Transcript

Independent / Provider - Sponsored Administrative Costs Accelerate in 2017

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<Title Page>

Thank you for participating in this year's review of the Sherlock Benchmarks for Independent / Provider - Sponsored Plans. I am Doug Sherlock, President of Sherlock Company.

Health plan managers endeavor to achieve administrative optimal costs. By "administrative" I mean the spectrum of costs ranging from Sales to Claims to Corporate Service and, importantly, Medical Management. If that goal is achieved, favorable health care trends amplify operating profits and mute operating losses. Managing what you measure facilitates your achievement of that goal. In a competitive environment, measurement implies comparison with the leaders of your industry. We offer what many call "the Gold Standard" for health plan benchmarks based on the performance of these leaders.

The 20 Independent / Provider - Sponsored plans that are the subject of this presentation serve 10.8 million people with comprehensive insurance. We believe this universe to be quite robust, though establishing the proportions of the market is difficult. If the seven staff model or government-focused plans are excluded from the 21 members of Alliance of Community Health Plans, eight of the remaining 14 are participants in this year's study. Of the 49 plans listed in the membership of the Health Plan Alliance only 8 are participating in the study but those eight serve 34% of the Health Plan Alliance combined membership. In a nutshell, if an Independent / Provider – Sponsored health plan enjoys national notice, it is likely that it is a participant in this year's benchmarking study.

Before I begin though, I want to express some appropriate thanks. This year marks the 21st year of the Sherlock Benchmarks. Cumulatively, it reflects the experience of approximately 815 health plan years, and includes Blue Cross Blue Shield plans, Medicaid Plans and Medicare Plans in addition to Independent / Provider – Sponsored Plans. This achievement has been possible through the efforts of my talented colleagues, the visionary industry leader Marty Hauser, formerly CEO of SummaCare, and the professionalism of the participating plans especially our primary contacts within those plans. Since the subject matter of this web conference is free of charge and beneficial even to more casual analysts, I hope you share my appreciation.

<Slide 2>

I'm going to breeze through this slide. It shows the topics that I will address, and lists some of the appendices. Note that the appendices contain last year's values and a list of all of the functions in each of the products offered by these health plans. That means that administrative expenses are segmented into more than 700 expense/product cells, each of which are separately analyzed. We only summarize broad trends here. We have also included some Market Segment cost information in the Appendix. Finally, we touch on protocols.

For those who have participated in web conferences in prior years, you may notice a difference in that we'll give greater emphasis on trends in Compensation, Staffing ratios and Outsourcing. The 80% continuity of participation makes that possible.

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

<Slide 3>

This slide summarizes long term administrative cost trends for Independent / Provider - Sponsored Plans. When I speak of growth in costs in this presentation, it will generally be in *per member* terms.

In 2017, excluding the effect of Miscellaneous Business Taxes, Independent / Provider - Sponsored Plans reported administrative cost increases of 5.5%, far higher than the previous three years, and the highest since 2013. The 2017 trend in Account and Membership Administration was also higher compared with the past nine years, with only one other year greater than 2017. We have not shown this but, after the effect of the Miscellaneous Business Taxes, PMPM total administrative expense actually *declined* by 3.8%.

As we will develop, Sales and broker Commissions declined but all other functions increased. Actuarial, Rating and Underwriting, Marketing, Association Dues, Customer Services and License and Filing Fees and Corporate Executive all increased at double digit rates. Staffing ratios were higher, and compensation increased. Outsourcing declined overall, driven by the Information Systems functional area.

The most important sources of increase were Information Systems, Medical Management, Corporate Services and Rating and Underwriting.

To review, you can see both Total costs and Account and Membership Administration sharply increased as the Affordable Care Act came into implementation in 2012 and 2013. Note that they tend to track similarly. Account and Membership Administration expenditure increases were central to Total growth since these core activities of Information Systems, Claims, Customer Services and Enrollment together are 40% of administrative expenses. Back in 2013, not only were existing insured products commonly replaced but their Information Systems had to be reworked as well. The rate of growth in per member costs has declined since then and Total costs fell in 2015.

