Transcript

Blue Cross Blue Shield Administrative Cost Growth Accelerates in 2022

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<Title Page>

This call reports on the 25th annual *Sherlock Benchmarks* for Blue Cross Blue Shield plans, and the 26th *Sherlock Benchmarks* overall. Thank you all for participating in this call. This has proven to be a very interesting year. I have a few intro remarks prior to getting in the meat of this: that is, thank you's, background on process and a description of the panel.

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

I also thank my colleagues for making this study come together. Each classification challenge for each Plan has a counterpart at Sherlock Company since we are responsible to the panel for uniformity of reporting. In addition, our team has developed systems for receiving surveys, compiling them, performing several automated validations, summarizing the results and then publishing. I am blessed with the best.

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

The 17 Blue Cross Blue Shield Plans that are the subject of this presentation serve approximately 52.2 million people in 26 states with comprehensive insurance. The median Plan membership in Comprehensive products is 2.1 million.

It results in a robust data set, with strong indicators of validity. These Plans collectively serve about 76% of the membership of Blue plans that are not publicly traded. We have tested and subjected the survey information to validation procedures. Besides these procedures, the Plans' practice effect contributes to accuracy: the average participation by this panel is 15.5 years.

<Slide 3>

As you can see from this slide, 2022 was a very interesting year. Looking at the navy blue line, you can see that total administrative costs PMPM increased by 7.2%. In 2021, total administrative costs actually decreased by 0.4%. The rates of cost increases were not only higher than since 2015 but their rates fell in each of the past three years. The next highest increase on this chart was in 2018; at 6.7%, it was a full half percentage point lower than 2022.

We don't know that we have ever seen cost increases quite this high. In the period before 2022, the economy was recovering from public policy induced recession to mitigate the effects of Covid-19.

The growth in 2022 for Account and Membership Administration was lower than 2018, the next highest increase, 8.3% versus 8.8%. This cluster of expenses composes nearly one-half of the total and has the Enrollment, Customer Services, Claims and Information Systems functions. But that change is more dramatic than for the total as it was a greater change in growth from the prior year. It was also a more dramatic shift than in 2018. Growth in 2022 was 6.6 percentage points faster than in 2021, while the 2018 growth was only 5.8 percentage points more rapid. This is shown in the light blue line.

<Slide 4>

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

At the lower right side of the table, you can see where Total expense growth has accelerated from a decline of 0.4% to an increase of 7.2%. I reflected this on the graph on the previous slide. To highlight this, these two values and their component clusters are identified through both ends of the *filled* blue arced arrow, the second and fourth columns. Similarly, in those columns, we show the acceleration in Account and Membership Administration from 1.7% in 2021 to 8.3% in 2022.

I emphasize the changes in the fourth column in slide 4 since they represent the change in expenses after eliminating the effects of any changes in product mix. The continuously participating Plans had a nominal increase in members of commercial products of 0.4%, their administrative costs are in the middle among the products. But both Medicare and Medicaid, high cost and low cost products respectively, increased sharply, by 7.1%. That the mix changes that emphasized the extremes at the expense of the middle is illustrated by the As Reported changes being the same as the Constant Mix changes.

Total Commercial represents a median of 78.8% of members, down from 81.4% in the prior year. Commercial *Insured* membership declined by a median of 1.9%, Commercial *ASO /ASC* increased at a median rate of 0.8%.

FEP, the product for US government employees, with low administrative costs, declined at a median rate of 0.1%. Medicare Supplemental declined at a median rate of 0.2%.

On a constant mix basis every cluster of functions accelerated in growth or reversed from a decline to an increase. Corporate Services growth sharply accelerated, growth of 5.7% versus a decline of 6.6% in the prior year. The 12.3 percentage point change is the greatest one in 2022. As noted earlier, Account and Membership Administration growth accelerated dramatically, by 6.5 percentage points to 8.3%. But, because of its size, its increase in costs was most of the increase when measured in dollars. The modest per member growth in Information Systems expenses muted growth in this cluster as Customer Services and Claims increased sharply.

Medical and Provider Management grew at approximately half the rate of Account and Membership Administration. The rapid growth in Provider Network overcame modest growth in Medical Management. Sales and Marketing growth accelerated from 2.4% in 2021 to 3.3% and was the slowest among the clusters.

The first and third columns are rates of change of Comprehensive expenses that the continuously reporting Plans *actually reported to us* and these trends are affected by the change in the business mix. They look remarkably similar to the Constant Mix growth because the products at the cost extremes, Medicare Advantage and Medicaid, both grew rapidly while commercial grew at a nominal rate.

