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# Reference Pricing as an Employer & Insurer Strategy for Cost Control

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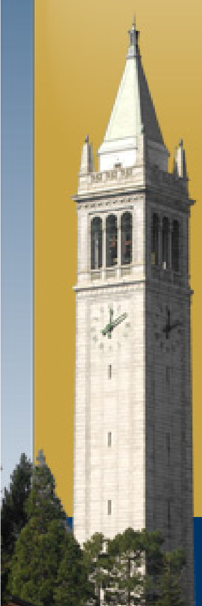
# Overview


- Variation in prices
    - Market consolidation
- Benefit design and cost sharing options
- Reference pricing
- Applications

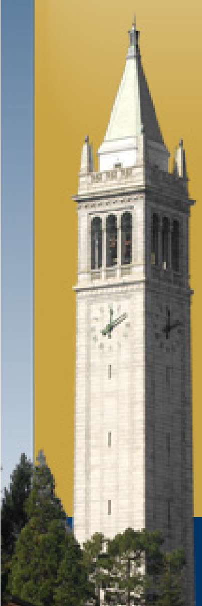


# Variation in Prices

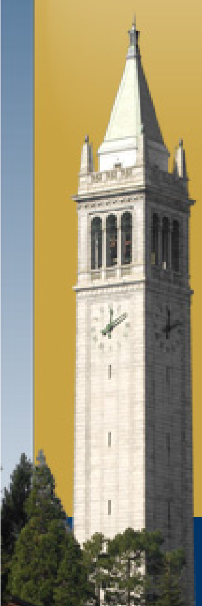
- While must attention has focused on variation in volumes of health services used (e.g., Dartmouth), attention now is shifting to variation in the prices charged
- Hospital market consolidation is resulting in major price increases for some providers
- All producers and providers can raise prices in the face of cost-unconscious demand, with variation in prices caused by variation in willingness to price aggressively
- Variation in price is often unrelated to variation in quality, especially for drugs, tests, standardized procedures

# Cost Sharing for Major Acute Procedures

- Traditional forms of consumer cost sharing do not provide strong incentives for cost consciousness, and hence are changing
  - For acute interventions: all patients exceed deductible and thus are cost-indifferent when choosing providers
  - Dollar copayments do not reflect variations in bundled case rates and episode costs across provider teams
- If consumers are not sensitive to cost differences across provider teams, they will favor high-cost teams (assuming high price=high quality), which will encourage price increases and non-price competition among providers



