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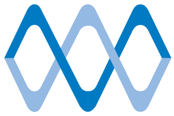
Current Issues in Employee Benefits



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COMPARING APPLES TO APPLES:
Evaluating Managed Care Arrangements

by Michael D. Sammons

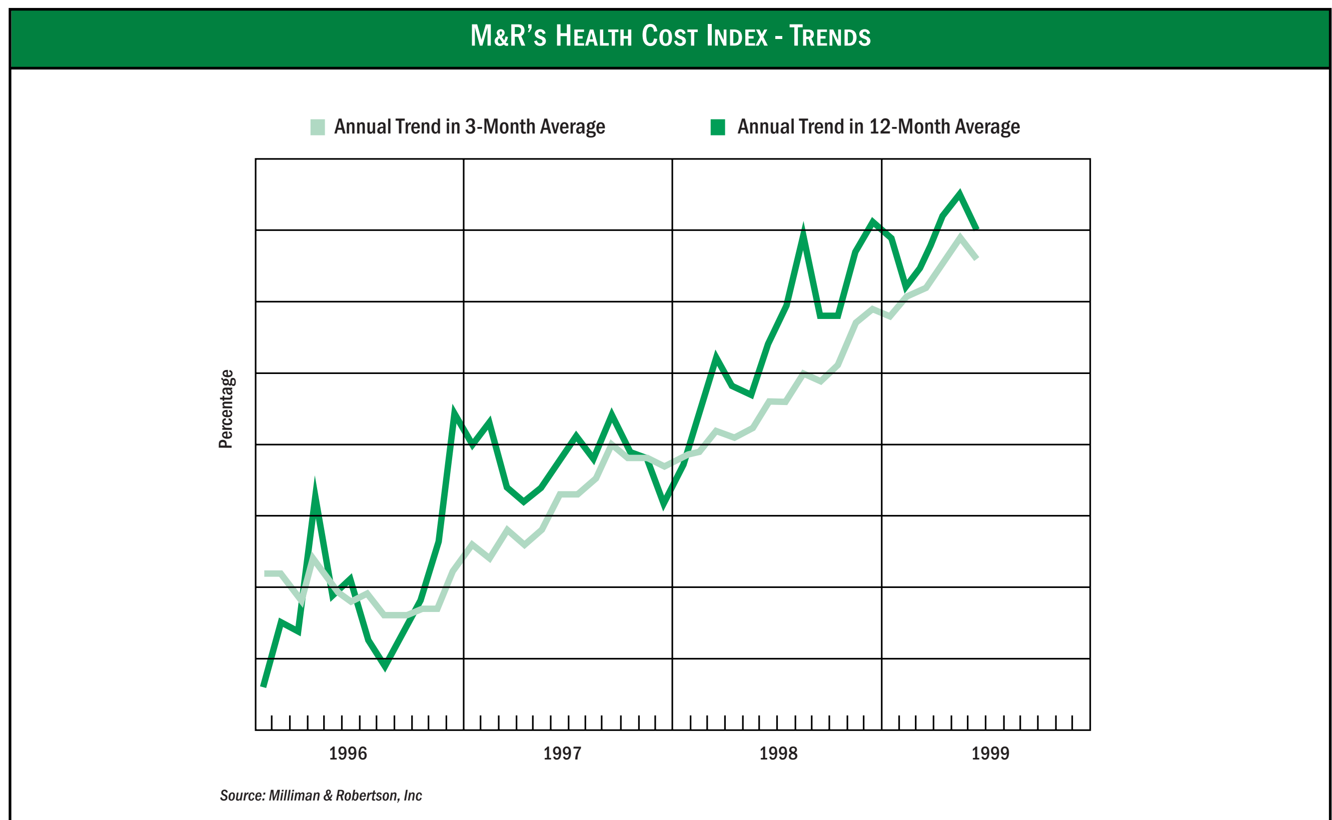
Employers selecting a managed care organization (MCO) to administer health benefits for employees have faced the difficult task of making valid pricing comparisons among potential MCOs. A critical element of this exercise is the reimbursement rates that an MCO pays to healthcare providers with whom the MCO contracts to provide the services. The methods employers commonly use to identify MCOs with the best provider contract rates have several shortcomings, which make a true evaluation and comparison across MCOs practically impossible.

With healthcare cost trends once again spiking, employers must have the ability to select an MCO that can meet their selection criteria, including those related to costs. This article describes a new method that addresses the imperfections of current techniques, while also detailing a more robust approach in analyzing MCO contract rates.