<Slide 4>

The comparisons on the prior slide are detailed in this one, in the second and fourth columns. These columns reflect the sixteen continuous plans, whose cost values have been reweighted to eliminate differences due to product mix. The first and third columns reflect the as reported values, that is, before the effect of our adjustments to eliminate year-over-year product mix differences. The arced arrows are to draw your attention to the comparison with prior year's values.

The increase in per member costs is in every cluster, and regardless of whether they are as-reported or constant mix. Corporate Services is by far the fastest growing cluster of functions, by more than 11%. Measured by the differences in the annual rates of growth, Corporate Services is also notable for its acceleration – by 9.9 percentage points in 2017 on a constant mix basis. Similarly calculated, all the other clusters, Sales and Marketing. Medical and Provider Management and Corporate Executive and Governance increased in the 6% range.

Growth was marginally higher on a constant mix basis, which implies a shift in favor of lower cost plans among the 16 that participated in the two comparison years.

Overall, and I want to digress slightly, the average commercial mix was 72.5%, up from 71.8% last year. 27.4% of the membership was in ASO, versus 23.3% last year. The various Medicare products was a mean of 10.6% of the total compared with 11.3% last year. Medicaid was 13.5% of membership versus 14.2% last year.

The 20 participating plans had 10.8 million members, the same number as last year, but which that served only 10 million members. The average plan had 405,000 members and the median size was 542,000. The geographic reach extended from coast to coast and the size was roughly evenly disbursed in tiers defined in four 300,000 member increments, plus there were 3 plans with fewer than 100,000 members.

Returning to changes in mix, while the new participating plans were more committed to the commercial market, among the 16 continuous plans, the picture was more nuanced: ASO had a 1.1 percentage point increase in mix, even as total commercial declined by 0.2 percentage points. While Medicare increased by 1.0 percentage points, only 0.8 percentage points was from Medicare Advantage. Medicaid share declined by 1.2 percentage points. Medicare Supplement increased by 0.4 percentage points. The increased focus on the ASO, Medicare Supplemental, combined with the less important shift in Medicare Advantage and the decline in Medicaid gave rise to slower as reported rates compared with when mix is held constant. Overall membership declined at a median rate of 4.4%, and a mean rate of 6.7%.

<Slide 5>

Slide 5 shows the rates of change and the most important reasons for the changes, after eliminating the effect of product mix differences. These are the “real” rates of increase so I will spend a lot of time on this and discuss trends in order of their importance. Costs increased by 5.5% PMPM. As you know, we don’t find many economies of scale here but we have found that some functional areas can be subject to short term swings in enrollment. Based on the decline in membership, that may be helpful context.

The cluster of Corporate Services costs increased by 11.1%, by far its fastest rate over the past five years. Moreover, it sharply accelerated in 2017. Association Dues and License and Filing Fees were the fastest growing function but, as the smallest function, unimportant in its impact on costs. The Corporate Services function was the most important contributor to the cost increase: Human Resources and Legal showed rapid growth in staffing. Risk Management compensation appeared to increase sharply. Outsourcing increased overall but notably in HR and Legal.

Not shown here but Actuarial was the second most rapidly growing function in this cluster. Non-labor expenses increased, outsourcing increased and staffing ratios increased.

The function of Corporate Executive and Governance was also among the fastest growing functional areas in cost growth. In addition to the CEO and COO, this function includes their staff, including enterprise process improvement and enterprise consulting. While this is among the smallest of the functional areas, it was also the fifth largest contributor to cost increases among the 16.

Staffing ratios for the Corporate Executive function increased somewhat and outsourced activities increased slightly as well. Compensation increased as well. One possible reason for this higher compensation is overall improvement.
For the Independent / Provider - Sponsored Plans as a whole, median PMPM operating earnings increased from a *loss* of $7.07 to $1.03, and from -2.9% to 0.7% of revenues.

The Sales and Marketing cluster increased by 6.8%, its fastest rate in the past five years. For the third year in a row, the fastest growing functional area within this cluster was Rating and Underwriting. Rating and Underwriting is not a large function so that its rate of growth made it the third largest in its effect on cost increase in 2017. Staffing ratios surged as outsourcing declined and compensation declined. The sub-function of Risk Adjustment expenses appeared central to growth of this function.

