Medical Expense Trend Targets: Methodology Options

Rhode Island Health Insurance Advisory Council
January 17, 2012

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Presentation Outline

1. Confirmation of our task
2. Refresher regarding medical expense trend and prior HIAC discussion on the topic
3. Seven methodology considerations, with a focus today on:
   - Our objective for the target
   - The nature of the target
   - How the target is set
4. Historical RI trend experience compared to an index
5. Options for use of an index for setting medical expense trend targets

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Confirming Our Task

- To develop a common understanding of how OHIC could define, set and enforce a maximum medical expense trend factor(s) to be used as part of an annual commercial health insurance rate factor review process.

- To recommend whether such a methodology should be implemented by OHIC as part of its rate review process.

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Refresher:
Key Information Re: Medical Expense Trends

- Medical expense trend is the projected increase in the costs of medical services assumed when setting premiums
- It is composed of two factors:
  - Price (including assumptions re: service mix)
  - Utilization
- It is generally calculated for five categories of cost
  - Hospital Inpt, Hospital Outpt, Primary Care, Other MD, Rx

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Refresher:
Key Information Re: Medical Expense Trends

- Underwriting projections are subject to a natural lag in the underwriting cycle, *when costs are decelerating forecasts tend to overestimate trends; when costs are accelerating forecasts tend to underestimate trends*.
- "…insurers and PBMs tend to make conservative projections for cost increases. Historically, forecasts are generally higher than actual experience."*

* 2012 Segal Health Plan Cost Trend Survey www.segalco.com/news-events/press-releases/?id=689

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Refresher:
Key Information Re: Medical Expense Trends

- Experience data is not comparable year-to-year due to changes in benefit design, for example comparing PMPM claims will always understate trends because it does not account for changes in employee cost sharing.
- More broadly, trend targets can't address the impact of aging, adverse selection, plan design, utilization trends, price trends on incurred medical expense trend.

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What HIAC has decided so far:

1. Focus on opportunities for setting aggregate medical expense trends, not trends by expense category.

2. Focus on the net actual trend to be experienced by the population covered by the carriers – segmented into large and small group.

3. Focus on setting plan-specific targets, rather than an aggregate target across carriers.

4. Do not focus on complementary strategies for achieving those targets (discussion noted that this has already been accomplished with affordability standards).

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Lessons From Other States

- Limited work by states so far on this topic. More on developing comprehensive rate review (we already have) and some discussion of payment reform.
- How would formal targets or caps to trends add to pressure created by attention, reports and publicity (Massachusetts).
- Any effort should have clear standards for setting trends and flexibility to adjust.
- Any effort should have sufficient analytical resources and industry experience.

Seven Methodology Considerations

1. What is our objective for the target?
2. What should be the nature of the target?
3. How should the target be set?
4. Is the target a goal or a requirement?
5. What are implications if an insurer proposes a rate that exceeds the target?
6. What state resources (e.g., data, staff) are needed to successfully implement the approach?
7. What help (if any) will insurers need to meet the targets?
8. What are the risks to each approach for setting the target (e.g., medical expense reported as admin expense), and what steps might be taken to mitigate them?

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Focus of This Meeting

1. What is our objective for the target?
2. What should be the nature of the target?
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What is the objective for the target?

- If OHIC's charge is to address affordability, how should HIAC define affordability of medical expense trend?
- Is an affordable trend rate one that grows at the rate of:
  - Wages?
  - Economic production?
  - Prices
    - Medical prices?
    - Non-medical prices?
    - Producer prices?
    - Consumer prices?

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What should be the nature of the target?

HIAC has already made the following decisions:

1. Trend rate target to be insurer-specific
2. Trend target to be business line-specific (i.e., large group and small group)

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How should the target be set?

1. Forecasts
   - Government sources (e.g., CMS, CBO)
   - Actuarial consultants (e.g., PwC)
2. Indices:
   - Consumer Price Index (CPI)
     - CPI less food and energy
     - CPI less medical
     - CPI Northeast
   - Producer Price Index (PPI)
   - nominal gross domestic product plus 1 percent (used in Wyden – Ryan Voucher Plan for Medicare)

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Forecasting

- Carriers develop their rate proposals using forecasting.
- Forecasting depends upon multiple variables:
  - Understanding the variables that influenced past spending and how they might be expected to change
  - Macro-economic trends (e.g., a recession)
  - Planned strategies to mitigate trend (e.g., benefit design change, disease management, payment reform)
  - Changes in supply (e.g., new drugs, hospital expansion, nurse shortage)
  - Legislation (e.g., covered populations, mandated benefits)
  - Market leverage (consolidation vs. competition)
  - Demographics

Challenges in Using Forecasting to Set Targets

- Forecasts define predicted medical expense cost growth, but not how much less medical expense could or should.
- Forecasting is complex - and not always accurate due to unforeseen events.
- Using forecasting to set rate targets will be even more complex, since estimates of avoidable spending will need to be developed each year to set the target.
- Forecast may yield targets that are more closely connected to likely medical expenses trend than general indices – a strength or a weakness?

Indices

- Indices track both broad and more narrowly defined economic trends.
- They provide a general gauge of economic activity.

Before considering use of an index, be aware...

- By definition all of these economic indexes are built using *retrospective* data*;* medical expense trend targets must be applied *prospectively.*
- Key index considerations:
  - data captured by the index and its intended use
  - specific version of the index, for example the PPI is not one index, but a “family” of indexes, each with different components
  - who puts out the index and what their update and revision schedule is
  - any costs associated with using the index
  - if forecasts are available

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Consumer Price Index (CPI)

- The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.
- Published monthly by the Bureau of Labor Statistics (BLS)
- Most volatile section of the CPI is food and energy which together represent 23% of the index

Consumer Price Index (CPI)

- Medical care represents 7% of the index
  - medical care commodities 2%
  - medical care services 5%
    - professional services 3%
    - hospital and related services 2%
- The BLS publishes many data series, including for:
  - CPI less food and energy
  - CPI less medical care
  - a regional CPI for the Northeast

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Historical Relationship Between CPI and Medical Expense Trend in Rhode Island

Three distinct analyses of BSBSRI and UHC:

1. comparison of requested and approved medical expense trend with the CPI for 2009-2012
2. medical expense trend expressed as a multiple of CPI for 2009-2012
3. total medical expense trend, with a breakout of the price and utilization components for 2009-2012

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Special Notes About The Data

- Medical cost trend data for 2009 consists of 1 quarter of 2008 and three quarters of 2009
- Primary care was not reported as a separate category for 2009
- The CPI data is that for All Urban Consumers for 2009 and 2010.
- The 2011 and 2012 data are taken from a consensus forecast, “Survey of Professional Forecasters, November 14, 2011” published by the Federal Reserve Bank of Philadelphia.