<Slide 5>

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

The Account and Membership Administration had the sharpest increase and, because of its size, dominated overall cost trends. The growth in Customer Services was the fastest, though it was closely followed by Claim and Encounter Capture and Adjudication. Information Systems costs increased relatively modestly compared with other functions this year but faster than the previous two years. Its size dominated the actual increase in PMPM costs in this function and in total. Its subfunction Application Maintenance, with both its own subfunctions, Benefit Configuration and Other Applications Maintenance, grew at low double digit rates as Operations and Support grew below inflation. Enrollment cost growth increased at approximately the rate of inflation.

The costs of the Corporate Services cluster of functions grew second fastest. The Actuarial function increased fastest, at low double digit rates. The Corporate Services *function* was most responsible for the increase, representing most of the function's costs. Its subfunctions include HR, Legal, Facilities, Audit and others. All of these costs I named increased and OPEB sharply declined.

Corporate Executive increased with inflation as Finance and Accounting grew modestly. Interestingly the Finance and Accounting subfunction, Credit Card Fees, increased at a low double-digit rate.

Medical and Provider Management increased by 4.4%. That modest growth was achieved only by the rapid growth in Provider Network Management and Services overcoming very modest growth in the Medical Management / Quality Assurance / Wellness area. The Provider Contracting subfunction was key to the Provider Network cost increase. Notwithstanding the modest Medical Management growth, Health and Wellness and Other Medical Management (where medical directors are classified) grew at double digit rates.

The Sales and Marketing cluster's growth was the slowest among the clusters. The Sales function grew fastest followed by Marketing. The most important reason for growth was Broker Commissions which increased with inflation. For the second year in a row, Advertising and Promotion declined. The pattern in this function seems to be a sharp increase followed by a year or two of declines. Rating and Underwriting costs grew modestly as Employer Group Reporting and Risk Adjustment costs decreased. Marketing's growth arose from Other Marketing, where the cluster's leadership is classified, and rapid growth in Product Development and Market Research.

<Slide 6>

The as-reported growth is, in total, identical to the previous slide's constant mix growth. But the components differ reflecting the change in the mix – recall that Medicare and Medicaid increased as commercial was effectively flat. While the prior slide is more useful in understanding the underlying cost trends, this slide can help illuminate how costs are distributed between Plan's products.

Note that the greatest weight in the Medical and Provider Management area shifted from Provider Network to Medical Management which I have circled. Medicare and Medicaid tend to use more of Medical Management than commercial. Also, Corporate Executive was the fastest growing function in Corporate Services on an as-reported basis, displacing Actuarial as the fastest growing function on the constant mix comparison. Corporate Executive can include product leadership with P&L responsibilities well in excess of product managers that reside in the Other Marketing subfunction.

There were other significant growth changes not visible here. Rating and Underwriting increased far faster on an as reported basis. Risk Adjustment is a larger factor for Medicare and Medicaid. By the same token, Sales grew slower. Customer Services and Claims each grew faster on an As Reported basis perhaps reflecting the growth and service requirements of Medicare Advantage.

The cost trends also reflected changes in some of the key drivers. For the continuously reporting plans, staffing ratios increased by 1.9% to 19.7 FTEs per 10,000. For Commercial Insured members the staffing ratios were 22.6 for all Plans and 21.8 for continuous plans. Areas with high staff increases included Customer Services and Actuarial, among others.

The staffing ratios include the effects of outsourced staffing. The median proportions of FTEs that were outsourced are 12.4% for all plans versus 12.3% for the continuously participating plans. The percent of FTEs outsourced increased by 0.6 percentage points among the continuously participating Plans. Areas that are heavily outsourced include Risk Adjustment, Health and Wellness, Nurse Line and Applications Acquisition and Development.

Median Compensation, including all benefits except OPEB, increased by 5.9%, to a median of $130,000 among continuing plans.

Oversimplified, the 7.2% increase in PMPM costs can be thought of as the product of the 6.5% rate of inflation and a higher staffing ratio. Note that the actual mix of employees changed with, for instance, both high wage Actuarial and low wage Customer Service people increasing their share of the mix of employees.

<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 2022 which have a different set of Plans from 2021, and even continuing Plans have different product mixes so there are some important limitations.

Total Expenses of $45.36 PMPM were 8.9% higher than last year's costs of $41.66. This is much higher than the 7.2% increases noted previously. But it is interesting to note that the order increase in costs of clusters of was the same as the order of the growth on an as-reported basis, shown in slides 4 and 6. The largest cluster, Account and Membership Administration, cost $20.76, 13.5% greater than last year's. The Medical and Provider cluster increased by 13.1% to $6.78. The Corporate Service Cluster had 8.8% higher costs to $6.78, PMPM the exact same amount as Medical and Provider. The increase in Sales and Marketing costs, at a median of $11.31 PMPM, was 6.7% higher than last year's value.