Marketing expenses also increased rapidly, notwithstanding declines in Sales and effectively flat broker Commissions. We are struck by the simultaneous growth in Marketing, along with Actuarial, Rating and Underwriting and Association Dues and License / Filing Fees, which could all be associated with new product development.

Account and Membership Administration accelerated but its growth was less and its acceleration was as well. Customer Services was the fastest growing functional area, and its growth was caused by a sharp increase in staffing. As a reminder, this was after the eliminating the effect of mix changes so we can rule out the sharp increase in Medicare Advantage as a driver.

Information Systems was the most important source of increase in the Account and Membership Administration cluster, which also increased faster than average. Staffing ratios increased as but compensation declined. Outsourcing was sharply lower, a trend evident in Applications Maintenance, Applications Acquisition and Development and Security Administration and Enforcement.

Both Enrollment and Claims posted growth but slower than for the cluster. Staffing for Enrollment was sharply higher as was outsourcing. Staffing declined for Claims but compensation increased.

The cluster of Medical and Provider Management grew by 6.1%, the slowest of the clusters. Having said that, it was also was the highest rate in the past five years. The acceleration and comparisons were evident in both Provider Network Management and Services and Medical Management / Quality Assurance / Wellness functions.

Medical Management was the most important source of increase in this cluster. Across the subfunctions, staffing ratios were higher but compensation was less. Outsourcing ran higher. Case Management appears central to this growth. Staffing ratios were sharply higher though outsourcing diminished. Staffing in Health and Wellness also increased sharply as outsourcing increased. Nurse Information Line, Quality Components and Utilization Review all posted declines in staffing.

Provider Network Management and Services grew slightly more rapidly. Staffing ratios fell as did per FTE compensation. It appears that the decline in staffing stemmed from Provider Contracting.

<Slide 6>

This slide explains the *reported* rates of change, that is, the values with no adjustments for changes in product mix. These trends, again, are based on continuous plans. For the most part, there is a correspondence between the constant mix and as reported renderings. So, I will focus on the differences between the as-reported and the constant mix trends.

On an as reported basis Marketing was the greatest source of cost increase in the Sales and Marketing cluster. One possible explanation is Product Development expenses found in Marketing. Possibly related to this, Actuarial was the fastest growing function in the Corporate Services Cluster. Rating and Underwriting displaced Association Dues as the function with the greatest percent increase. Not shown here, broker Commissions grew modestly while they were essentially flat for on a Constant Mix basis. As with Blue Cross Blue Shield Plans, this broker Commission trend difference may have stemmed from some groups that were previously insured becoming ASO, but the higher commission structure of these accounts remained intact.

Let me close this section with a few summary observations. All my trend comments are based on continuously participating plans and includes the effect of staffing and costs performed on an outsourced basis. Overall, it appears that staffing is higher than last year among continuing plans. Of these continuously participating Independent / Provider - Sponsored Plans have approximately 23.1 FTEs per 10,000 members, though it likely differs between products and market segments. Of the 14 functional areas with staff, seven had ratio increases and none had declines. Key areas of staffing growth included Rating and Underwriting and Actuarial functions.

Compensation had higher median values but varied by function. Eight of the fourteen were lower but some high compensation areas reported increases. Risk Management, Corporate Executive, Finance and Accounting and Advertising and Promotion had above average increases.

Overall, outsourcing was lower than last year. Five of the 14 functions increased in outsourcing while two decreased, notably the substantial Information Systems and closely linked Claims functional areas.

<Slide 7>

Up until now, I have focused solely on the administrative expenses that managers can control. For instance, we have excluded from the discussion capital costs such as interest and dividends because they are the result of financing decisions made at the board level or at least beyond the purview of the operating managers. For those of you with an interest in investment theory, this separation of capital structure from operating performance comports with the observation that they are independent and affect shareholder value regardless of whether the organization or the portfolio manager employs the debt.

For that same management control reason, we have excluded Miscellaneous Business Taxes from this analysis. These taxes, which are primarily associated with the Affordable Care Act, layer in additional costs. Unless the plan restructures to consolidate government business in one non-profit, these taxes are unaffected by management, especially operational management. From an operating perspective, perhaps the central attribute of such taxes is to amplify the need to manage administrative costs.