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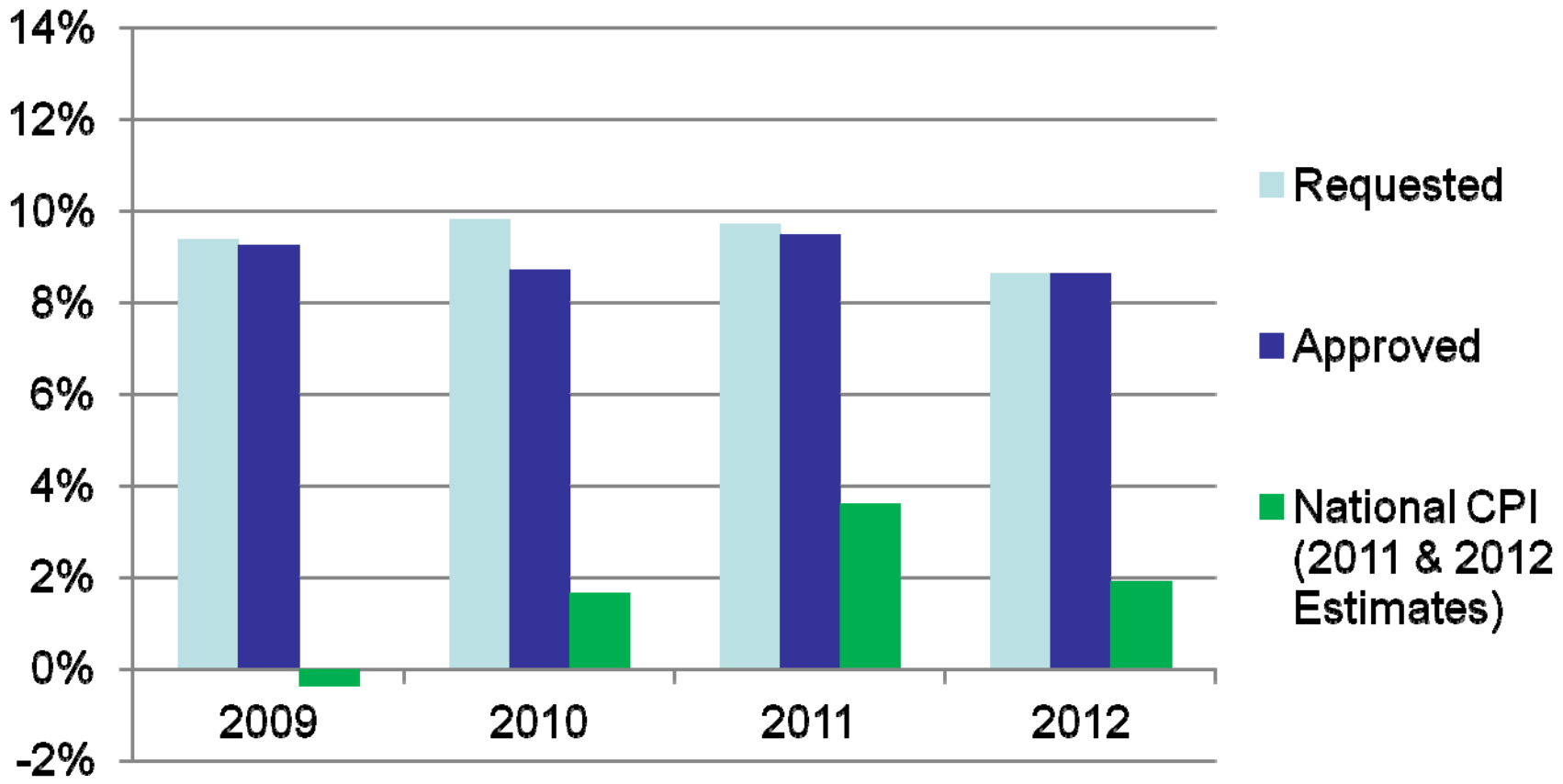
Weighted Average Medical Cost Trend BCBSRI Large Group Compared to CPI



Note: In 2010 OHIC asked carriers to withdraw their initial 2010 medical cost trends and resubmit them; the requested and approved trends for 2010 shown are from the second review.

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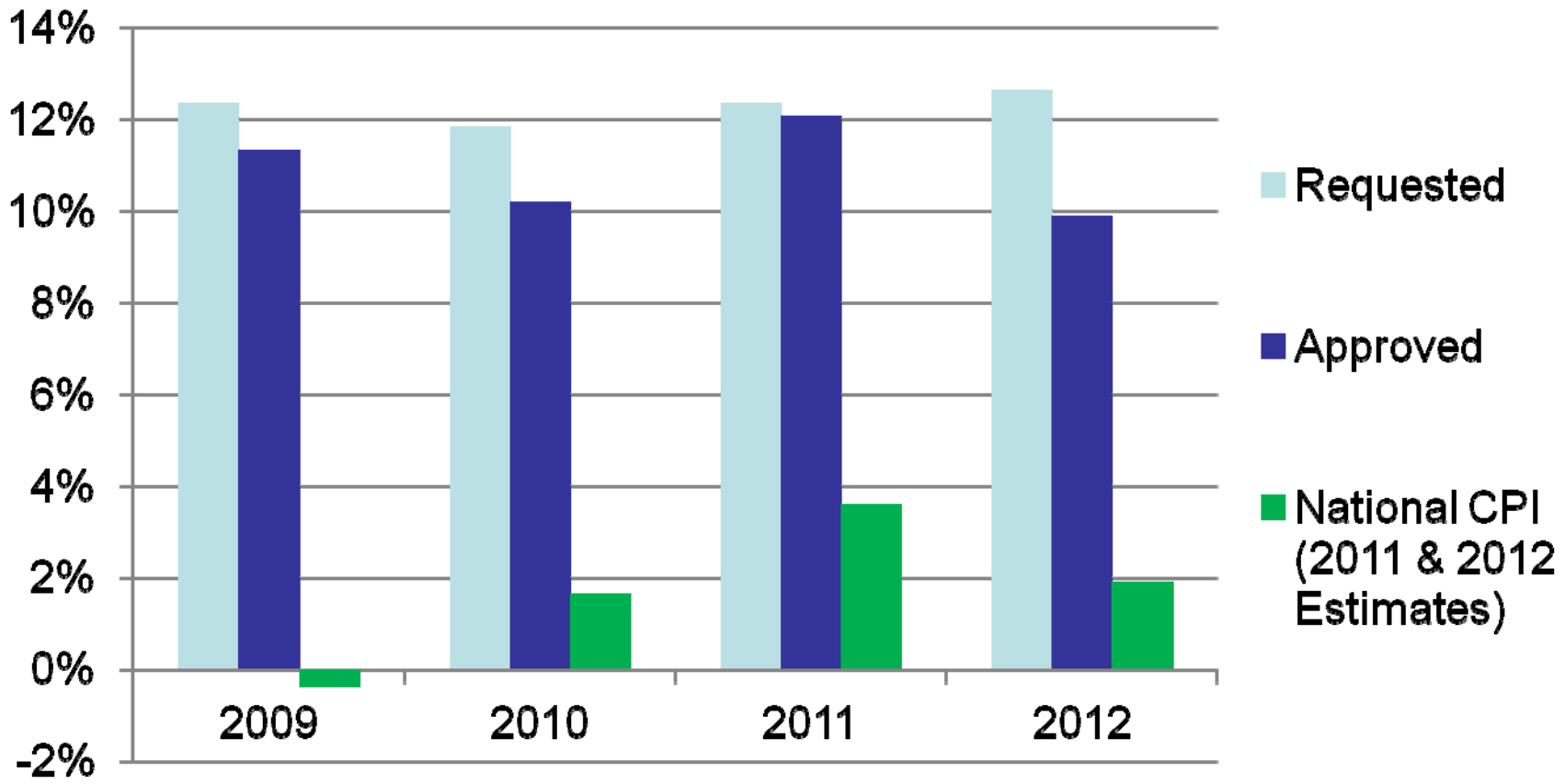
Weighted Average Medical Cost Trend
UHC Large Group Compared to CPI