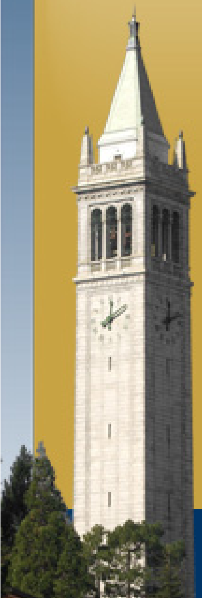
# Reference Pricing



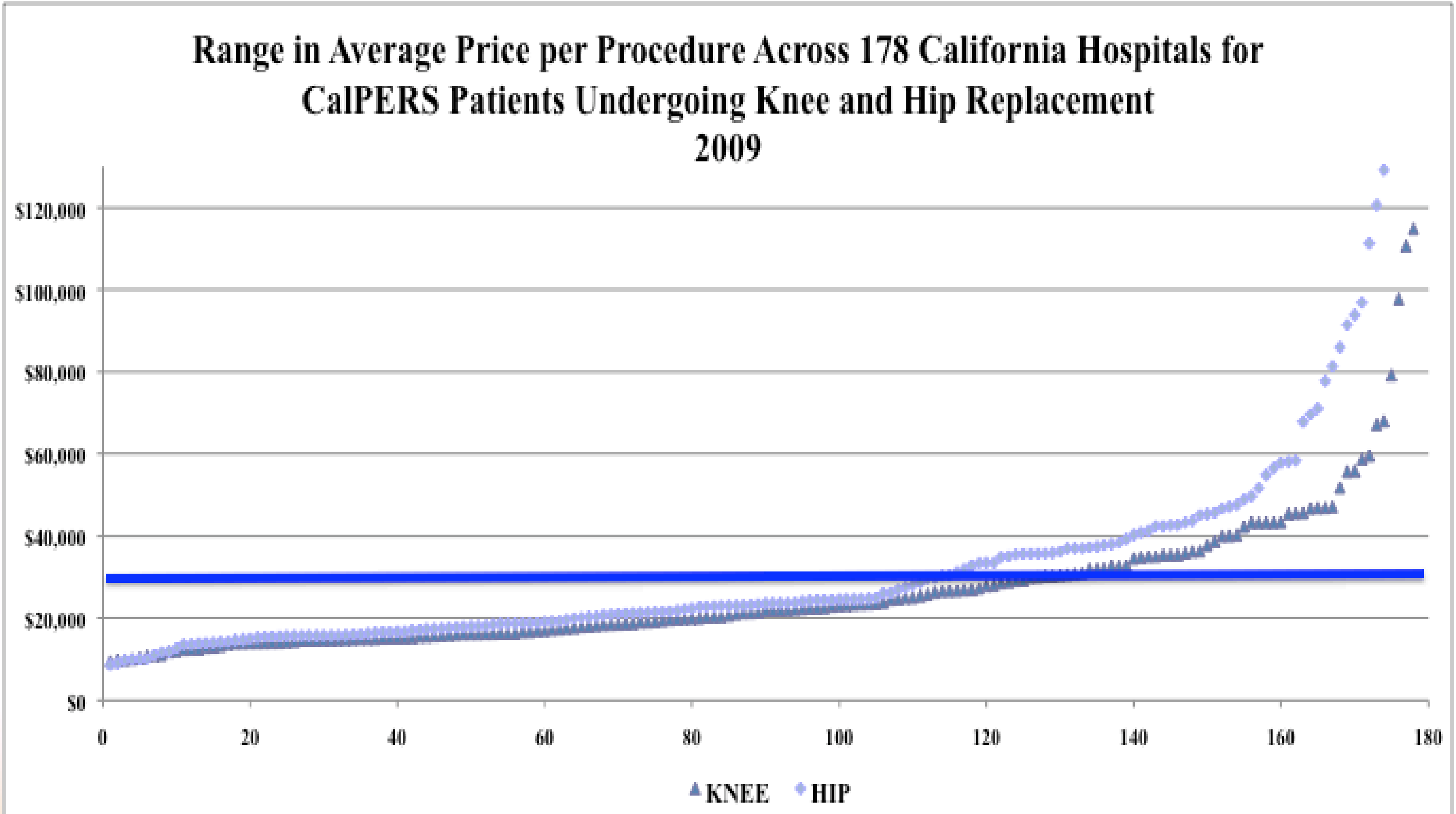
- Insurer/employer establishes a maximum benefit limit for each product or procedure and pays provider up to that benchmark. The employee/patient pays the difference between that benchmark and the rate actually charged by the provider chosen by the consumer.
- It can be conceptualized as a “reverse deductible”, where the insurer pays the first part and the patient the remainder, whereas under a deductible the patient pays the first part and the insurer the remainder
- It embodies the principle that the patient has discretion over the total price, because the patient chooses the product or provider from across a range of prices
- This is “defined contribution” applied to the product or procedure (rather than to the health plan)

