



*Transcript*

## Blue Cross Blue Shield Administrative Costs: A Review of 2008 Results

July 23, 2009

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<Title Page>

I am Doug Sherlock. Welcome to our summary of the benchmarking study for Blue Cross Blue Shield Plans. This is the second of a series of presentations on health plan performance metrics. Independent / Provider - Sponsored financial metrics were summarized two weeks ago and we expect to host similar web conferences for Medicare and Medicaid plans in September.

I'll share who *we* are in just a moment but you may be interested in knowing who *you* are. There are now 141 people registered to participate in this web conference. As of 10:15 this morning, there were 137 people registered, 72 were with health plans, 48 were consultants or affiliated with business process outsourcing firms, 5 were with health plan associations, 4 were actuaries or benefit consultants and the balance was comprised of providers, regulators, employers, media and capital markets people.

Some of the health plans who are on the call are participants in our benchmarking studies. A byproduct of their participation are the reports that are summarized today. This summary benefits the health plan industry as a whole, and we are grateful for this.

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Today, I would like to touch upon our background, the levels of costs that the Blue Cross Blue Shield plans incur and the sources of cost increase in 2008. Then I would like to speak to the costs, by product, reported by these plans. For the sake of brevity, I have included some supporting information only in appendix form.

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To briefly summarize the key points of this presentation, costs increased moderately in 2008. Looking at the per member per month costs, the increase was 2.7%, down from 4.3% in 2007. Some of this represented a shift in the product mixes of the participating plans in favor of products that had lower administrative expenses: Holding mix constant, costs increased by the still moderate 4.0% versus 2.5% in 2007. That mix change was an increased focus by plans on the Federal Employees Plan, and ASO/ASC. The growth of Medicare Advantage was significant but its small size limited its total effect. Of the cost increases, more than 40% was attributable to Medical Management / Quality Assurance / Wellness and Information Systems.

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As you may know, we have been performing these benchmarking studies for many years. Sherlock Company is now completing its 12<sup>th</sup> annual survey of health plan operations and our benchmarks are based on 396 health plan years of experience. In all of our universes this year, the plans serve 39 million members. Our focus is administrative expenses and related operational drivers, but also include metrics of health care utilization.

These benchmarks are widely accepted by health plans and others, and plans serving more than one in every 2.7 insured people used our 2008 metrics. Most Blues and most plans whose officers serve on the board of AHIP are users or participants. Since this is designed for plans' internal use, it has a high ratio of insight to effort. Our benchmarks benefit from cross fertilization across universes.

Plans participating in our benchmarking studies agree to complete our survey form in exchange for the resulting report. Costs must be segmented by product as well as by functional area: that segmentation is shown in the appendix slides. Our quality assurance procedures are also summarized in the appendix.

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The 22 plans that participated in our benchmarking study for Blue Cross Blue Shield Plans serve 31.3 million members, in all regions, nationwide. This represents most Blue



Cross Blue Shield plans. They are substantial organizations, with more than one and a half million members each. If you exclude the Blues' two largest primary licensees, the participants are typical of Blue Cross Blue Shield plans. One third of the typical plan's membership are enrolled in ASO / ASC arrangements. Their businesses were focused on commercial members. Only 7% of members were in Medicare Supplemental and less than 3% of members were in Medicare HMO products. Medicaid was only an incidental product of these plans.

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Here are the results for 2008. Median administrative costs for comprehensive products were \$25.95 per member per month and if you refer to Appendix A, you'll see that this can be compared with \$25.36 last year. By the way, the median costs, expressed PMPM or as a percent of revenues, will be the way that we'll refer to cost metrics. Comparing this slide with Appendix A is an imperfect comparison since the plans in the annual universes differ. Despite this, it is notable that Provider and Medical Management costs increased by \$0.22 to \$3.34, and Account and Membership Administration increased by \$0.55 to \$10.78. Account and Membership Administration includes all of the core activities of health plans - Customer Services, Claims Adjudication, Enrollment and Information Systems. The growth in Account and Membership Administration and Provider and Medical Management are themes we'll return to in this presentation. By the way, the figure numbers on the slide refer to our free newsletter, *Plan Management Navigator*, which is available on our web site, along with this presentation.