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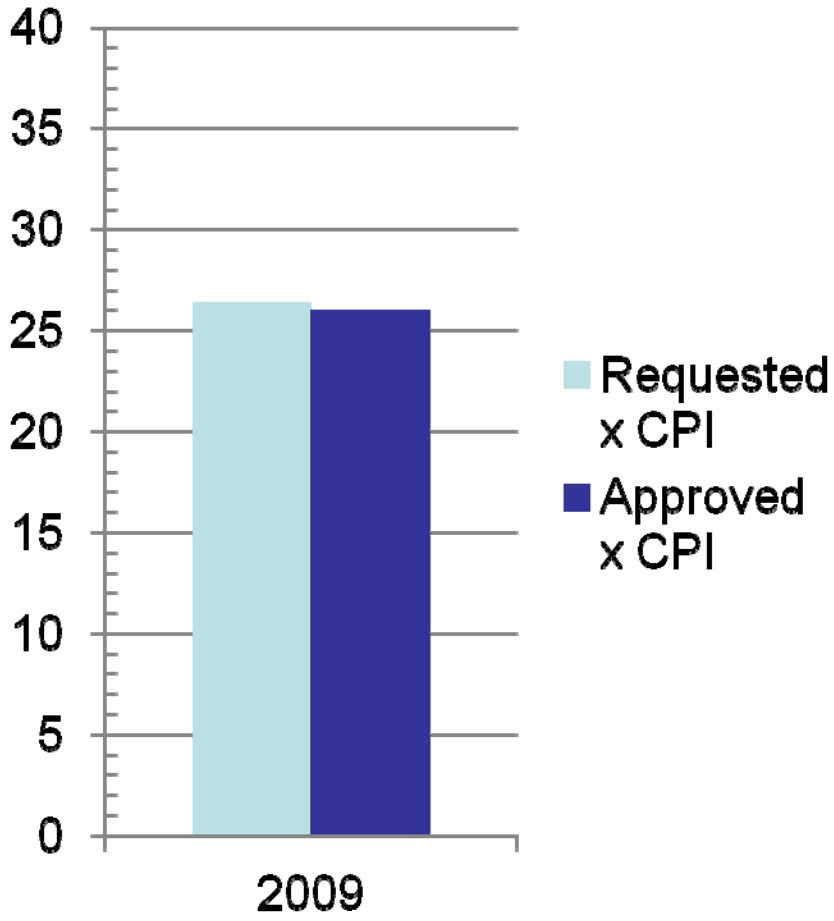
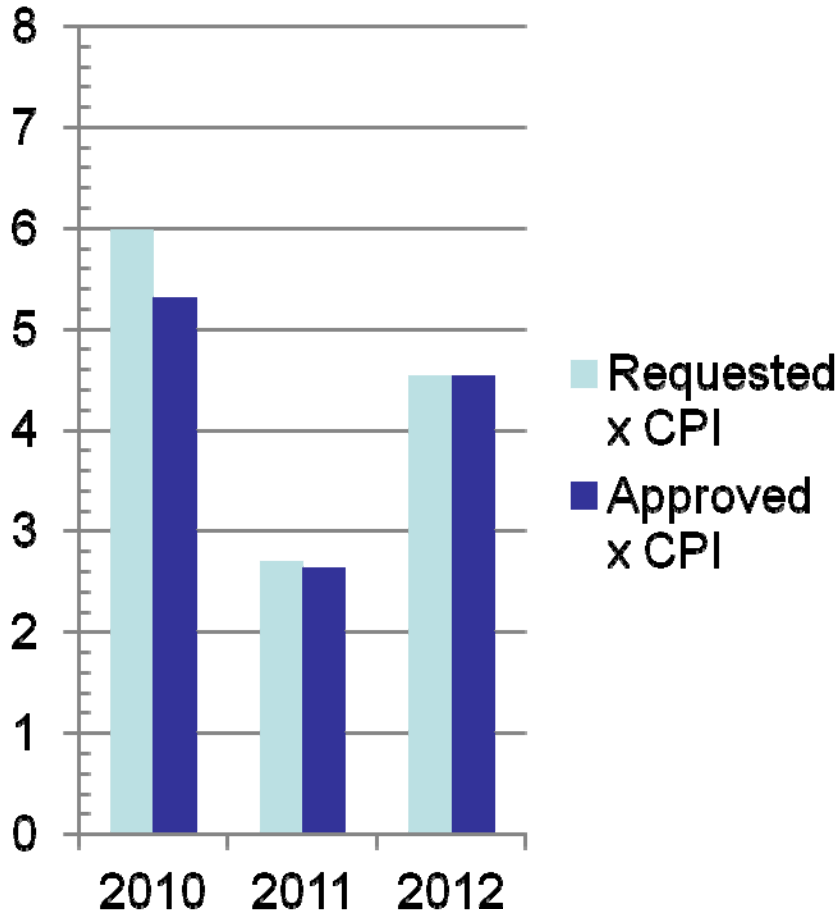
Weighted Average Medical Cost Trend
BCBSRI Large Group as a Multiple of CPI





In 2009 the CPI was negative, hence the medical expense trend as a multiple of the CPI is a negative number. However, the medical cost trend should be considered as being above the CPI and is presented as such.

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Weighted Average Medical Cost Trend
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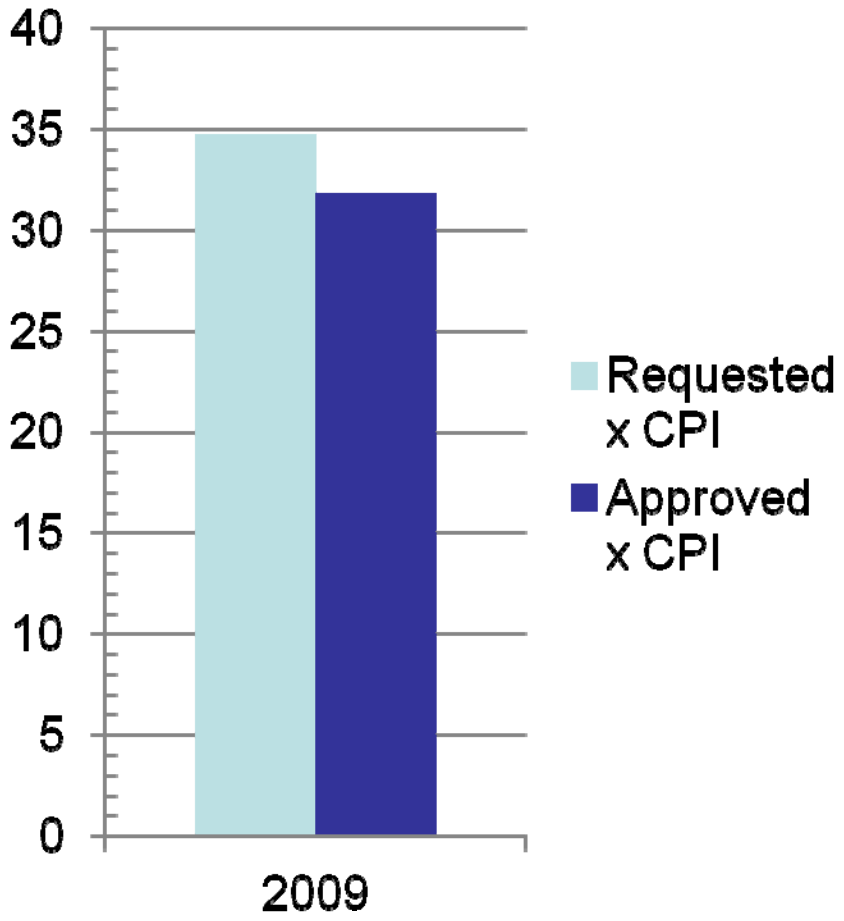

