach to understanding the activities of health plans is quantitative and we do not ask for prospective information. But some of the trends suggest potential strategic initiatives. I am only speculating here but perhaps the increase in Product Development, Actuarial, Employer Group Reporting and Benefit Configuration are linked as potentially associated with the development of new and tailored products. The increase in Claims and Encounter Capture and Adjudication, especially in its FTE growth, may also be associated with such product development.

Also, perhaps the increase in Credit Card fees is associated with the increasing importance of the individual market as well as the increasing use by small and middle market groups. Among reporting plans, Individual increased by 1 percentage point to a median 17.9% of commercial insured.

The cost trends also reflected changes in some of the key drivers. For the continuously reporting plans, staffing ratios decreased by 1.5% to approximately 23 FTEs per 10,000 Commercial Insured members. This includes the effects of outsourced staffing. The median proportions of FTEs that were outsourced are 13.5% versus 12.9% for 2020 among continuously participating Plans. Median Compensation, including all benefits except OPEB, increased by 0.8%, to a median of $114,000 among continuing plans.

<Slide 7>

The *Sherlock Benchmarks* present the administrative expenses in high granularity, by more than 70 functional areas for each of up to 11 Comprehensive products plus four other products for a total of about a thousand product/expense cells. Because this is a summary presentation, we can only touch on very high-level aspects of Comprehensive expenses and totals of each of the Comprehensive products.

This slide shows median costs of each cluster in Comprehensive products. I'd like to make some comments on the year-over-year changes in the values of these. Of course, these are costs for 2021 which have a different set of Plans from 2020, and even continuing plans have different product mixes so there are some important limitations.

Total Expenses of $41.66 PMPM were 0.7% higher than last year's costs of $41.36. The largest cluster, Account and Membership Administration, cost $18.29, 2.4% lower than last year's.

Sometimes the changes in expenses loosely correspond with the actual trends noted earlier. Sales and Marketing costs were an important source of reallocation per Slide 4 and, at a median of $10.60 PMPM, was 13.0% higher than last year's value. The Corporate Service Cluster was the sharpest declining in the Slide 4 analysis and had a decrease of 7.4%, between 2020 and 2021, to $6.23 PMPM. On the other hand, Medical and Provider growth was modest in Slide 4 and the change in annual values was up by 4.2% to $5.99.

<Slide 8>

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

This slide of the product values illustrates the merits of this. If you recall from the previous slide, the comprehensive per member per month costs have a median value of $41.66. The blue circled value near the bottom of this chart is that value. It can be thought of as the median of each of the listed products of each Plan, such as Indemnity and PPO or Medicare Advantage, weighted by that Plan's product mix.

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

As you can see, there are 14 products shown here of which 11 are Comprehensive. (Host is excluded.) They vary greatly in costs, from FEP at $28.02 PMPM to $157.67 for Medicare Advantage sold to individuals. While this universe excludes SNP from Comprehensive, others do include it, and its costs are $192.56, nearly seven times higher than the FEP product. So, product mix makes a difference in costs and trends in 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, Member Services, Credit Card fees and Actuarial expenses.

FEP is low in part because 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 there are also low Account and Membership 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 were higher for this product in 2021.

Stand-Alone Medicare Part D and Stand-Alone Dental are very low administrative cost specialty, non-comprehensive products.

<Slide 9>

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

Nevertheless, a comparison between the PMPMs and percents of premiums shows greater clustering. While MA is nearly three times the PMPM of Commercial HMO Insured, it is only 60% 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 and Stand-alone Medicare Part D are similar in its high burden of admin relative to premiums but low costs.

<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 somewhat true even between years. On Slide 7, we reported very modestly higher PMPM costs in 2021 versus 2022, by 0.7%. The percent of premium ratios are also modest, though lower in this slide, in total by 0.8% to 8.7%. Sales and Marketing cost *growth* declined: similarly, at 2.1% of premium equivalents, it was 0.1 percentage points lower. The modest growth in Account and Membership Administration in the Slide 4 presentation was paralleled by three-tenths of a percent decline in its percent of premium ratio. The relatively fast declining PMPM for Corporate Services corresponded with this 0.1 percentage point decrease as a percent of premium equivalent. Finally, modestly changing Medical and Provider Management was unchanged relative to the premium equivalents.

Professor Uwe Reinhardt once asked me why administrative expenses in insurance did not fall relative to health care, given health care's more rapid growth. In 2021, it did just that.

<Slide 11>

When we analyze the companies that participate in the *Sherlock Benchmarks*, our focus is on actual outcomes rather than expressed strategies. For Blue plans, 2021 reflected trends in membership, the effects of cost management and a redeployment of expenses.

Costs, totaling $41.66 PMPM, decreased in 2021, or were flat if product mix changes are ignored. The driver appeared to be a sharp decrease in the Corporate Services *cluster* and the Corporate Services *function* in particular. The decline in Legal expenses was especially notable.

All clusters' growth declined, with the exception of a slight acceleration in Sales and Marketing on an as reported basis. Sales and Marketing was the fastest growing cluster, suggesting the redeployment I mentioned earlier. Marketing, especially Product Development, was especially rapid but broker Commissions remained a key contributor. This increase plus that of Benefit Configuration, Credit Card fees and Actuarial suggests Blue adaptation in a competitive environment.

Account and Membership Administration *growth* declined. Information Systems actually declined as Claim and Encounter Capture and Adjudication accelerated. Both are quite unusual for recent years.

Medical and Provider Management declined. Medical Management is the dominant cost here and, under any rendering, this function's costs declined. Provider Network Management and Services either declined or grew slightly depending on whether it was calculated as reported or to eliminate mix differences.

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

Thank you for your participation in our presentation. This year marks the 25th year of the *Sherlock Benchmarks*, and the 24th for the Blue universe. Cumulatively, by year end, our cumulative experience will be approximately 963 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.

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

Since the subject matter of this web conference is free of charge and beneficial to health plans that do not or cannot participate in the study, I hope you share my gratitude.

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

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Q. How much do you think the reduction in Covid-19 expenses had to do with the decline in total and costs?

A. The few plans that reported these expenses showed median costs of $0.08 versus $0.43 last year, so a reduction of $0.35. If we make the assumption that the three reporting plans this year and the four reporting plans last year are representative, that would actually explain all of it. After all, negative 0.4% of $41.66 is $0.17, only one-half of the reported decline in Covid costs.

But, in truth, we don't know whether that reported reduction is representative of all Plans, or just those whose costs were high. So, I would say that it probably contributed but I don't know by how much.

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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 24th 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.