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If you look at the two right columns labeled "2008 Data", you'll see more appropriate comparisons but they tell a similar tale. In this slide, we have made all comparisons reflect the same plans in both years. Focusing on the bottom row and the left columns for each year, PMPM costs increased by 2.7% in 2008 versus an increase of 4.3% in 2007. Obviously, these are both low rates of increase.

But that low increase difference reverses if you hold constant the product mix. Again, I am referring to the bottom row, but in this instance, the right columns. (Incidentally, we control for mix by weighting the 2007 expenses by the 2008 product mix. Remember, plans report to us expenses by functional area and also by product.) Adjusting for this, expense growth is 4.0% versus 2.5% last year. This is still low but higher than last year.

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Note particularly the sharp increase in Provider and Medical Management costs. They were up 11.3% before backing out the effect of product mix differences, and 9.1% holding constant that mix. By either measure, this is a faster rate of growth than for 2007. It is plain that Blue plans sharply increased their commitments to this cluster of functions.

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I previously mentioned the greater importance of certain product areas and this slide loosely quantifies this. While membership increased by 1.0%, membership in FEP and ASO increased by 2.3% and 5.4% respectively. Medicare membership increased very sharply, but since it remains less than 3% of members had a smaller effect.

This tilting in favor of FEP, ASO and Medicare is also reflected in the revenue mix changes. These are not enormous differences overall, but remember we are seeking to explain relatively modest differences in the rate of expense growth of 4.0% adjusted versus 2.7% reported in 2008.

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This slide highlights the functional areas within each cluster that contributed to the increase in costs. We looked at both *fast* growing cost areas as well as costs that were responsible for *most* of the increase in the cluster of expenses. Marketing costs, which increased by 3.5% in this universe, was lower than the 4.2% increase last year. Advertising and Promotion cost growth was relatively high. Even though broker Commissions posted the lowest rate of increase since 2005, and the second lowest in the past nine years, because of its high relative size, it was responsible for the highest proportion of this year's cost increase for this cluster.

Medical and Provider Management, at an 11.3% growth rate, was the fastest growing cluster. While Provider Network Management and Services grew slowly, Medical Management / Quality Assurance / Wellness grew at a double digit rate and was responsible for more than 80% of the total increase for that cluster. This appears to reflect a commitment to managing care way above that which can be explained by the increasing prominence of Medicare HMO in the portfolios of Blue Cross Blue Shield plans.



Growth in the cluster of Account and Membership Administration was essentially at overall inflation levels, at 2.2% in 2008. Customer Services and Claim and Encounter Capture and Adjudication increased by approximately one percent PMPM, the small Enrollment area grew faster but Information Systems costs increased by nearly 6%. Information Systems was also the central factor in the increase in the costs of this cluster.

Corporate Services costs actually declined on a PMPM basis in 2008. Finance and Accounting declined fastest. It continued a long trend of declines and this was the fourth time in five years that such a decline occurred. Support services such as HR, mailroom, facilities also declined: As a relatively large functional area, its decline comprised the greatest share of the total.

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This slide reflects the contribution to expense growth of various functions *holding constant the product mix*. Marketing expenses grew by 2.8%, somewhat lower than the 3.5% reported without this adjustment. It was lower than the 4.9% rate of last year. Internal Sales and Marketing costs were primarily responsible for the increase in this cluster, though Advertising and Promotion grew fastest, at low double-digit rates. Notably, Product Development and Market Research declined, and broker commissions did not grow, PMPM, at all in 2008.

While the rate of growth, at 9.1%, in Medical and Provider Management was lower than the as-reported rate of 11.3%, it was still quite high. It compares with an adjusted rate of 2.2% last year. Provider Network Management and Services costs grew moderately on a PMPM basis while spending for Medical Management / Quality Assurance / Wellness grew by nearly 10%. It was, accordingly, mainly responsible for the increase in this cluster of expenses. It appears to have reflected a commitment to this activity unsurpassed since 2005.

The expenses committed to Account and Membership Administration increased from 2.2% on an as reported basis to 4.1% on a constant mix basis. This is slightly higher than the 3.9% adjusted rate for 2007. Information Systems costs increased at their fastest rate since 2003, high single digits, and was the *sole* reason for the increase in this cluster. On a constant mix basis, the costs of Enrollment and Customer Services actually declined



and Claim and Encounter Capture and Adjudication costs increased by less than 1%. The coincidence of fast Information Systems growth and slow growth in other functional areas in this cluster is consistent with technical substitution between them.

