Transcript

Blue Cross Blue Shield Administrative Cost Growth Decelerates in 2023

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<Title Page>

This call reports on the 26th annual *Sherlock Benchmarks* for Blue Cross Blue Shield plans, and the 27th *Sherlock Benchmarks* overall. Thank you all for participating in this call.

In a nutshell, this year, Blue Cross Blue Shield Plans achieved a combination of nearly contradictory objectives. They invested in Sales and Marketing associated with growth in membership. They also made large commitments to Information Systems and to Customer Services. But rather than increasing expense growth, the Plans decelerated.

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

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

We will be posting the slides and the transcript of this 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 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 in Comprehensive products is 1.7 million.

It results in a robust data set, with strong indicators of validity. These Plans collectively serve about 59% of the membership of Blue plans that are not publicly traded. We also have subjected Plan 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 2>

I am going to skip this slide except to note the appendices. The Plans report expenses to us segmented in about 70 functions and subfunctions. They are listed in the appendices and shown how they roll up. Also, we provide some background on users and participants in the Benchmarks. Finally, the appendices show some cost information from the 2023 cycle.

<Slide 3>

As you can see from this slide, in 2023 cost growth declined. Looking at the dark line, you can see that total administrative PMPM costs increased by 5.6%, a sharp reduction from the 8.7% of the prior year. Growth more or less returned to the 2017-2020 pattern from the more volatile 2021 and 2022 years of Covid-19. Because of the higher inflation in 2023, its real increases are likely below earlier trends.

The decline in the rate growth in 2023 for Account and Membership Administration was 3.6 percentage points, from 8.8% to 5.2%, shown in light blue. This cluster of expenses comprises more than 40% of the total and has the Enrollment, Customer Services, Claims and Information Systems functions. That 3.6 percentage point change is more dramatic than for the total.

<Slide 4>

This slide is a key summary. It shows the rates of growth in per member costs, as compared with that of the prior year. At the lower right side of the table, you can see where Total expense growth has decelerated from an increase 8.7% to 5.6%. This was expressed graphically in on the prior slide. Similarly, you see the deceleration in Account and Membership Administration from 8.8% in 2022 to 5.2% in 2023.

Each column shows rates of growth for the comprehensive products. We avoid distortion from changes in universes by using the same plans in both years of each comparison. We go one step further for the “constant mix” comparisons. Because the Plans report to us administrative costs segmented by *product* as well as by function, we reweight the expense costs in the prior comparison year so that the product mix remains the same. So, since among continuous participants’ MA increased by 3.8% in 2023 and Medicare Advantage mix increased from 0.1% to 3.5%, we reweighted the 2022 values so that Medicare Advantage was 3.5% of the total membership in that year too. The MA growth, compared with median comprehensive membership growth of 0.5% was in large part responsible for the higher 5.9% percent reported growth compared with the constant mix growth of 5.6%. I am stressing the changes in the fourth column since they represent the change in expenses after eliminating the effects of any changes in product mix.

The continuously participating Plans had a 0.6% median growth in commercial but it was all in low cost ASO/ASC, muting Medicare’s effect. Similarly, low-cost Medicaid increased by 2.3% and low cost FEP grew by 0.5%.

On a constant mix basis most clusters of functions decelerated in growth. The exception, Sales and Marketing growth, sharply accelerated from 3.3% in 2022 to 6.2% in 2023 and was the fastest among the clusters. As noted earlier, Account and Membership Administration growth decelerated dramatically, by 3.6 percentage points to 5.2%. Medical and Provider Management grew far slower than Account and Membership Administration. Corporate Services growth was unchanged between the years.

The first and third columns are rates of change of Comprehensive expenses that the continuously reporting Plans *actually reported to us* and these trends are affected by the change in the business mix. Thanks to MA, as-reported expenses grew faster in total and in Account and Membership Administration and Corporate Services in particular.

<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 to the increase in the cluster’s PMPM costs.

The Sales and Marketing cluster’s growth was the fastest and three of the five functions showed unambiguous growth. Rating and Underwriting costs grew most rapidly, notably featuring Risk Adjustment costs.

The most important reason for this cluster's growth was Broker Commissions. While it grew slower than the Sales function, broker Commissions are a much greater share of total Sales and Marketing expenses. Marketing and Advertising and Promotion had very modest changes which direction varied by Plan.

The Account and Membership Administration had the third most rapid increase but, because of its size, dominated overall cost trends. For the second year in a row, the growth in Customer Services was the fastest growing function. Information Systems costs increased second fastest but its size dominated the increase in PMPM costs in this cluster and in total. Its subfunction Applications Acquisition and Development, with both its own subfunctions, Applications Amortization and Licensing Expenses and Pre-Planning Project Costs, grew at high single digit rates. Enrollment cost and Claim and Encounter Capture and Adjudication grew at approximately the rate of inflation.