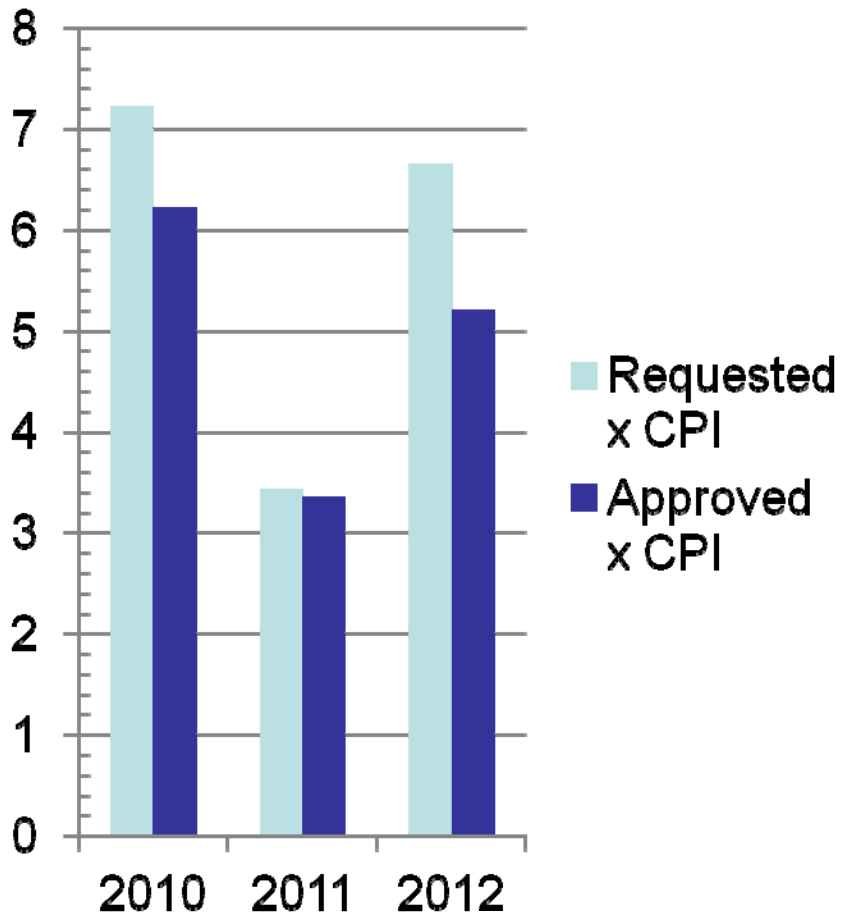

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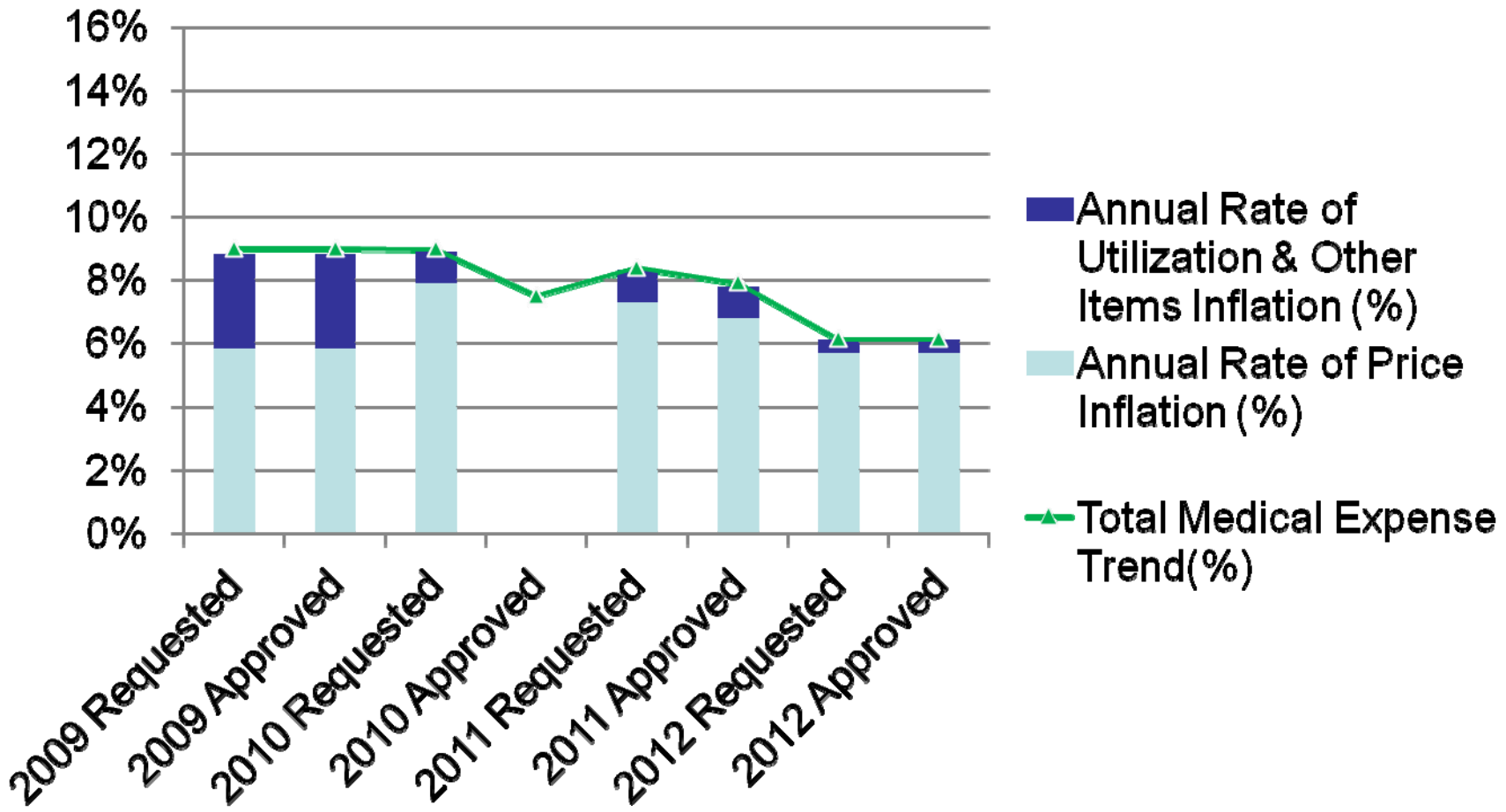
Hospital Inpatient Medical Cost Trend
BCBSRI Small Group, Price vs. Utilization



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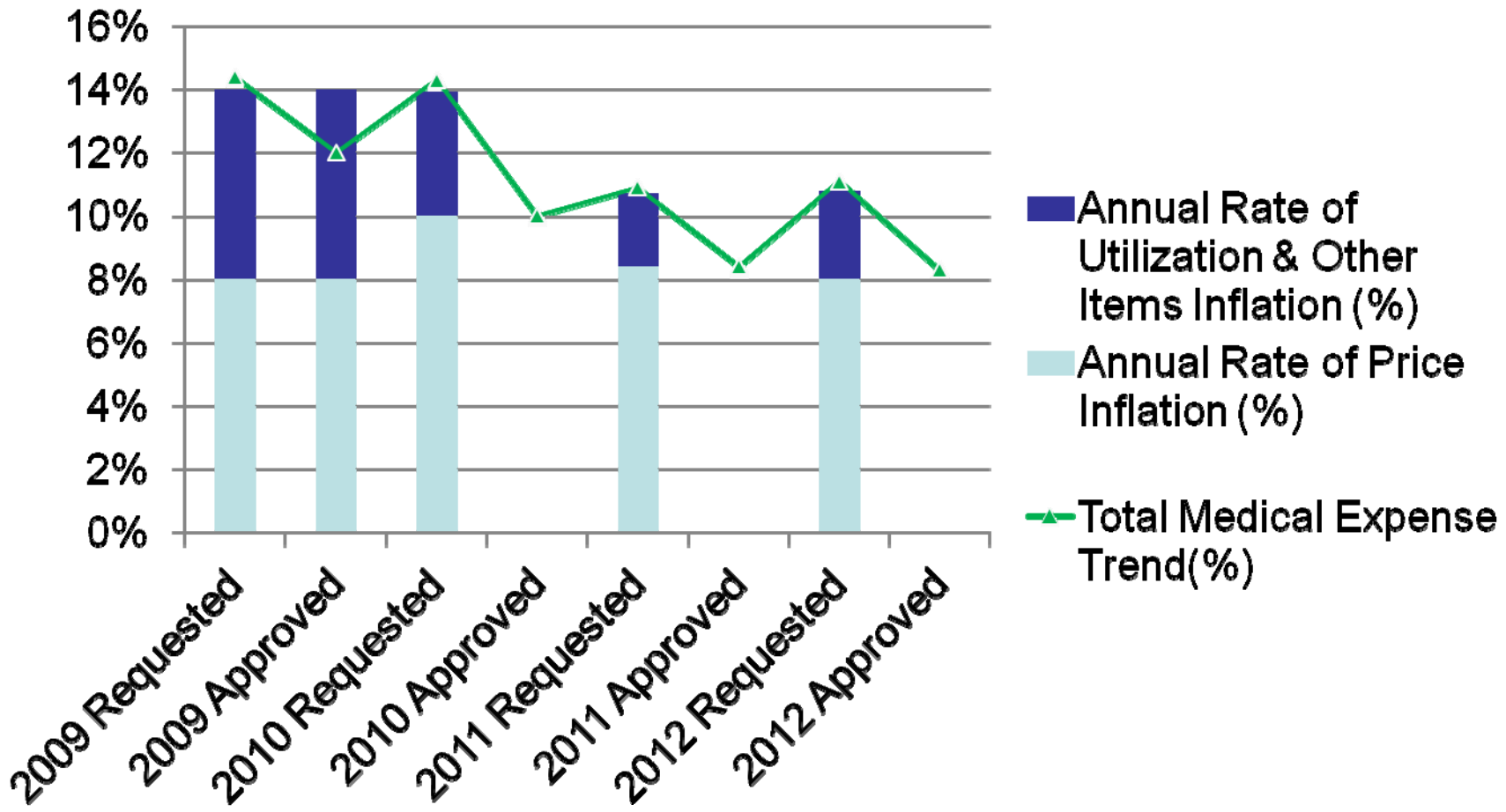