On a mix adjusted basis Corporate Services costs increased by 1.6%, compared with a decline of 0.1% on an as-reported basis, and a decline of 6.2% last year. Corporate Executive and Governance was responsible for most of the increase since Finance and Accounting, other Corporate Services and Association Dues actually declined. Actuarial costs grew however. Corporate Executive and Governance was also the fastest growing function in this cluster. (By the way, this function includes the CEO, the COO and board costs, but also Strategic Planning and Business Process Improvement.)

So, just to reiterate, cost growth was relatively low for participating Blue Cross Blue Shield plans, compared with recent trends. But regardless of how product mix changes are treated, increases in Information Systems and Medical Management were central factors in the growth that did occur. Together these functions comprised more than 40% of the PMPM increase in total costs.

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This slide shows administrative expenses as a percent of premium equivalents. At 9.9%, it is probably lower than conventional wisdom for health plan administration. Please note that it excludes taxes imposed by state governments. Our calculations of premium equivalents is discussed in the August edition of *Plan Management Navigator*.

Note that the percent of premium equivalent is 50 basis points lower than last year's value of 10.4%, as shown in Appendix B. A precise comparison is impossible since medians don't sum and the universes differ. However, on a percent basis, Marketing and Corporate Services declines, relative to premium equivalents, seem to be central to the ratios being lower. This is sort of the reciprocal of the importance of Information Systems and Medical Management as a source of cost increase in 2008.

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If health benefits grow at, say, 9%, and administrative costs grow by 4%, then administration will naturally come to represent a smaller proportion of the health care dollar. However, the increasing role of ASO/ASC and FEP products probably



contributes to the low administrative expense ratios and also the change from last year's reported ratios. Note that the ASO / ASC products are approximately 7% of premium equivalents and FEP's administration is at 5.4% of premium. Even the shift to Medicare improves administrative expense ratios since its administrative expense is only 7.8% of premium for this product.

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This slide shows the administrative expenses of each product offered by the Blue Cross Blue Shield universe of plans. The health care needs of plan members vary quite a bit by product as do the associated administrative expenses. I want to key on a few comparisons by way of illustration.

Except for the unique FEP product, the various ASO/ASC products have the lowest per member administrative expenses. They each run approximately \$10 less PMPM which is mainly explained by the lower marketing costs, especially broker commissions, of the larger accounts that are self-insured. FEP costs are even lower than the ASO/ASC costs mainly due to lower marketing costs, but also due to somewhat lower Information Systems costs. Somewhat offsetting these lower costs is that Medical Management costs are higher for FEP. Medicare Advantage administrative costs are more than twice as high as comparable products for younger people because of the high health care needs of seniors. But the difference is not proportional as demonstrated by the low ratios for Medicare Advantage, as shown in the previous slide.

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This is the end of my formal presentation. Just to reiterate, PMPM administration increased by 2.7% versus 4.3% in 2007. However, holding product mix constant, PMPM costs increased by 4.0% versus 2.5% last year. This increase in costs was more than 40% attributable to growth in Medical Management / Quality Assurance / Wellness and Information Systems. There was a shift in product mix in favor of low administrative cost products. While Comprehensive membership grew by 1.0%, growth was focused on ASO / ASC, FEP and MA.

I have attached to the end of this presentation some appendices in support of this presentation. They include our publication schedule for our benchmarks, last year's



costs, how we segment products, the functions found in the clusters we have been speaking of and some notes on our quality assurance and business model.

Now I would like to open this for questions about the results of the Blue Cross Blue Shield benchmarking study.

### *Questions*

I want to again thank you for your participation in this web conference. More in depth and actionable information is available in the benchmarking study itself, which anyone can license. Please contact me directly if you are considering licensing these materials.

I want to add that we'll be having several more web conferences in this series. In August, we'll perform some comparisons between the universes of Independent / Provider - Sponsored and Blue Cross Blue Shield plans, which naturally touches on the benefits of scale. (As you may know, we acknowledge some scalability but, in our experience, its benefits are limited.) In early September, we will highlight our Medicare and Medicaid studies. Late in the fall, we'll resume our series on operational drivers of functional administrative costs, with Erin Sawchuk. We'll follow up in coming weeks with a schedule and hope that you will consider participating again in these web conferences.

I want to close by thanking once again all of you who participated in this study for your efforts. Your efforts not only enhance your own firm's performance but also raise the bar for all other plans.

Thank you.