This Miscellaneous Business Tax expense is not part of the expenses that give rise to the 5.5% total increase, but those costs sharply declined in 2017. Plans posted median Miscellaneous Business Taxes for commercial insured products of $5.46 in 2017, compared with $10.74 in 2016. According to the IRS, "The Consolidated Appropriations Act of 2016, Title II, § 201, Moratorium on Annual Fee on Health Insurance Providers, *suspended* collection of the health insurance provider fee *for the 2017 calendar year only*." Taking this into account, the trend would have been a decline of 3.8%.

So, relative to the roughly $47 PMPM for commercial insured products that prior year $4.55 not paid as an Annual Fee on Health Insurers is substantial. On a constant-mix basis, per member Miscellaneous Business Tax costs decreased by 54.9% down from decrease of 6.4% last year and a surge of 922% in the 2014. The median value of Miscellaneous Business taxes for commercial insured products is $5.32, down from $10.51 in 2016. It is approximately 11% of all administrative costs last year versus 20% in the prior year.

<Slide 8>

To this point, we have focused on rates of change rather than the underlying values of the components of administrative costs. The next few slides speak to the values of these activities, though it is necessarily a summary.

A very rough gauge of trend is difference in the raw numbers between last year's values and this year's. The median PMPM value of $38.35, 0.3% greater than the median value of $38.23 last year. This sharply understates the as-reported increase of 5.2% among continuous participants.

The prior year values are shown in Appendix A and are also excerpted on this page. The total medians are higher, and the cost mixes vary. Recall that the universes of IPS plans vary as well.

There is little correspondence with the overall administrative cost trends on Slide 4 and increases that resulted in the values shown here. Corporate Services, with costs of $6.58 are considerably higher, and it did post the fastest growth. Sales and Marketing posted the slowest as-reported growth and its costs of $10.22 were 2.6% lower.

Account and Membership Administration increased by 6.2% on a constant basis in Slide 4 and was 10.7% lower than last year to $15.32. This is 40% of the overall costs to deliver coverage products to this universe. It is the core elements of Enrollment, Customer Services, Claims and Information Systems.

Medical and Provider Management grew by 6.1% on a constant mix basis but, at $6.80 PMPM, was essentially unchanged from last year.

The costs appear more disbursed. For costs as a whole, differences between 25th and 75th percentile values are greater, and the coefficients of variation tend to be greater as well. This varies by cluster with Sales and Marketing being more dispersed, Corporate Services being more clustered and the other clusters mixed.

<Slide 9>

I have noted the effect of product mix changes on trend and this slide shows what I mean. Note that the ASO products have costs that are about half that of the insured commercial products. The overwhelming reason for the differences stem from Sales and Marketing cost differences, relating to employer group size.

The median ASO PMPM costs are $21.68. Medicaid has the other low-cost products, at $26.34 for HMO and $26.24 for CHIP. That these three are the only ones that are below average illustrates the importance of Medicaid in the overall cost picture.

Insured commercial product costs ranged from $43.10 for POS to $49.67 for Indemnity and PPO. The HMO is the most important product at $46.95.

The highest cost in IPS Comprehensive products is Medicare SNP at $146.97, followed by Medicare Advantage at $84.73. Medicare Supplemental is at $54.35 while the Medicare Cost product is $57.71. Both of the latter two provide Medicare eligible members health benefit coverage for only a subset of the scope of their total benefits.

Medicare Part D is a specialty product, therefore not included in our analysis of comprehensive products. It is also low cost at $20.14, PMPM.

<Slide 10>

This is similar to the previous slide, only expressed in percents of premium equivalents. The median administrative expense relative to premiums was 8.5% while the equivalent value for last year was 8.7%. As an aside, increases in copayments and deductibles can push those ratios higher. In many respects, the relationships between the costs of various products measured in percents parallel those measured in PMPM values. The ASO product has a median value of 5.7%. Like the PMPM ratios this percent is substantially lower than the ratios for insured products that go from 9.5% for POS to 10.3% for Indemnity and PPO. HMO is the plurality product, at 10%.

Like the ASO product, Medicaid HMO is also low cost at 7.1%. Again, the prominence of this product, along with the ASO, explains why the total Comprehensive value is so low. CHIP is higher than average at 11.3%.