# Applications of Reference Pricing

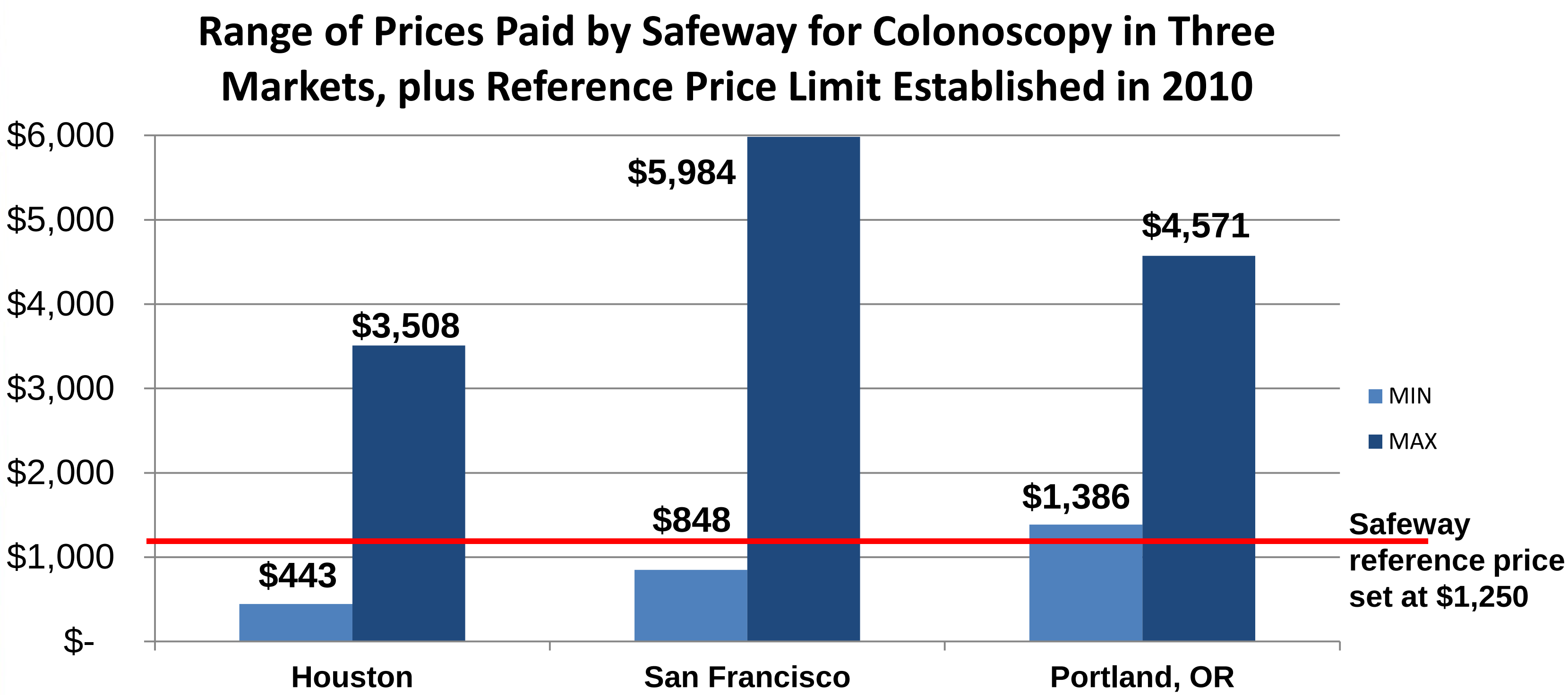
- Reference pricing is applicable to services that exhibit wide range in prices but only narrow range in quality
  - Insurers/employers do not want to be accused of channeling patients to low quality options
- Sponsors invest in communication strategies with patients, so that they understand financial consequences of their choice of product or provider
- Principal targets for reference pricing
  - Drugs (contrast to tiered formulary)
  - Lab tests
  - Diagnostic imaging
  - Acute surgical procedures



