California’s Health Care Gamble: Can We Afford the Trend Toward PPO?

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President and Chief Executive Officer

August 23, 2005
The Market Share Shift Has Begun

2004: 50% HMO, 36% PPO, 12% POS
2003: 52% HMO, 29% PPO, 17% POS
2002: 54% HMO, 30% PPO, 16% POS
2001: 54% HMO, 25% PPO, 21% POS

Source: California Health Care Foundation

California Association of Physician Groups
The Driving Forces

National Employer Single Source Purchasing
California outnumbered 49:1

Path of Least Resistance to Deductible Benefit Design

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What’s the Big Deal?

The Choice is NOT as simple as the first-year’s savings
More Than A Product Name

HMO
- Organized Care
- Prepayment
- Outcome Incentive
- Embedded Care Processes

PPO
- Disaggregated Care
- Fee For Service Payment
- Increased Services Incentive
- Over-layed Care Processes

Efficiency Reward

Efficiency Penalty

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California HMO Premiums remain highest-value health care purchase

2004 Average Family Premium

- CA HMO: 721
- US HMO: 792
- CA PPO: 981
- US PPO: 851

Source: California Health Care Foundation

California Association of Physician Groups
California HMO Premiums remain highest-value health care purchase

2004 Average Single Premium

- CA HMO: 261
- US HMO: 288
- CA PPO: 374
- US PPO: 317

Source: California Health Care Foundation

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CA Results in Hospital Use Rates Are Superior to National Rates

Source: Kaiser Family Foundation
Hospital LOS Management is Material Driver of Results - Particular in Medical Admissions

Organized
Non-Organized

2003

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Source: OSHPD Inpatient Discharge Databases 2003
The Pressure Is On

- Hospital Unit Cost
- Benefit Mandates
- Un-insurance
- Pharmacy
- New Technologies
- Gov’t Cost Shift

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Employer Response: The Means and the End

- High Deductible
- Reduce Benefits
- Savings Accounts

- Common Wisdom

- PPO Design
- FFS Payment

- Chosen Path

- Consequences

- Undermine Delivery
- Model Performance

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Inability to Manage Deductibles

Health Plan
Hospital & RX Claims

Medical Group
Professional Claims

Simultaneous Transacting
Real-Time Accumulators

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Management Principles At Work in Organized Delivery Systems

- Strategic Resource Allocation
- ROI Mentality
- Staff Recruitment and Teamwork
- Organized to Optimize the Whole
- Data Driven
- Incent Improvement
  Organizational → Individual

Leverage Technology & Volume

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What Gets Lost in the Shift?

- Strategic Resource Allocation
- Staff Recruitment
- Data Driven

- ROI Mentality
- Organized to Optimize the Whole
- Incentive Improvement: Organizational – Individual

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Optimizing Technology

Administrative vs Cost and Quality Improvement

Stand-Alone Office

Integrated Network

Automation
Record Keeping/Transacting

Leverage Communications
EMR → EHR
Registries
Clinical Team Communication

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Pay for Performance
Systemic Quality Improvement

First Year Results

<table>
<thead>
<tr>
<th>Prevention</th>
<th>Increase of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Breast Cancer Screening</td>
<td>135,000</td>
</tr>
<tr>
<td>Cervical Cancer Screening</td>
<td>150,000</td>
</tr>
<tr>
<td>Childhood Immunizations</td>
<td>10,000</td>
</tr>
<tr>
<td>Diabetes Testing</td>
<td>18,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Disease Management</th>
<th>Avoidable Deaths</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asthma</td>
<td>800-1000</td>
</tr>
<tr>
<td>Diabetes</td>
<td>4,300-9,600</td>
</tr>
<tr>
<td>Heart Disease</td>
<td>6,900-17,000</td>
</tr>
<tr>
<td>Blood Pressure</td>
<td>15,000-26,000</td>
</tr>
</tbody>
</table>

Total Avoidable Costs $250 Million

112 Medical Groups

40,000 Physicians

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Can’t the Plan do it?

