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Beating Medical Trend - *Managed Care vs Reference Based Pricing*

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The Problem

Medical inflation continues to rise at a rate above the growth rate in the economy. Facing rate increases year after year, plan sponsors, with their financial backs to the wall, have historically resorted to cost shifting. These continued failed attempts to control costs have driven some to seek alternate means to restore pricing sanity to health care. To many, the cost of health insurance can mean the difference between profit and loss.

Understanding the cost of health care is directly related to what we agree to pay, more and more employers are questioning managed care contracts upon which their health care costs are based. Many are discovering the truth for the first time. Secretive contracts between health care givers and third party intermediaries contain provisions that guarantee continuous and systematic cost increases. Shared savings side agreements and other schemes found in the health industry economic chain help fuel raging health insurance costs.

Known as medical trend, cost increases have proven to be consistent and predictable. The expected rise in the cost of medical services over time is expressed as an annual percentage increase and is an important element in underwriting future risk. Medical trend is a dominant cost driver in rate making. The annual compounding effect can double or triple health care costs in just a few years.

"For managed care plans, the medical care inflation part of trend is a function of the changes in provider reimbursement rates that are negotiated. To the extent that such negotiations entail factors such as outliers and provider bonuses, the trend rate may be materially more than simply the weighted average increase in fees." Kevin Gabriel, MBA, FSA, MAAA, Chief Actuary of Sierra Berkshire Associates, Inc.,

The Solution

Moving away from managed care contracts, more and more employers are embracing a myriad of reference based pricing models. These models can vary in scope and reach; however all share certain common characteristics in conformance with prudent business practices. Price transparency and claim benchmarking are key elements.

In 2007 – 2008 we approached several of our clients to suggest something different to control costs. The concept was simple. Eschew managed care contracts in lieu of claim benchmarking off multiple data points such as Medicare reimbursement rates. Removing managed care contracts, i.e, PPO, and paying providers quickly, fairly and directly had an immediate impact on claim costs.

After 15 months we performed a study by running 100% of claims back through the prior PPO network reimbursement rates. This exercise proved a net savings of 43% above and beyond the PPO discounts we would have otherwise experienced. Instead of doing the same thing year after year, our clients did something different and it worked.

It has been seven years since our first client exited the managed care world. Subsequently more clients have embarked on the same journey, most with equally good results. None have returned to the world of managed care.

The Evidence

Skeptics may ask "*How have your clients fared over time? Have they won the battle against medical trend?*" The answer may be found by reviewing the experience of four of our clients who have been on a reference based pricing model for five years or more.

Our study is based on actual paid, mature medical claims through succeeding plan years starting in the first year on reference based pricing benchmarked off the prior year under a managed care plan. All claims above stop loss levels have been excluded.

This abbreviated analysis does not recognize changing demographics and plan changes. For example the leveraging effect of higher deductibles will increase trend factors. Of particular importance it should be noted that plan changes occurred in each case through *improved benefits* supported by *claim savings*. This study includes medical claims only.

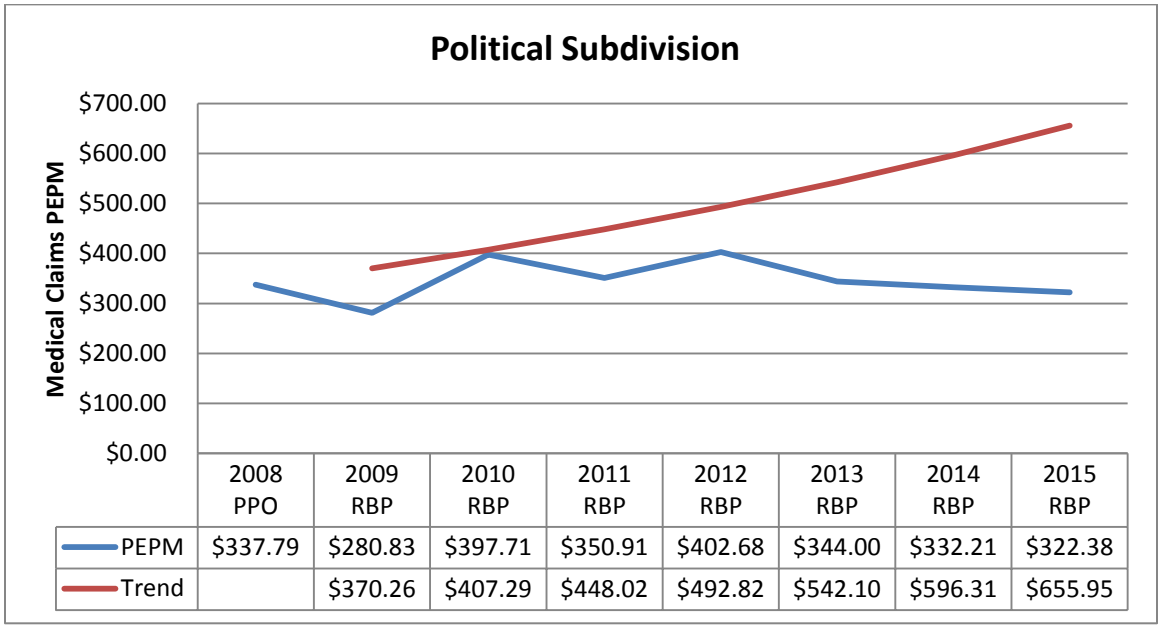
One must understand that medical trend is just one of the factors used to calculate renewal rates for health plans and stop loss insurance. Each year carriers set their own trend level based on various factors, including the current health care inflation rate, analysts' forecasts and their own experiences. However, our clients are self-funded and thus bear most risk with actual trend directly affecting costs without the benefit of pooling to any significant degree.