Reasons to Reprice

Healthcare cost trends have risen steadily since late 1996, with pronounced cost spikes appearing in mid-1998 and throughout 1999. As detailed in M&R's *Health Cost Index Report*, the "All Benefits" trends in the last year's second quarter alone rose by 0.4% to 6.6% (see Graph 1), led by higher price and utilization trends. The "All Benefits" 12-month trends have not exceeded

Graph 1



6.0% since the end of 1993. In addition, since the late 1980s, cost trend differentials among the various healthcare product lines have been significantly compressed—with premium increases among traditional fee-for-service, health maintenance organizations, and preferred provider organizations within three percentages points—providing further evidence of the breadth of the cost trend increases.

The combination of increasing healthcare costs and diminished product trend differentials puts significant pressure on employers to enhance the data collection and evaluation process when selecting an MCO. The November/December 1999 issue of *Health Affairs*, for example, found the following MCO selection criteria used by employers, and the relative importance of cost factors versus non-cost selection factors:

Employers' MCO Selection Criteria

	% of Employers Using Criteria
Cost-Based Criteria	
• current cost/premiums	79%
• financial strength/stability	65%
Non-Cost-Based Criteria	
• access/geographic coverage	78%
• prevention/wellness	47%
• member satisfaction	47%
• physician turnover	38%
• accreditation	36%
• disease management programs	35%
• reporting	15%

Clearly, employers evaluate cost and non-cost factors when selecting an MCO. Often, employers use the non-cost criteria as a basis to identify MCO selection finalists. Having identified those MCOs meeting the non-cost selection criteria, employers then proceed to evaluate a "short list" of MCOs based upon the ability of an MCO to effectively manage provider contract rates.

Based upon feedback received from seven major employers, evaluating provider contract rates is common and has a significant impact on the selection of an MCO. In fact, all of the employers interviewed conducted this type of MCO evaluation when reviewing responses to recent requests for proposals. Furthermore, the employers rated the importance of this MCO evaluation step near the top of the scale in selecting an MCO.

Troublesome Current Methods

Employers generally use two primary methods to identify MCOs with the best provider contract rates:

A. For selected high-volume procedures (defined using standard physicians' codes) and hospital services, MCOs are requested to disclose their provider contract rates.

B. An electronic claim file containing some or all of the employer's prior-year claims is sent to MCOs with a request that they submit a claim payout projection using their provider contract rates.

Neither method has been adequate because:

- Nearly all MCO provider contracts prohibit the disclosure of contract rates, thereby preventing the MCO from disclosing specific provider data.
- The distribution of services across the provider network cannot be measured under method A.
- Projecting a claims payout from an electronic claims file is a costly exercise for MCOs to complete, and it does not provide a uniform MCO evaluation platform, because MCOs do not complete the exercise in a uniform manner.
- Some qualified MCOs are not able to perform method B due to the absence of a centralized provider contract rate file.

The employers and the five major MCOs interviewed were uniformly dissatisfied with the current methods. Drawbacks cited by employers were that methods A and B limited the number of MCOs that could compete for the employers' business; the information from one MCO could not be compared with that of the others; the suitability of a specific MCO for a given market could not be determined; and the methods raised significant data quality concerns. MCOs viewed the methods as entailing high completion costs and breach-of-contract concerns, as well as providing a perceived advantage to the incumbent MCO since the incumbent actually paid the claims and can therefore easily forecast future claims cost for the employer.

New Evaluation Method

A cost model approach (see sidebar on p. 3) can easily replace existing MCO evaluation methods while addressing their shortcomings. The process begins with an employer providing its consultant with an electronic file containing detailed claims experience. The claims data are sorted into service categories and summarized in the cost model format. Separate cost models can be created for each plan, location, line of business, etc. The cost model provides the employer with a baseline of average unit price, utilization, and net cost experience.

Subsequently, MCOs are asked to report their average unit prices during the baseline period for their existing book of business. The MCOs are given detailed instructions on allocating services to specific service categories. It is critical that the consultant's criteria for allocating baseline data are consistent with the MCOs' criteria. Alternatively, an MCO can provide an electronic file of its detailed claims experience to the consultant, who can then create the MCO required data.