**Health Plans**
- Stand-Alone Inpatient Services
- Engages Member But Not Physician
- Large Networks Diffuse Volume

**Medical Groups**
- Hospitalist
- Disease Mgmt
- Contracting
- Integrated with all Care Delivery
- Engages Members And Physicians
- Service-Specific Leveraged Volume

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50% of Members selected a Clinic that changed from Physician Capitation to Fee-For-Service on 1-1-2004

<table>
<thead>
<tr>
<th>10-Month Experience Periods</th>
<th>Members Covered</th>
<th>Physician Capitation</th>
<th>Physician FFS Claims</th>
<th>Outpatient FFS Claims*</th>
<th>Total M.D. Capitation &amp; Claims</th>
</tr>
</thead>
<tbody>
<tr>
<td>3/03 - 12/03</td>
<td>3,260</td>
<td>$2,124,577</td>
<td>$252,180</td>
<td>$298,491</td>
<td>$2,675,248</td>
</tr>
<tr>
<td>3/04 - 12/04</td>
<td>3,127</td>
<td>$1,454,009</td>
<td>$1,795,638</td>
<td>$674,616</td>
<td>$3,924,263</td>
</tr>
<tr>
<td>% Change</td>
<td>-4%</td>
<td>-32%</td>
<td>+612%</td>
<td>+126%</td>
<td>+47%</td>
</tr>
</tbody>
</table>

* Includes diagnostic x-ray and lab outpatient surgery.

Barney & Barney

California Association of Physician Groups
Deductible-based plans were the norm in the 1980’s when trend topped 20% - what will be different?

The care requiring most management - and most patient engagement - occurs AFTER the first $1000 is spent.

Physicians control up to 87% of health spending. Current options only incentivize increased spending.
Consequences: Disproportional Effect

- Disproportionately affects low wage-earning employees - resulting in under-care
- Effects of under-care ultimately cost the system more

2004*

<table>
<thead>
<tr>
<th>Because of Cost...</th>
<th>All</th>
<th>Income &lt;25,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Did not obtain a preventive service</td>
<td>17%</td>
<td>24%</td>
</tr>
<tr>
<td>Did not visit doctor for known condition</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>Did not follow medical advice</td>
<td>16%</td>
<td>23%</td>
</tr>
</tbody>
</table>

*Source: California Health Care Foundation
# Eventual Increase in Employer Trend

<table>
<thead>
<tr>
<th>Year One</th>
<th>Year Two</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Option A</td>
</tr>
<tr>
<td>Per Person</td>
<td></td>
</tr>
<tr>
<td>Medical Costs</td>
<td>$3,000</td>
</tr>
<tr>
<td>Deductible</td>
<td>-$1,000</td>
</tr>
<tr>
<td>Benefit</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>+15%</td>
</tr>
</tbody>
</table>

**Employee Share or Trend?**

California Association of Physician Groups

Barney & Barney
Can We Afford the Migration?

$8.5 Billion Per Year

14,000,000 Californians in Commercial HMOs

$609 per year = $8,526,000,000

- Per Person Per Month CA HMO Costs: $259.25
- Per Person Per Month US PPO Costs: $310.00

Difference: $50.75/mo → $609/yr
Seizing the Opportunity

Financing & Delivery Model

Product & Benefit Design

Co-Insurance Based Benefit Design
- Physician Engagement in Cost & Quality
- Effectively Leveraged Data & Info Technology

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Long Term Success Requires Alignment on Direction

Consumers

Co-insurance to engage in long-term care financing

Radical RX design

Incentives for
- Achieving Disease Management Goals
- Healthy Lifestyles
- Selecting of high-performing provider
- Avoidance of poor-performing providers

Providers

Prepayment for overall cost management

Reward for total health care cost/outcome management

Incentives for
- Prevention
- Technology
- Promotion of Healthy Lifestyles
- Performance in Disease Management
- Demonstrated Improved Outcomes

Cost & Quality Incentives