# CalPERS Reference Pricing for Knee and Hip Replacement Surgery (Limit = $30,000)



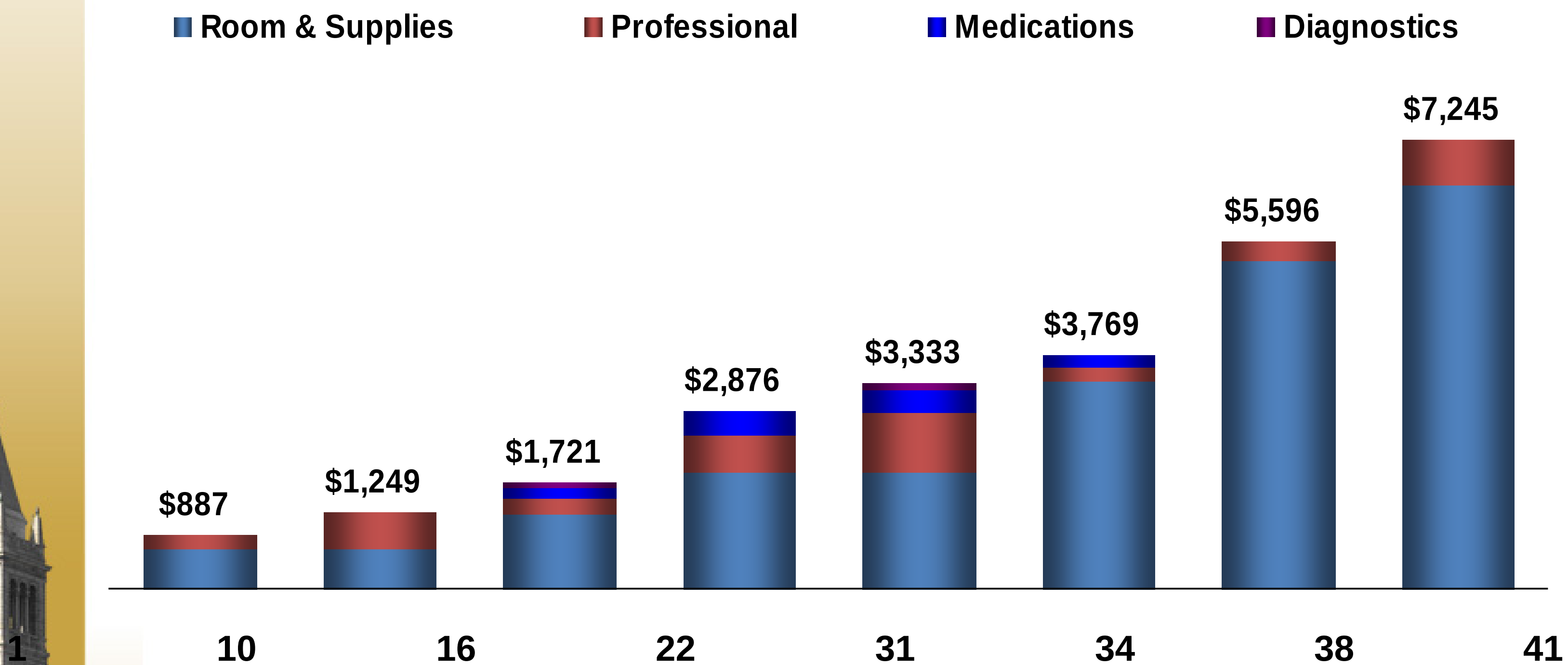
# Safeway Reference Pricing for Diagnostic Colonoscopy (Limit = $1,250)




Source: Safeway Health

## Safeway Colonoscopy Cost Per Procedure

## within one geographic market

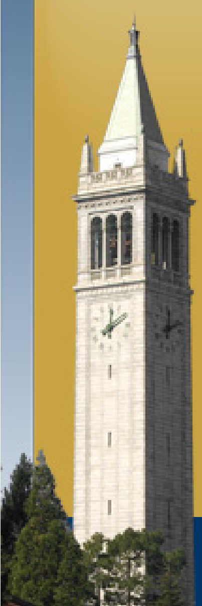



**Diagnostic Colonoscopy Providers**

Representative sample: 8 out of 41 facilities

# Center of Excellence (COE) as Alternative to Reference Pricing

- Insurer/employer contracts with one hospital nationally or in each region for particular classes of procedures. Insurance benefits for employees are structured to strongly favor use of those facilities
  - Blue Shield of California (orthopedic surgery)
    - One COE in each of 16 regions
  - Lowes self-insured (interventional cardiology)
    - On COE nationally (Cleveland Clinic)
- COE strategy limits consumer choice but offers insurer/employer greater leverage to improve quality and cost performance by providers

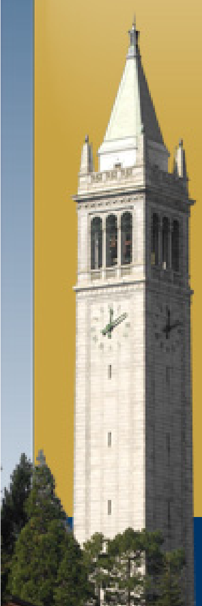


# Further Information on Reference Pricing

JC Robinson and K MacPherson

Employers Re-Design Insurance Benefits in Response to Variation in Hospital Prices

Health Affairs, in press (September 2012)



# Conclusion

- There exists considerable unjustified variation in prices, unrelated to variation in quality
- Insurer contracting leverage is limited due to provider market consolidation
- Reference pricing is an increasingly popular and effective benefit design innovation
- Drugs, lab tests, imaging, routine surgery