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

Donald Crane
President and Chief Executive Officer

August 23, 2005
The Market Share Shift Has Begun

<table>
<thead>
<tr>
<th>Year</th>
<th>HMO</th>
<th>PPO</th>
<th>POS</th>
<th>Idemnity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>50</td>
<td>36</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>52</td>
<td>29</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>54</td>
<td>30</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>54</td>
<td>25</td>
<td>21</td>
<td></td>
</tr>
</tbody>
</table>

Source: California Health Care Foundation
The Driving Forces

- National Employer
  - Single Source Purchasing
  - California outnumbered 49:1

- Path of Least Resistance to Deductible Benefit Design
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

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

2004 Average Single Premium

Source: California Health Care Foundation
CA Results in Hospital Use Rates Are Superior to National Rates

Per 1000 Population 2003

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

All Admissions: 3.9 (Organized), 4.3 (Non-Organized)
CHF: 3.7 (Organized), 5.5 (Non-Organized)
Pnuemonia: 4.5 (Organized), 5.6 (Non-Organized)

Source: OSHPD Inpatient Discharge Databases 2003
The Pressure Is On

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

10+%
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
Inability to Manage Deductibles

Health Plan
Hospital & RX Claims

Medical Group
Professional Claims

Simultaneous Transacting
Real-Time Accumulators
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

California Association of Physician Groups
What Gets Lost in the Shift?

- Strategic Resource Allocation
- Staff Recruitment
- Data Driven
- ROI Mentality
- Organized to Optimize the Whole
- Incent Improvement Organizational + Individual
- Average Technology & Volume

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Optimizing Technology

Administrative vs Cost and Quality Improvement

Automation
Record Keeping/Transacting

Stand-Alone Office

Integrated Network

Leverage Communications
EMR → EHR
Registries
Clinical Team Communication

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Pay for Performance
Systemic Quality Improvement

112 Medical Groups

40,000 Physicians

First Year Results

Prevention
- Breast Cancer Screening 135,000
- Cervical Cancer Screening 150,000
- Childhood Immunizations 10,000
- Diabetes Testing 18,000

Disease Management
- Asthma 800-1000
- Diabetes 4,300-9,600
- Heart Disease 6,900-17,000
- Blood Pressure 15,000-26,000

Total Avoidable Costs $250 Million

Avoidable Deaths

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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.
The Incomplete Economics

- 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

<table>
<thead>
<tr>
<th>Because of Cost...</th>
<th>All CA</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>

2004*

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

<table>
<thead>
<tr>
<th></th>
<th>Year One</th>
<th>Year Two</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Option A</td>
<td>Option B</td>
</tr>
<tr>
<td>Per Person</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical Costs</td>
<td>$3,000</td>
<td>$3,300</td>
</tr>
<tr>
<td>Deductible</td>
<td>-$1,000</td>
<td>-$1,000</td>
</tr>
<tr>
<td>Benefit</td>
<td>$2,000</td>
<td>$2,300</td>
</tr>
<tr>
<td></td>
<td>+15%</td>
<td>+10%</td>
</tr>
</tbody>
</table>

*10% Trend Increase*

**Employee Share or Trend?**

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
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