"*Over the past several years, trend rates have consistently run 8-10% nationally, though certain regions have seen significantly higher or lower figures. Prescription drug trends (which are a component of this) have been more volatile. In the early 2000's these trends were above 15%. They then fell back to single digit levels. But they have now returned to the teens."* – Kevin Gabriel, MBA, FSA, MAA

In comparing our client's experience with average medical trend, we relied upon Heffernan Benefit Advisory Services – 2013 Trend Report; Historical Trend Factors. Based on this report, we are using 9.615% as average annual medical only trend factor.

Political Subdivision – 400 Employee Lives

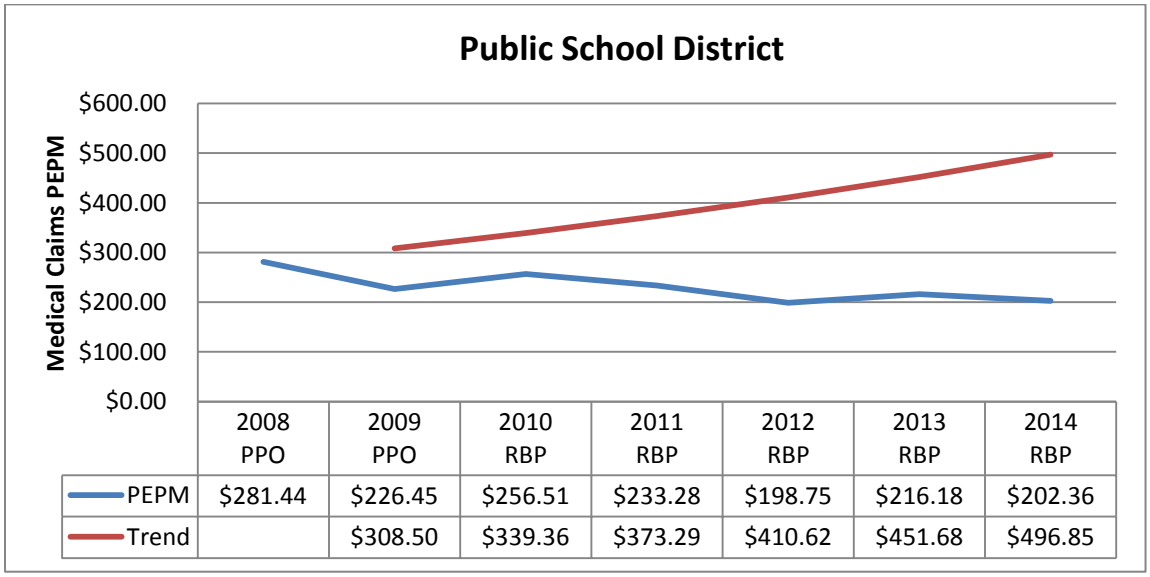
This case has been on RBP for 7 years. They experienced poor claim years in 2010 and 2012. In 2012, for example, there were 14 large claims that approached or exceeded $125,000. Medical PEPM for 2014 and 2015 (to date) is less than 2008. Benefits have been improved; no deductible or co-insurance features with all benefits subject to co-pays only. Funding increase over seven years has been 15.6% or 2.23% per year.