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Hospital Outpatient Medical Cost Trend
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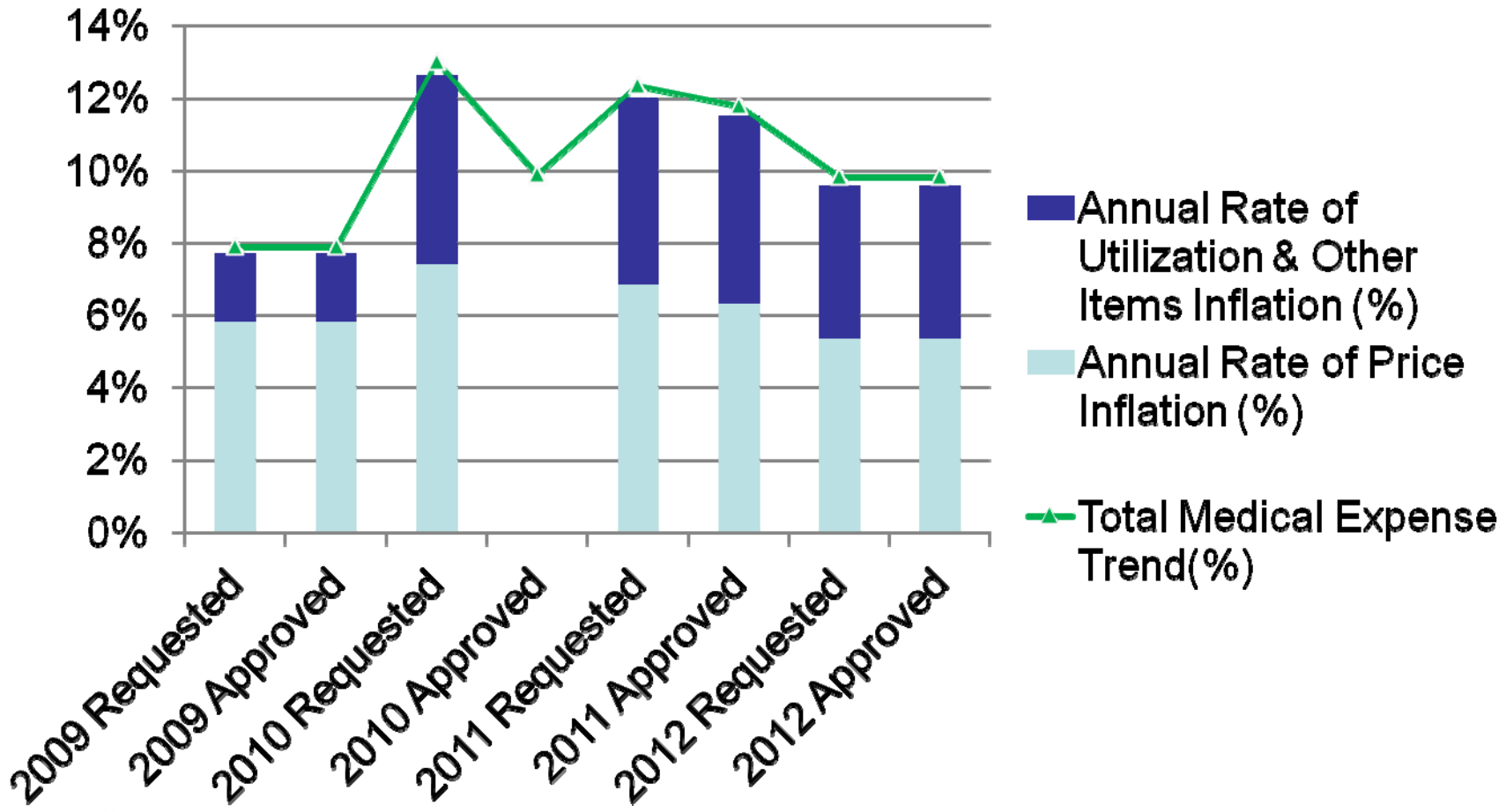

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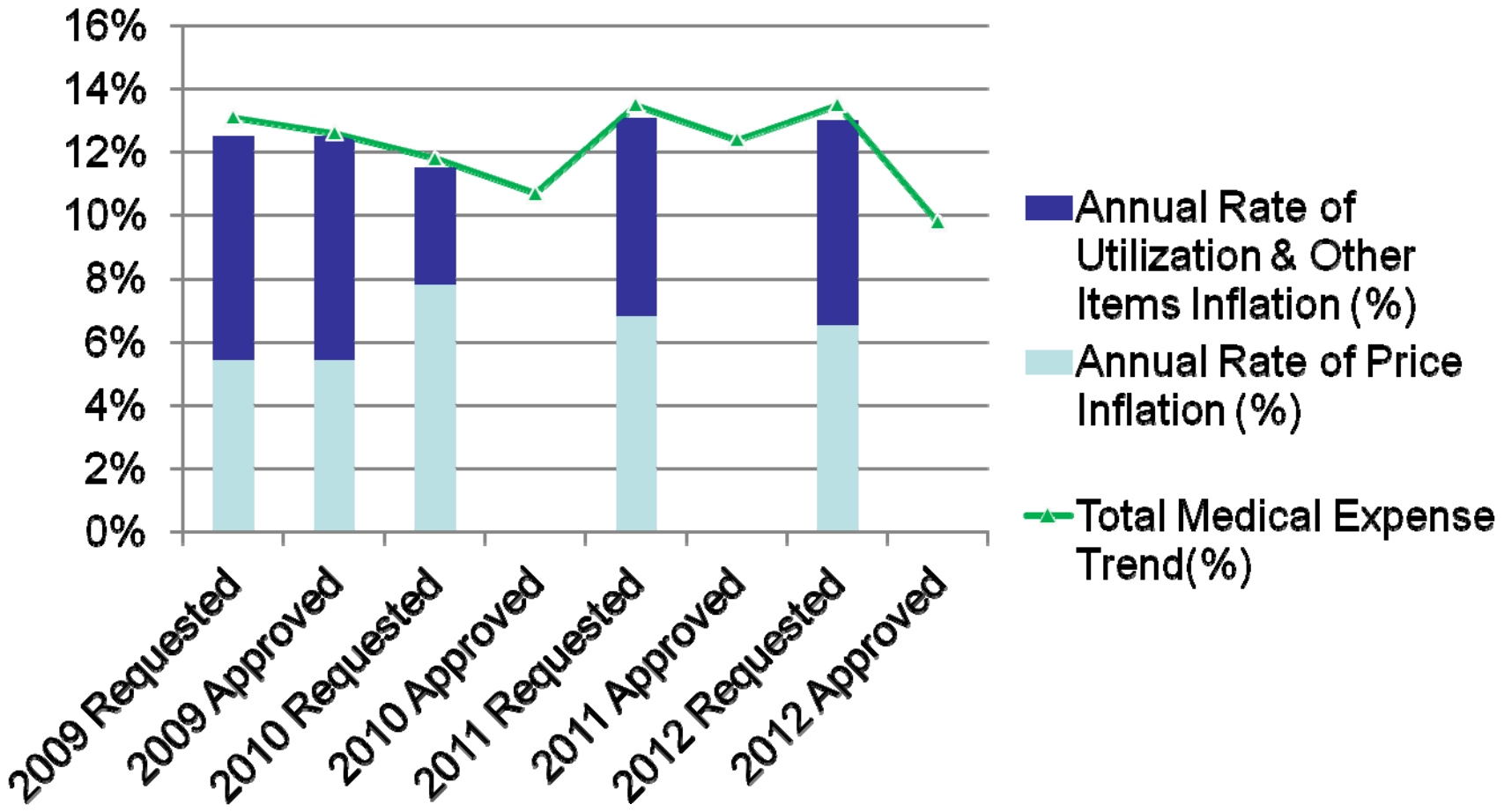