<Slide 8>

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

This slide of the product costs illustrates the merits of this. If you recall from the previous slide, the comprehensive per member per month costs have a median value of $45.36. The blue circled value near the bottom of this chart is that value. Because we are using medians here, this is not exactly accurate but, if we were using mean values you could think of the total as the product values, such as Indemnity and PPO or Medicare Advantage, each weighted by their mix, and them summed.

As you can see, there are 14 products shown here of which 11 are Comprehensive. (Host services by Plans for other Plans is not presented.) They vary greatly in costs, from FEP at $31.64 PMPM to $152.68 for Medicare Advantage sold to individuals. While this universe excludes SNP from Comprehensive, others do include it, and its costs are $197.45, over six times higher than the FEP product. This explains that, even if there was no change in the per product expense, a change in the mix would show an apparent change in costs: more Medicare would increase apparent cost trends and more Medicaid would reduce it.

The median costs of Commercial Insured and Commercial ASO/ASC, with insured 88% greater than the cost of ASO / ASC. This is mostly due to far lower Sales and Marketing, but also other areas including Enrollment, Member Services, Credit Card fees and Actuarial expenses.

FEP is low in part because this product is actually a subcontract with the Blue Cross Blue Shield Association which performs nearly all of the Sales and Marketing. Medicaid is a relatively new product to Blue Plans and only eight in our set offer it. There are few marketing costs in that product, and they have low Account and Membership Administrative costs. On the other hand Medical Management is higher in Medicaid than commercial.

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 approximately double commercial insured.

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 more than twice the PMPM of Commercial HMO Insured, it is only 45% 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 below average but its percent of premiums are quite high reflecting that it is a secondary payer to Medicare. At least some of the administrative work for Med Sup members has to be performed even when the Plan is not bearing the risk of health care cost variance.

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>

When discussing slide 7, I observed that the order of the increase in the clusters matched the order of the increase in costs among the plans on an as reported basis. That is mostly not the case in the percents shown here. The percent of premium ratios increased by 0.2 percentage to 8.9%. The biggest jump was in Sales and Marketing, by 0.2 percentage points, notwithstanding that it had the slowest cost growth. The fastest growing cluster was Account and Membership Administration but its increase in the administration ratio was only 0.1 percentage points to 3.9%. Both Corporate Services and Medical and Provider Management was unchanged from the prior year relative to the premium equivalents.

<Slide 11>

The 7.2% PMPM increase was very high compared with last year and over many years prior. I offered a simplified explanation earlier, that it is the product of inflation and higher staffing ratios. The effect of inflation on wages does not capture that staffing shifted in favor of both Actuarial and Customer Services.

The 7.2% increase was the same for both as-reported and constant mix calculations. This too simplifies trends. It is not that the product mix of these companies remained the same, rather the middle cost commercial products declined slightly in importance as low-cost Medicaid and high-cost Medicare Advantage grew very rapidly.

Costs, totaling $45.36 PMPM for the 17 participating plans, were higher than for those that participated in 2021 by 8.9%.

Based on the fourteen continuously participating Plans, Account and Membership Administration grew fastest and was responsible for most of the dollar increase in costs. IS had the single greatest impact and Customer Services grew most rapidly among functions in this cluster and in total.

Other notable highlights to growth were the surge in Actuarial and the growth in Provider Network Management and Services, chiefly driven by Provider Contracting. On the other hand, Advertising and Promotion declined as Rating and Underwriting grew modestly. Broker Commissions remained a key source of cost increase.

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

Thank you for your participation in our presentation. This year marks the 26th year of the *Sherlock Benchmarks*, and the 25th for the Blue universe. Cumulatively, by year end, our cumulative experience will be roughly 1,000 health plan years, and will include Independent / Provider – Sponsored Plans, Medicaid Plans, Medicare Plans and TPAs. In mid-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. Since the Benchmarks are 1,300 pages in length, please call me if we can elaborate our descriptions.

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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Questions and Answers

Q. What inflation rate are you using?

A. We are using the annual rate for CPI-U for December 2022.

Q. How do you calculate the outsourced staffing ratios that are baked into your overall staffing ratios?

A. These are estimates based on normal total costs per FTE and reported invoice amounts, unless the plan has better estimates.

Q. Does the emerging use of SAAS affect trends?

A. It might have the effect of emphasizing changes in the components of Information systems. For instance, Application Maintenance might grow at the expense of Operations and Support under these arrangements. This does not bear the separate question of outsourcing affecting the reporting of end-to-end activities.

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I want to close by hoping that you are fully back to your pre-COVID lives and that you and yours were not too severely affected. If you were, it is our hope that you or they made a speedy and complete recovery.

Thank you again for your participation in this web conference. In 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 25^{th} 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.