The costs of the Corporate Services *cluster* grew second fastest. The function of Association Dues and License/Filing Fees grew fastest. In fact, it was the only function in its cluster that grew greater than the cluster as a whole. The Corporate Services *function* was most responsible for the increase, representing most of the *cluster's* costs. Its subfunctions include HR, Legal, Purchasing, Risk Management and others. All of these subfunctions I named increased while OPEB, Imaging, Printing and Mailroom all sharply declined.

Corporate Executive increased approximately as fast as the Corporate Services function as Actuarial and Finance and Accounting grew at very low single digit rates. Interestingly, the Credit Card Fees subfunction of Finance grew at double digit rates.

Medical and Provider Management increased by 3.7%. Medical Management / Quality Assurance / Wellness exceeded the growth in Provider Network Management and Services. This, plus the much greater expense in Medical Management, made this the more important function in cost growth. Subfunctions notably contributing to growth included Provider Relations Services, Disease Management and Health and Wellness, though only the first was in double digits.

Regarding the total trends, the very rapid growth in Customer Services, the heavy effect of Information Systems, combined with the relatively fast growth in the Sales and Marketing cluster seem possibly reflective of a strategy of membership growth and the development of an infrastructure to support such growth.

<Slide 6>

The as-reported growth is similar to constant mix with two exceptions that I have circled. First, the function of Provider Network Management and Services grew much faster absent the mix adjustment. Without the adjustment, its growth exceeded that of the Medical Management function in the Medical and Provider Management cluster. I speculate that growth in Medicare entails additional efforts in network development and provider service for a population that does, after all, require more health care.

Also note that Rating and Underwriting displaced Customer Services for the fastest change among all of the functions. Recall that the subfunction of Risk Adjustment was central to Rating and Underwriting's growth on a constant mix basis. Risk Adjustment (chart reviews and coding) are a very important activity in Medicare Advantage which grew faster than any other product.

As an aside, the cost trends also reflected changes in some of the key drivers. For the continuously reporting plans, staffing ratios increased by 4.7% to 20.8 FTEs per 10,000. For Commercial Insured members, the staffing ratios were 22.6 for all Plans and 21.5 for continuous plans. Areas with high staff increases included Risk Adjustment, Provider Relations Services, Disease Management, Nurse Information Line, Utilization Review, Other Medical Management, Customer Services' Grievance and Appeals, Claims' Payment Integrity, Applications Acquisition and Development and Risk Management.

The staffing ratios include the effects of outsourced staffing. The median proportions of FTEs that were outsourced are 12.5% for all Plans and also for the continuously participating plans. The percent of FTEs outsourced increased by 0.6 percentage points among the continuously participating Plans. Areas that are more than 20% outsourced include Risk Adjustment, Nurse Information Line, Health and Wellness and Applications Acquisition and Development.

Median Compensation for combined employees, including all benefits except OPEB, increased by 2.2%, to a median of $120,000 among continuing plans.

The 5.6% constant mix increase in PMPM costs can be loosely summarized as the product of the 2.2% compensation increase and a 4.7% increase in the staffing ratio, combined with a 0.9% decline in non-labor costs.

<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 of the Comprehensive products. I'd like to make some comments on the year-over-year changes in the values of these. Of course, these are costs for 2023 which have a different set of Plans from 2022, and even the continuing Plans have different product mixes so there are some important limitations.

Total Expenses of $46.59 PMPM were 0.6% higher than last year's costs of $46.32. This is much lower than the increase noted previously. But the order of the increase in costs of clusters is similar to the order of the growth, shown in Slides 4 through 6. Sales and Marketing, at $11.44, was higher by 1.1% and Corporate Services, at $7.02, was higher by 3.6%, reversing these two from the growth when holding universes constant. The third fastest growing area was, at $20.70, Account and Membership Administration. In the constant universe trend information, it was a decline of 0.3 percent. Finally, the slowest growing cluster, measured in trends, is Medical and Provider Management, at $6.71: this is decline of 1.0% in its year over year values.

<Slide 8>

I earlier observed that any changes in product mix will affect cost changes: Medicare Advantage growth amplified expense increases in 2023. That is why we give greater weight to the constant mix changes when we look at trends.

This slide of the administrative costs of various products illustrates the merits of this. Recall that the comprehensive per member per month costs have a median value of $46.59. The red circled value near the bottom of this chart is that value. But the comprehensive products range from $32.04 to $138.76. The range gets even broader if you include the products other than comprehensive.

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

By benefit plan sponsor, I mean who is ultimately financing the benefits. They can be an employer, an individual purchasing the product or a government. If a benefit plan sponsor is a larger group, then the distribution costs are less. For instance, the Indemnity & PPO ASO/ASC product costs $33.35 to administer while its insured counterpart costs $57.22, 1.7 times that of ASO/ASC. ASO/ASC products are generally sold to large groups with the ability to bear health care cost variances. So, Rating and Underwriting will be less and so will Medical Management unless the sponsor requests it. But the correlate expenses are even more important. The main cost difference between the cost of those products is overwhelmingly broker Commissions, Sales and so forth because, with size, there are fewer decision points per customer. You can see similar differences in the other two commercial products and also in the Group versus Individual Medicare Advantage products. FEP, though not self-insured, is sponsored by the Federal Government and so largely reflects that benefit plan sponsor cost advantage. Also, it is subcontracted with the Blue Cross Blue Shield Association which performs nearly all of what Sales and Marketing is required.