	2008 PPO	2009 RBP	2010 RBP	2011 RBP	2012 RBP	2013 RBP	2014 RBP	2015 RBP
PEPM	$337.79	$280.83	$397.71	$350.91	$402.68	$344.00	$332.21	$322.38
Trend		$370.26	$407.29	$448.02	$492.82	$542.10	$596.31	$655.95

Public School District – 900 Employee Lives

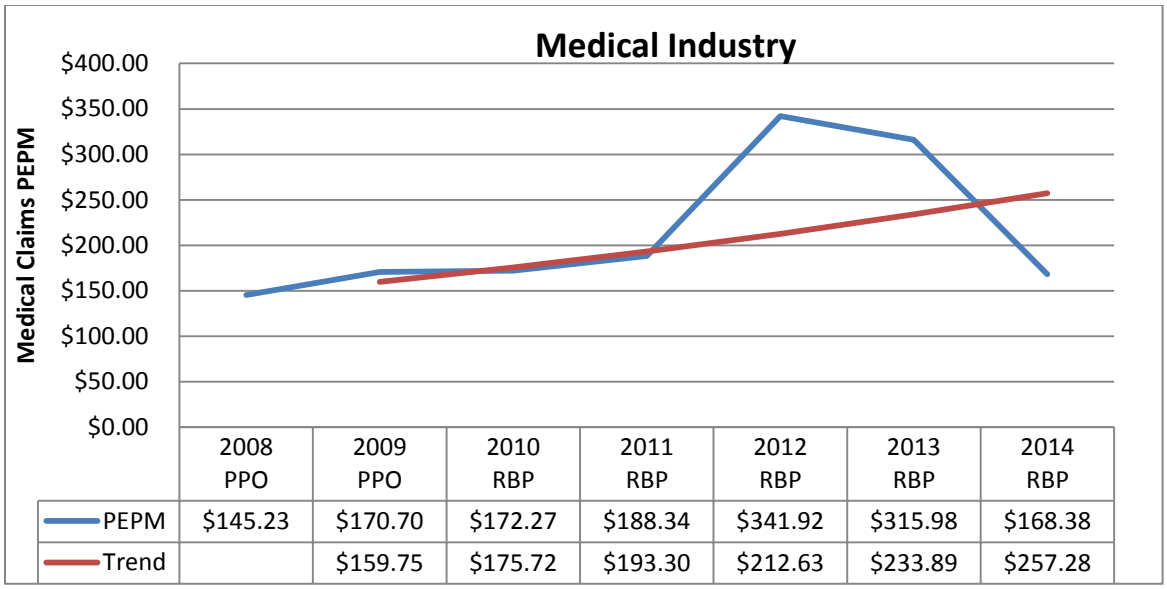
This case has demonstrated a consistent downward claim trend. Current PEPM (2015) is less than 2008-2009. No benefit reductions. Some benefit improvements. Plan funding has remained essentially static for the past five years.



	2008 PPO	2009 PPO	2010 RBP	2011 RBP	2012 RBP	2013 RBP	2014 RBP
PEPM	$281.44	$226.45	$256.51	$233.28	$198.75	$216.18	$202.36
Trend		$308.50	$339.36	$373.29	$410.62	$451.68	$496.85