Cost Model Application

M&R's Health Cost Guidelines help MCOs determine claims cost assumptions and premium rates. A key component of the Guidelines is the actuarial cost model, which details utilization, unit price, and cost for the full range of covered healthcare services. The cost model allows MCOs to understand the relationship of contract rates and utilization levels to total health costs. The use of actuarial cost models for cost analysis and rating is a standard within the health insurance industry, with every MCO interviewed acknowledging its ability to organize data in the cost model format.

	Adjusted Charges	Adjusted Utilization		Cost Sharing	Before Cost Sharing	PMPM PMPM Cost Sharing	Final PMPM (Net)
Hospital Inpatient							
Medical	$1,432	103.7	days	$0.00	$12.37	$0.00	$12.37
Surgical	2,426	66.1	days	0.00	13.36	0.00	13.36
Psychiatric	598	18.1	days	0.00	0.90	0.00	0.90
Alcohol & Drug Abuse	442	10.1	days	0.00	0.37	0.00	0.37
Maternity Deliveries	1,196	25.3	days	0.00	2.52	0.00	2.52
Maternity Well Newborn	444	16.5	days	0.00	0.61	0.00	0.61
Maternity Non-Deliveries	1,459	2.4	days	0.00	0.29	0.00	0.29
Extended Care Facility	331	10.3	days	0.00	0.29	0.00	0.29
Hospital Inpatient	$1,562	236.1	days	$0.00	$30.72	$0.00	$30.72
Hospital Outpatient							
Emergency Room	$215	184.5	cases	$0.00	$3.30	$0.00	$3.30
Surgery	1,198	82.8	cases	0.00	8.27	0.00	8.27
Radiology	410	175.7	cases	0.00	6.01	0.00	6.01
Pathology	131	190.7	cases	0.00	2.09	0.00	2.09
Pharmacy and Blood	51	233.0	cases	0.00	0.99	0.00	0.99
Cardiovascular	91	92.8	cases	0.00	0.71	0.00	0.71
PT/OT/ST	68	32.0	cases	0.00	0.18	0.00	0.18
Other	163	80.2	cases	0.00	1.09	0.00	1.09
Maternity Non-Deliveries	541	6.7	cases	0.00	0.30	0.00	0.30
Hospital Outpatient	$255	1,078.4	cases	$0.00	$22.94	$0.00	$22.94
Physician							
Physician Surgery	$601	411.8	proced	$0.00	$20.62	$0.00	$20.62
Physician Maternity	1,506	21.3	proced	0.00	2.67	0.00	2.67
Inpatient Visits	89	193.0	visits	0.00	1.43	0.00	1.43
Office Visits & Misc. Services							
Office/Home Visits	44	3,382.4	visits	0.00	12.34	0.00	12.34
Urgent Care Visits	74	86.9	visits	0.00	0.54	0.00	0.54
Therapeutic Injections	30	150.9	proced	0.00	0.37	0.00	0.37
Allergy Testing	4	569.2	proced	0.00	0.20	0.00	0.20
Allergy Immunotherapy	11	490.7	proced	0.00	0.44	0.00	0.44
Misc. Medical	32	322.0	proced	0.00	0.85	0.00	0.85
Emergency Room Visits	113	154.2	visits	0.00	1.46	0.00	1.46
Consults	131	99.6	consults	0.00	1.09	0.00	1.09
Physical Medicine	25	641.0	visits	0.00	1.34	0.00	1.34
Cardiovascular	89	169.1	proced	0.00	1.25	0.00	1.25
Physician Radiology	107	965.2	proced	0.00	8.63	0.00	8.63
Physician Pathology	35	2,435.1	proced	0.00	7.02	0.00	7.02
Total Physician (w/o Additional)	N/A	N/A	N/A	$0.00	$60.25	$0.00	$60.25
Other	$39	6,879.2	units	$0.00	$22.09	$0.00	$22.09
Additional	$62	2,694.8	proced	$0.00	$13.94	$0.00	$13.94
Grand Total	N/A	N/A	N/A	N/A	**$149.93**	**$0.00**	**$149.93**

The MCO's average unit prices are substituted into the baseline cost model (leaving baseline utilization unchanged). An employer thus has a baseline cost model for the incumbent MCO and each bidding MCO. Comparisons then can be made easily on the impact of the MCOs' provider contract rates, using consistent and actual utilization experience data. Using this analysis, the employer can select the MCO with the best aggregate results, across all or a subset of locations.