The second reason for expense differences is the characteristics of the population that purchases the product. Since Medicare Advantage members are typically 65 or older, they have more health care needs. That means they also have greater need for claims adjudication, customer services, medical management and the information systems undergirding them. So Medicare Advantage sold to individuals with administrative costs of $138.76 PMPM is 2.5 times that of Commercial HMO Insured of $54.84.

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

The *scope* of benefits affects the non-comprehensive products. The low costs of Stand-Alone Part D and Stand Alone Dental show this as their administrative activities are smaller stemming from their fewer benefits. This is also the case with Medicare Supplemental where this product is a secondary payor to the traditional Medicare program.

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

<Slide 9>

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

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

The actual costs are reflected in higher administrative expenses as seen in the previous slide. When we expressed administrative costs PMPM, Individual Medicare Advantage was 2.5 times that of its closest comparable, Commercial HMO Insured. When we are expressing administrative costs as a percent, the revenue numerator is already taking the higher health and administrative expenses into account. Therefore, expressed as a percent, the reduced population effect drops the Medicare Advantage to HMO difference to only 1.4 times.

By contrast, there is very little difference between health care required for Insured and ASO/ASC populations. So the higher costs of Insured Indemnity & PPO versus ASO/ASC Indemnity and PPO were reduced between the PMPM and the percent approaches but not by very much. On a PMPM basis, administrative costs for Insured Indemnity & PPO were 1.7 times that of ASO/ASO, but 1.5 times on a percent basis.

These comparisons are all between comprehensive products. A different dynamic affects the specialty products like Dental and Part D. Since the scope of the health benefits are narrower than the comprehensive products, the dollar administrative expenses tend to be lower. However, many of the same activities found in comprehensive products, with all their attendant costs, remain in place. That means the cost to enroll a member and the cost to manually process a claim is not greatly affected by the scope of the benefits or the lower dollar value of the claim being processed. For this reason, while specialty products have low PMPM costs, they also have high costs relative to their premiums.

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

<Slide 10>

Recall that Slide 7 had the cluster's PMPMs. While overall they did not change much, where they did change, the order sort of resembled that of the actual constant universe trends. Notably, Sales and Marketing grew faster than most and Account and Membership Administration grew slower.

The parallel in this slide to the trends in cost growth is that Sales and Marketing is higher than last year. The other cluster changes were basically nil, including the total, the effect of rounding of the percents notwithstanding in the case of Corporate Services.

<Slide 11>

The 5.9% PMPM as-reported increase was a sharp deceleration from last year, and the constant mix decline to 5.6% from 8.7% in the prior year was sharper still. Costs, totaling $46.59 PMPM for the 14 participating plans, were slightly higher than for those that participated in 2022, $46.32. Reported comparisons were affected by a shift towards high cost Medicare Advantage. That conflates population needs with pure technical needs, which is why we emphasize the constant mix comparisons.

Expenses remained at 8.9% of premium equivalents. Only Sales and Marketing expenses percents increased.

Sales and Marketing was the fastest growing cluster – it accelerated while all others decelerated. Customer Services was the fastest growing function. The most important dollar factor in administrative cost increase was the growth in Information Systems.

Medical and Provider Management also increased but it grew slowest.

It appears that the Plans invested in their growth, through higher Sales and Marketing, invested in their infrastructure through greater Information Systems and Customer Services and at the same time moderated overall expense growth. Moreover, staffing ratios increased along with a slight increase in outsourcing.

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

Thank you for your participation in our presentation. This year marks the 27th year of the *Sherlock Benchmarks*, and the 26th for the Blue universe. Cumulatively, our cumulative experience exceeds 1,000 health plan years, and includes Independent / Provider – Sponsored Plans, Medicaid Plans and Medicare Plans. 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 on our descriptions.

Once again, I thank the participating Plans and our contacts in those Plans for their efforts. I appreciate your participation especially recognizing the challenges of accessing any siloed information, and as you meet other company obligations. We truly appreciate your implied compliment that we meet your high "insight to effort." requirements.

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

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

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Questions and Answers

Q. Which functions had the fastest growing staffing ratios?

A. Risk Adjustment of the Rating and Underwriting function, and Customer Services. (Additional functions not mentioned during the webinar that also were at or above these functions included Provider Network Management and Services and Medical Management.)

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Once again, thank you again for your participation in this web conference. Please stay in touch for announcements for a similar web conference on the results of the Independent / Provider - Sponsored plans in July, and also later the results of the Medicare and Medicaid plans.

Once again I want to thank everyone involved in the 26th 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 benefit the industry as a whole.

This is Douglas Sherlock of Sherlock Company.