Medical Industry – 280 Employee Lives

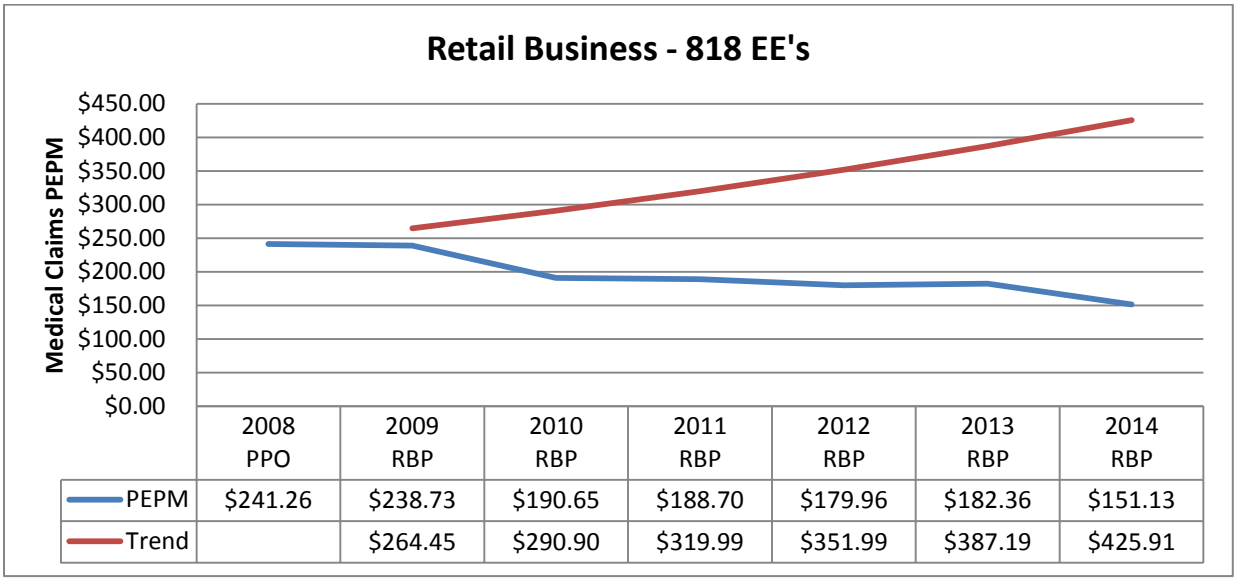
Plan year 2012-2013 experienced an outlier year with several large claims and 34 pregnancies. Current medical PEPM is 16% higher than under managed care plan in 2008-2009, representing a 2.66% increase per year (sans outliers). This illustrates that higher utilization and outlier claims will result in increasing cost which would occur under either managed care or RBP model. However, RBP trend factor continues below industry benchmarks.



	2008 PPO	2009 PPO	2010 RBP	2011 RBP	2012 RBP	2013 RBP	2014 RBP
PEPM	$145.23	$170.70	$172.27	$188.34	$341.92	$315.98	$168.38
Trend		$159.75	$175.72	$193.30	$212.63	$233.89	$257.28

Retail Business – 818 Employee Lives

This case has consistently been well below medical trend. Current medical PEPM is significantly lower than plan year 2008-2009. This case has not raised plan contributions in seven years.



	2008 PPO	2009 RBP	2010 RBP	2011 RBP	2012 RBP	2013 RBP	2014 RBP
PEPM	$241.26	$238.73	$190.65	$188.70	$179.96	$182.36	$151.13
Trend		$264.45	$290.90	$319.99	$351.99	$387.19	$425.91

Conclusion

Managed care has failed. Medical costs continue to soar. Providers are charging more and we continue to agree to blindly pay up through secretive contracts negotiated by vested interests. Medical trend has, and continues to be, consistently at double digits or close to it.

Cost plus insurance / reference based pricing is a proven method to maintain and even improve comprehensive coverage while at the same time keeping costs reasonable, predictable and consistent. Industry sources estimate reference based pricing plans represent 10% market share and rising. An east coast hedge fund, seeking opportunities in reference based pricing models, predicts reference based pricing will gain 60% market share within the next five years.

"What moves things is innovation. But it's not easy to innovate in stagnant, hyper-regulated, captured sectors" - Max Borders (www.fee.org) Cost shifting under the Affordable Care Act will continue to fail to control costs.

Reference Based Pricing represents the last frontier in *innovation* to control health care costs in a tightly regulated and controlled market.

Plan sponsors can reasonably expect to reduce their health care costs below medical trend without benefit reductions or cost shifting of any kind.

About The Author

Bill Rusteberg is a fee based insurance consultant and principal of RiskManagers.us since 1998. He has been involved in the insurance industry for over 41 years specializing in self-funded employee welfare plans. Bill has spoken nationally on continuing changes affecting our health care delivery system, most recently at the Physician Hospital of America (PHA) annual forum in 2013 and the Health Care Administrators Association (HCAA) Executive Forum in 2014. Bill walks his audience through the complicated maze of the American health care delivery system. He exposes industry secrets that drive costs by outlining specific findings not generally known to Plan Sponsors. Bill offers common sense solutions to ever increasing health care costs. Armed with the knowledge industry insiders have kept hidden for years, Plan Sponsors are, for the first time, empowered to negotiate with insurance companies, managed care organizations and other third party intermediaries from a position of strength and can better achieve cost effective health care for their employees while often improving benefits at the same time. Bill is a licensed Risk Manager, Life & Health Counselor, Property & Casualty / Life & Health Insurance agent and Surplus Lines broker in Texas. He holds reciprocal licenses in several other states.

About RiskManagers.us

RiskMangers.us is a specialty company in the benefits market that, while not an insurance company, works directly with health entities, medical providers, and businesses to identify and develop cost effective benefits packages, emphasizing transparency and fairness in direct reimbursement compensation methods

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