Medicare Advantage and Medicare SNP are similar to the commercial insured products at 10.1% and 8.7% respectively. This is consistent with many administrative requirements of insured people tending to track their health needs. The partial benefit Medicare Supplemental and Medicare Costs products are relatively high at 22.2% and 13.4% respectively. (Again, both of these may be responsible for much of the administrative support required of members, though they are at risk for a subset of the health benefits.)

Stand Alone Part D, low cost in PMPM is also low cost in percent, at 6.7%.

<Slide 11>

This slide shows the administrative expenses by cluster of functions. As in the previous page overall costs were at 8.5% of premium equivalents, lower than the 8.7% last year. Except for Sales and Marketing, which increased, the median values for all of the clusters declined or were flat in comparison to the 2016 values shown in Appendix B. These ratios cluster more than are found in the PMPM values on Slide 8. I suspect that this is because local cost differences are as not much reflected in percents.

<Slide 12>

The overall cost trends accelerated by 5.5% (Constant Mix) or 5.2% (As Reported), far higher than the previous three years and the highest since 2013. Account and Membership Administration was also high compared with the past eight years, with only one of them greater than 2017.

The breadth of the expense growth was notable. Each cluster increased more rapidly than the prior year, however growth was calculated. The Corporate Services Cluster sharply accelerated, with Actuarial, Association Dues and License / Filing Fees and Corporate Executive growth as the catalyst.

Information Systems and Medical Management, while not growing quite as fast as some other functions, dominated the increase because of their size.

Staffing ratios increased to 23.1 FTEs per 10,000 members, and grew especially in Rating and Underwriting and Actuarial functions. Outsourcing was lower than last year, notably the substantial Information Systems area. Compensation was higher but focused on Risk Management, Corporate Executive, Finance and Accounting and Advertising and Promotion.

This presentation, (transcript and slides) will be posted on our web site in the next few hours. In addition to these slides, we include last year’s values, some descriptive materials and, for those who might find this of interest, a slide analyzing costs by market segment. By market segment, I mean ACA, Non-ACO, total individual and small, medium and large groups.

Later this summer, we will host similar web conferences for Medicare and Medicaid plans. Additional information, including Tables of Contents on the benchmarks themselves are found on the website. Call me if we can elaborate.

Thank you for your attention to our presentation. Now I would like to open this for questions.

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Questions and Answers

Q: You have used the term "Independent / Provider – Sponsored Health Plans." What precisely do you mean?

A: This universe is a mix of Independent and Provider-Sponsored Health Plans. Of the 20 plans, approximately 13 of them are outright owned or controlled by providers, typically health systems. There are three more health plans that were founded by providers and maintain a notable board presence. There are three additional plans that are independent of national organizations but have pretty much no governance relationships with providers.

Q: I have a follow-up question. Suppose we were interested in a subset of health plans that excluded those organizations that have little relationship with providers: is that possible for you to compile?

A: Yes, easily. For those with an interest in analysis of subsets, please reach out to me off-line.

Q: You mentioned that there was a decline in membership among the plans. Could that have contributed to the increase in costs?

A: That is certainly a possibility. Among the continuously participating plans, membership declined at median rate of 4.4%. We have found that while true economies of scale are scarce and modest, there is some short-term sensitivity to volume. This sensitivity is especially acute in the Corporate Services cluster, which showed the greatest increase in costs.

Q: These plans posted declines in membership: why is that?

A: We did not ask this of the panel but, it appears to be in line with industry trends. For instance, CMS reported two weeks ago that average monthly enrollment in individual market plans decreased by 10 percent between 2016 and 2017. In January, Gallup reported that at the end of 2017, 14.8% of those under 65 had no insurance, up from 13.1% in the prior year.

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

Later in the summer, we will have a similar web conference on the results of the Medicare and Medicaid plans. We hope that you will consider participating in those web conferences as well.

Let me thank the participants for the hard work that goes into the 16th annual edition of the IPS benchmarks. We know, because we measure this, that participation pays off in lower costs. But the "by-product" is something that benefits the industry as a whole. Thank you!

This is Douglas Sherlock of Sherlock Company.