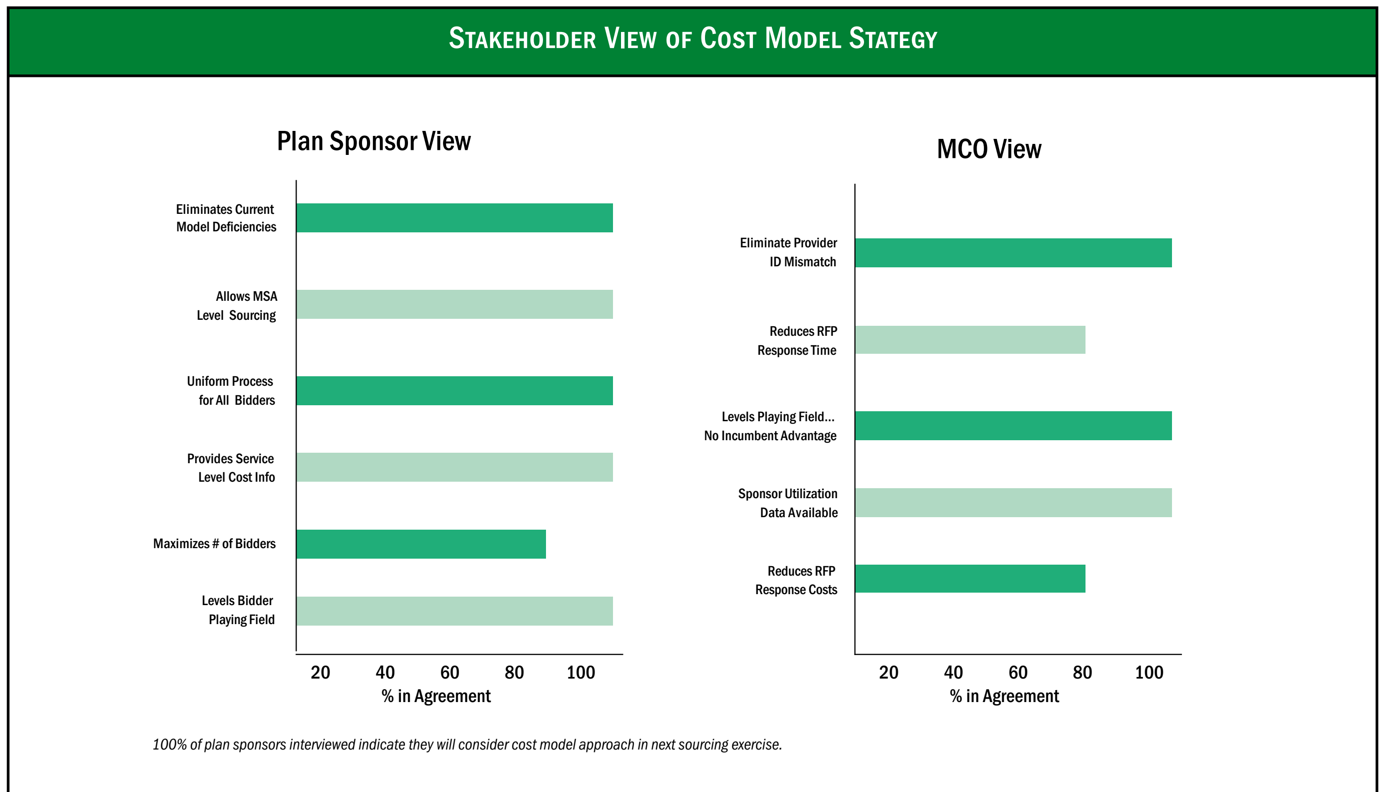
Using the cost model repricing methodology is contingent upon the employer having access to documentation of employee and member headcount by location, and ready access to historical claims data in an electronic format.

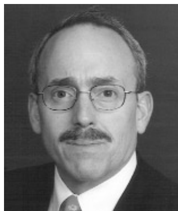
The employers interviewed all indicated that they could readily satisfy these requirements. In addition, the cost model repricing tool presents a significant process improvement opportunity for both employers and MCOs, according to those interviewed. Graph 2 summarizes the feedback received on the advantages of the cost model methodology.

Conclusion

Employers that sponsor health benefit plans have many issues to consider when selecting an MCO plan administrator. The ability to evaluate an MCO's provider contract rates has traditionally entailed a difficult process, one that frequently produced questionable data at best. The cost model claim repricing method can provide the necessary data to put employers on a more solid foundation when it comes to evaluating and selecting an MCO.

Graph 2





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