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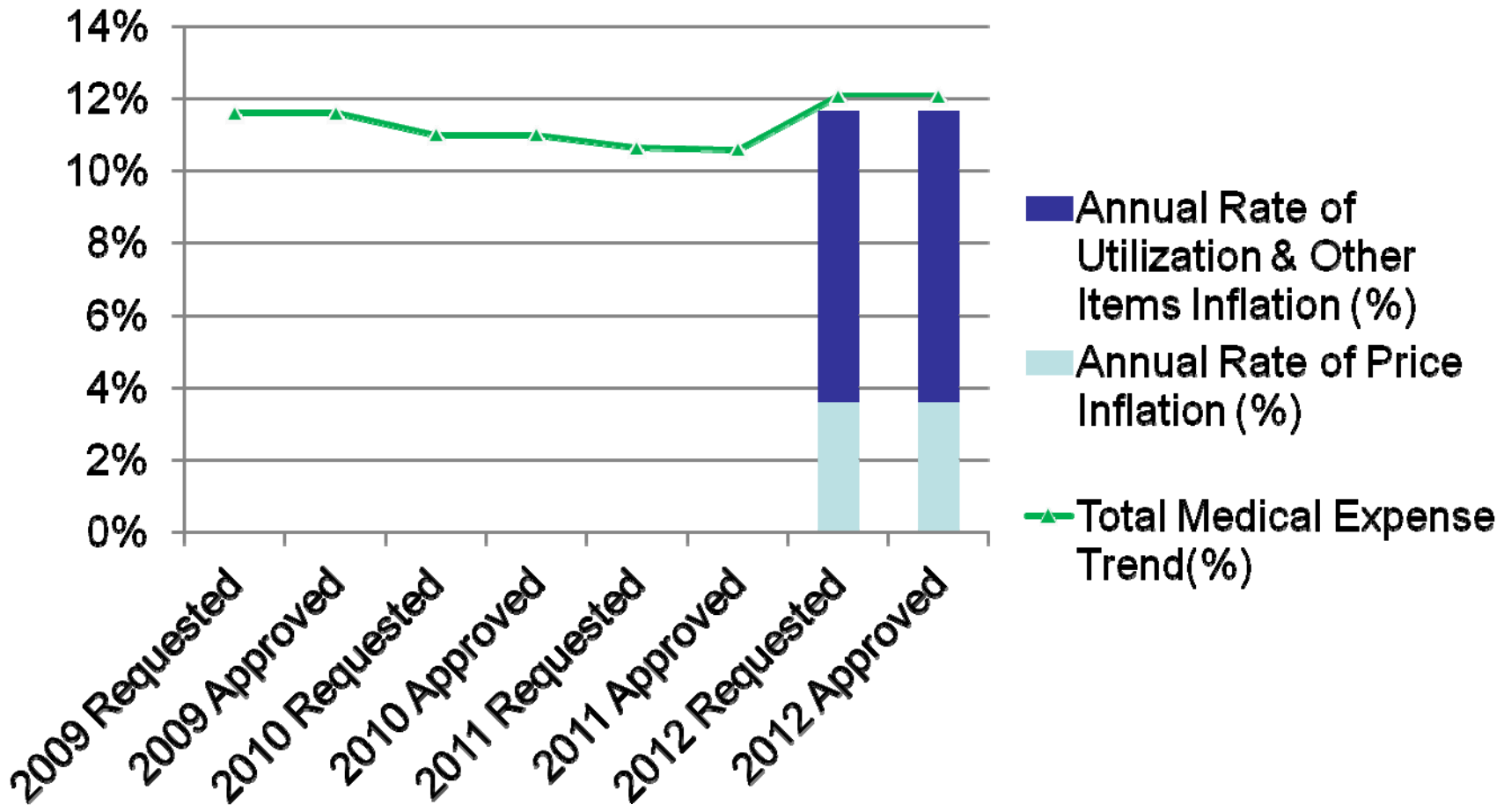
Pharmacy Medical Cost Trend
BCBSRI Small Group, Price vs. Utilization



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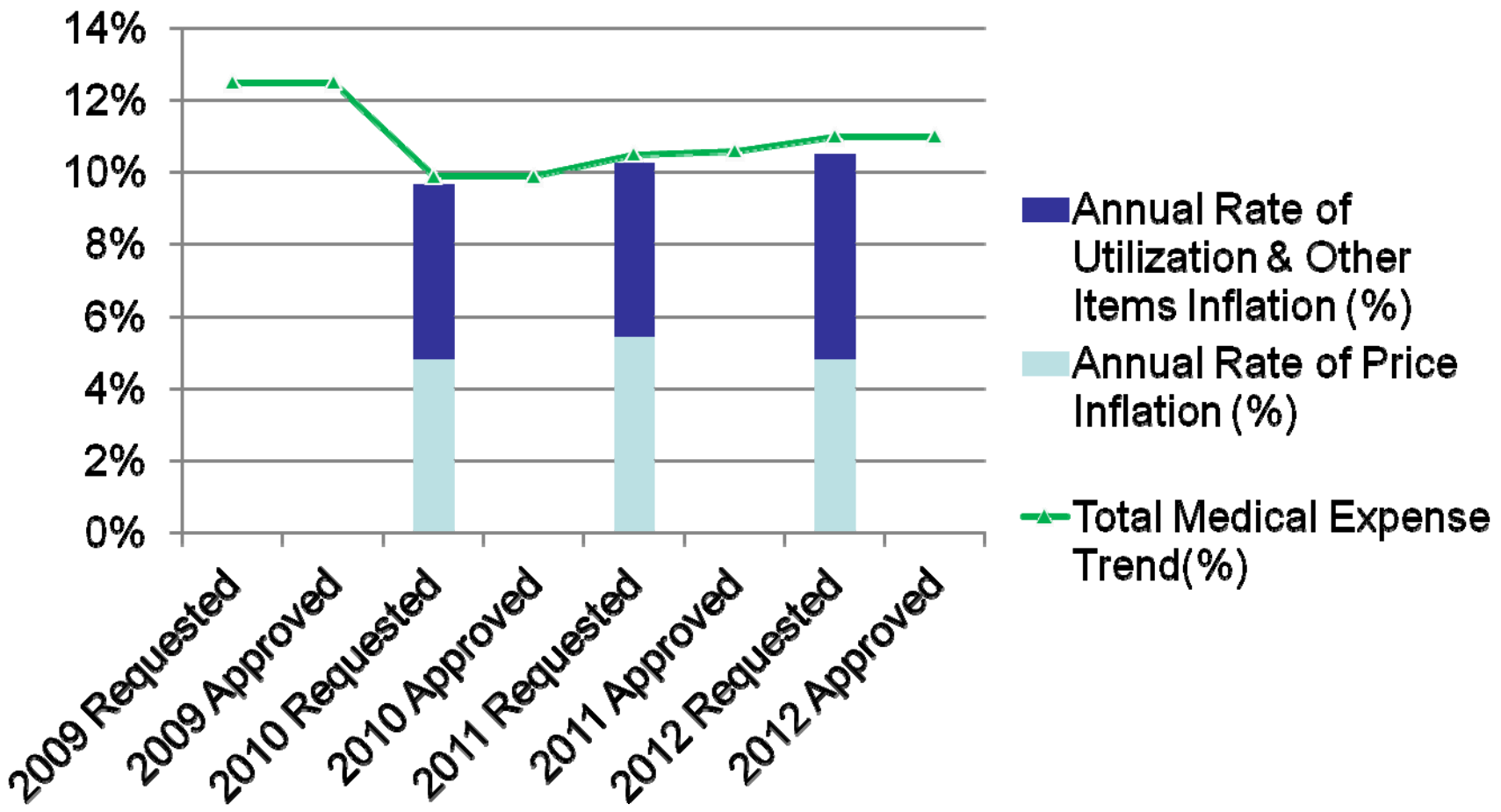

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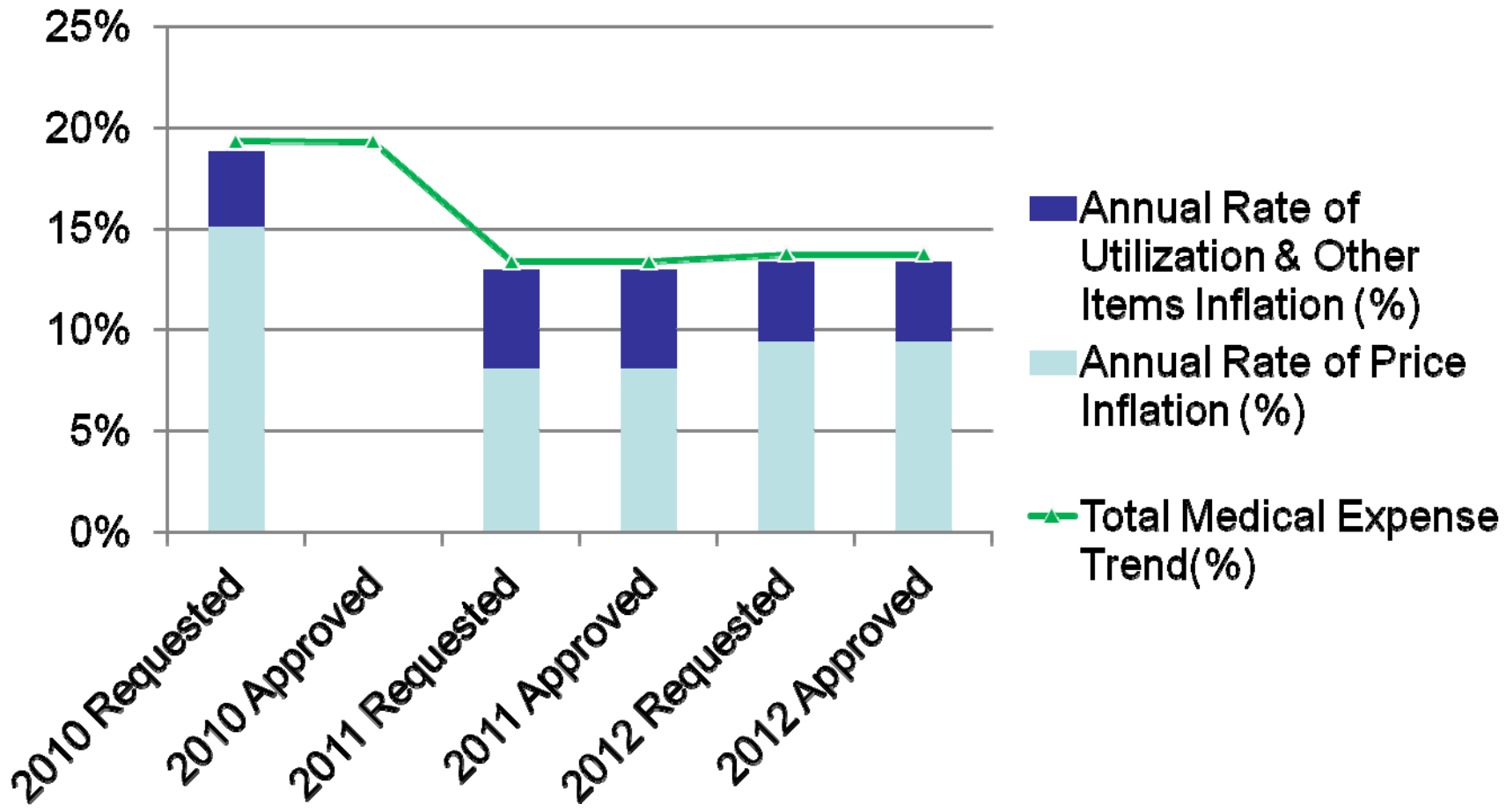
Primary Care Medical Cost Trend
BCBSRI Small Group, Price vs. Utilization



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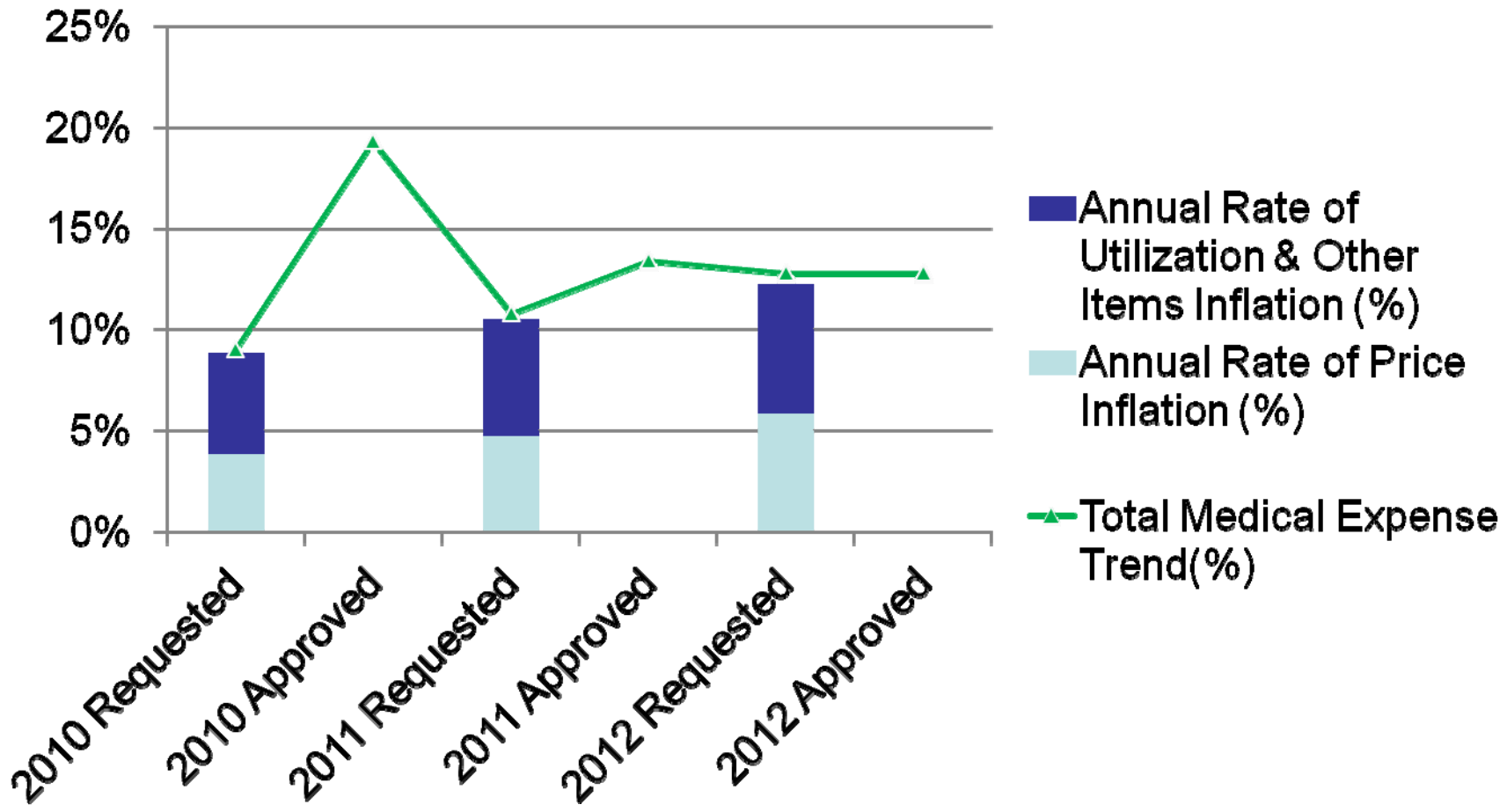

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Index Options

- Consumer Price Index (CPI)
  - CPI less food and energy
  - CPI less medical
  - CPI Northeast
- Producer Price Index (PPI)
- Nominal gross domestic product (GDP) plus 1 percent (used in Wyden – Ryan Voucher Plan for Medicare)

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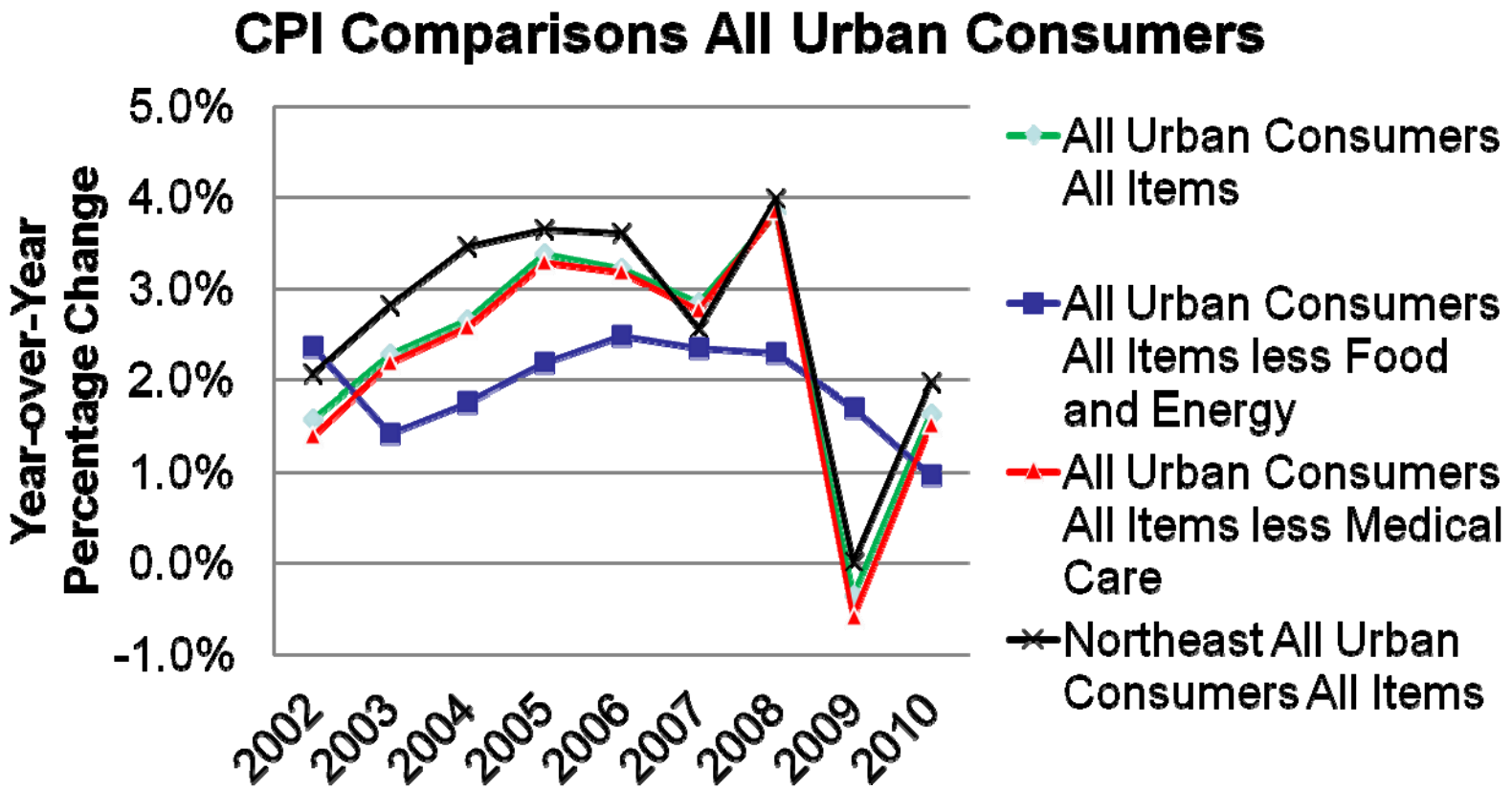
CPI Indices: Four Options



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CPI Index Comparison: General Observations

- The CPI including all items and the CPI excluding medical expense tend to move in the same direction
- The CPI excluding food and energy is much less volatile that the two other indexes
- The Northeast CPI is generally higher than the national all urban consumers CPI

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Producer Price Index (PPI)

- The Producer Price Index is a group of indexes that measures the average change over time in the selling prices received by domestic producers of goods and services. The PPI measures price change from the perspective of the seller.
- The target set of goods and services included in the PPI is the entire marketed output of U.S. producers. The includes both goods and services purchased by other producers as well as goods and services purchased by consumers either directly from the service producer or indirectly from a retailer.
- The PPI contrasts with the CPI which measures price change from the purchaser's perspective. Sellers' and purchasers' prices may differ due to government subsidies, sales and excise taxes, and distribution costs.

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CPI Compared with PPI

- Major difference between the PPI and the CPI are:
  - Uses
    - The PPI is used to deflate revenue to measure real growth in output
    - CPI is used to adjust income and expenditures for changes in the cost of living
  - What is included in the indexes
    - The CPI includes services, imports, and sales taxes; the PPI excludes them
    - Distribution costs are included in the CPI, but not in the PPI
    - The PPI includes capital equipment and the CPI does not
- Given that the CPI is focused on what consumers pay for products and services, it seems the more relevant choice for a medical expense target

Gross Domestic Product (GDP)

- Gross Domestic Product is the market value of all final goods and services produced in the country
- “Nominal GDP” is GDP based on current market prices
- “Real GDP” is GDP adjusted for the impact of inflation/deflation in prices and is what is most commonly reported in the media
- “Nominal GDP + 1%” is an idea that was proposed in the revised Wyden – Ryan Voucher Plan for Medicare
- Using nominal GDP or nominal GDP +1% would show both the change in production (volume) and the change in price.

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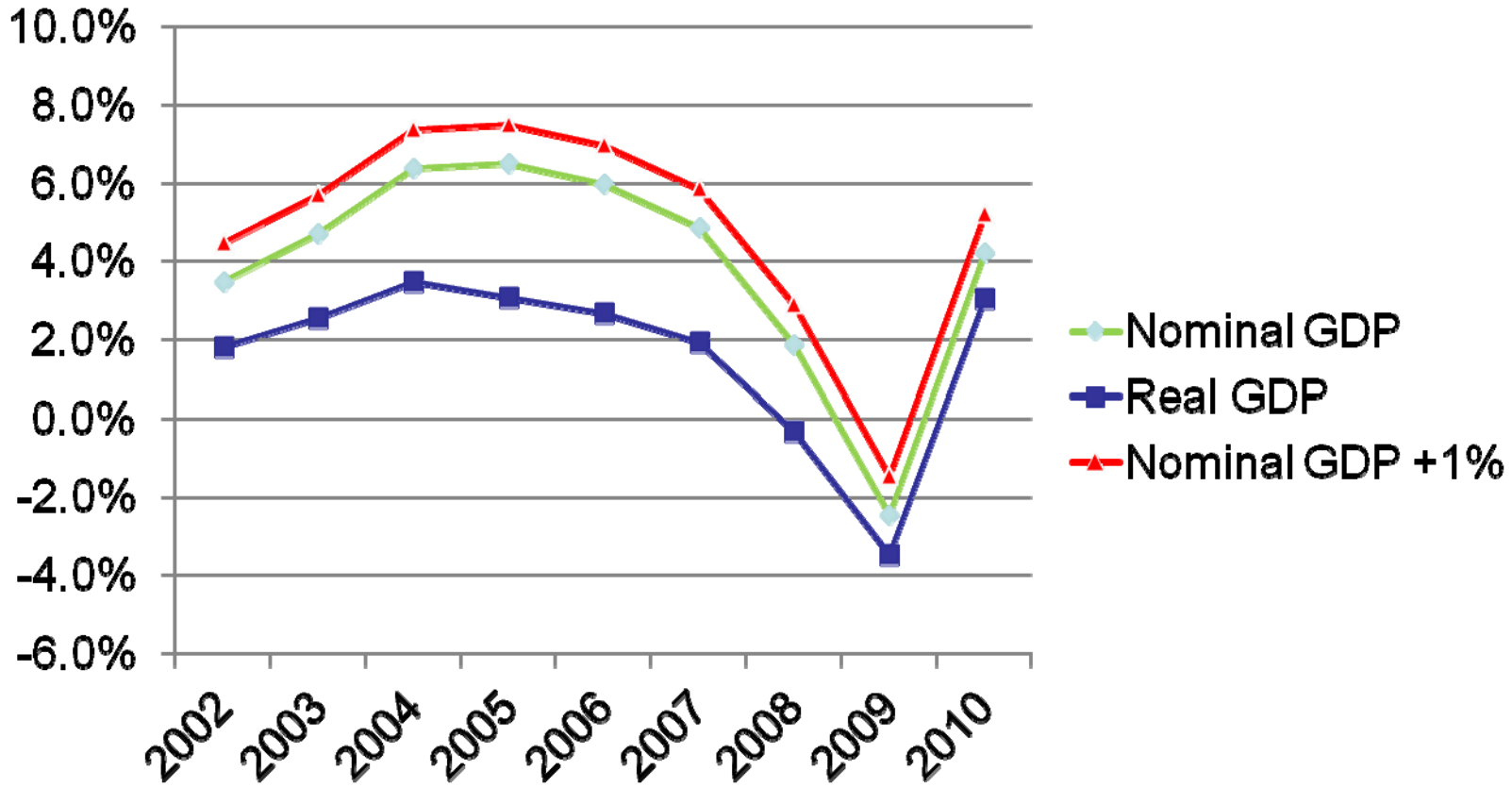
Nominal GDP vs Real GDP vs Nominal GDP +1%



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In Summary

- There are multiple index options.
- The indices produce different results.
- National experts who were queried recommended use of an index.
- The HIAC needs to consider using a forecast or an index methodology, and if an index, which one and how to employ it.