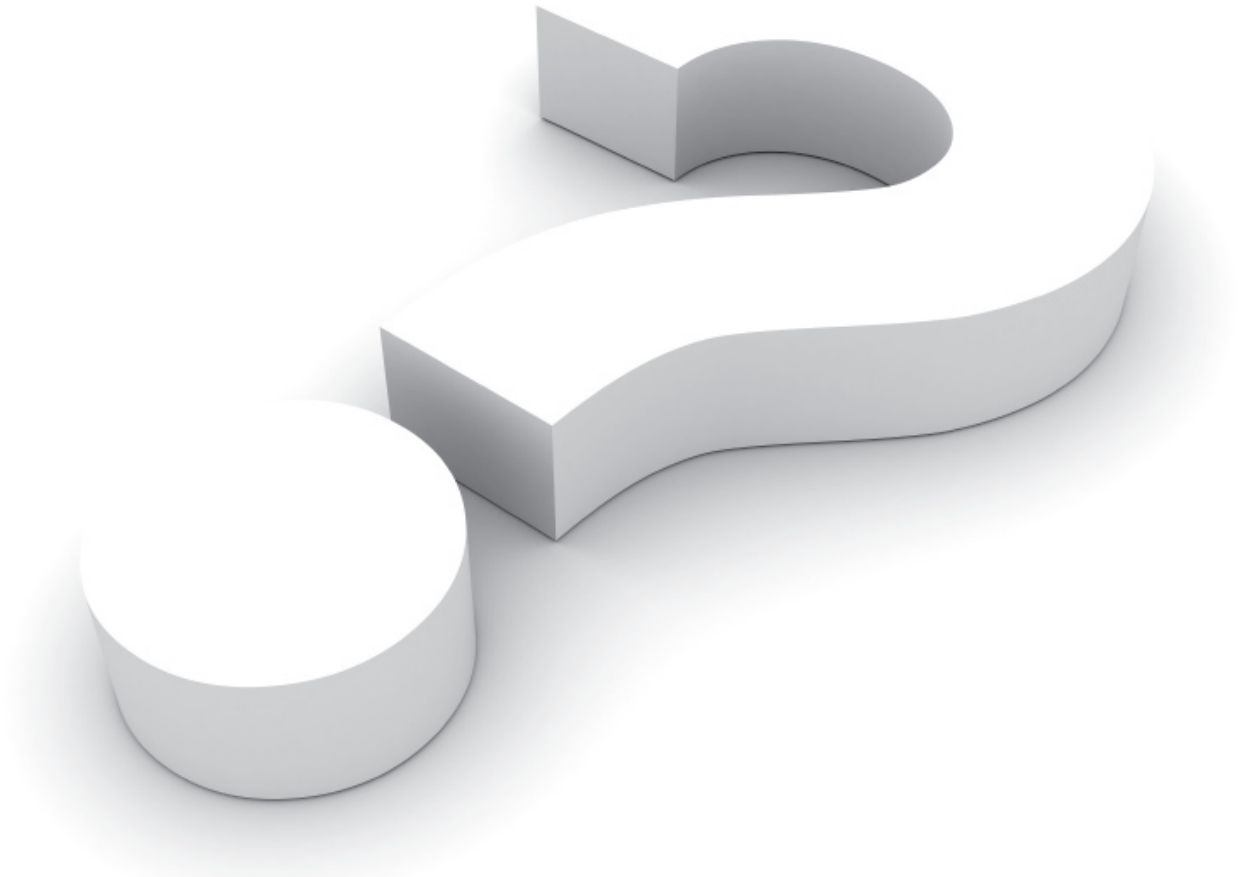

Seven Tough Questions Every Insurer Must Ask

About your Next Hospital Contract

A White Paper for Health Insurance Executives

HEALTHPLUS TECHNOLOGIES

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Executive Summary

When a hospital contract comes across your desk for approval, you naturally focus on one all-important question, "How much will this cost us?"

It's your job to ask tough questions about your next hospital contract... and make sure your people do, too.

As an insurance company executive, it's your job to ask tough questions about your next hospital contract... and to make sure your people do, too.

These questions should drill down into areas like the **ratio between discounts on billed charges and fixed charges**... the real impact of the **stop-loss clause**... and the actual **profit margins** provided by this contract.

And then there's the toughest question of all: Is the hospital seeking to enhance its revenues at your expense?

Most insurers aren't asking these questions today, or at least, they're not getting the full answers.

That means you may end up overpaying certain hospitals, and shelling out reimbursements that are unreasonable, unjustified, and unfair.

Like it or not, your counterparts on the hospital side may be better prepared to negotiate. They may have more complete numbers, more powerful software, and aggressive consultants coaching them on how to maximize the revenue cycles from each contract.

They are definitely targeting your contract to generate most of their profit, because they know they can't get any more money from Medicaid, Medicare, or the uninsured.

That's why you owe it to your company to ask some tough questions, and get some clear answers.

This white paper describes seven of these questions:

1: Is this hospital setting prices to boost profits on selected services?

2: How much of this contract will be paid on billed charges, and how much on fixed rates?

3: Does this stop-loss clause capture only the true outliers, or does it also enhance the hospital's revenues?

4: Is this hospital profiting unreasonably from outlier admissions, or are you reimbursing it near cost?

5: Is this contract competitive, compared to Medicare rates?

6: What margins does this contract give to this hospital?

7: Are you allowing for this hospital's ongoing markups in your discount rates?

Tough question #1: Is this hospital setting prices to boost profits on selected services?

Does the inflation rate for this contract appear lower than it really is? Is the hospital raising prices on some selected services much more than on others?

Your payouts can increase dramatically, since the biggest increases fall on the most costly services.

Background

To help control costs, most contracts include a cap on the total increase permitted for inflation, such as 6%. But this percentage can be manipulated.

Like it or not, your counterparts from the hospital may be better prepared to negotiate the fine print of the contract. They likely have better figures on costs and margins at their fingertips. They may have powerful number-crunching software that can compare numerous pricing scenarios.

And many hospitals even hire seasoned consultants to help them maximize the revenue cycles from each contract.

With all this help on their side, the hospital may see a clear path to more profit: Boosting fees for selected highly profitable services.

Hospitals seek to gain from selective fee increases in two ways.

First, they seek to have **more services "carved out"** and paid at a discount from the hospital's billed charges. These charges are much less transparent than a fixed fee.

And second, hospitals press for **higher reimbursements for selected services**, planning to aggressively market these services in the coming months.

For instance, by increasing cardiac services by 9% but everything else only 3%, the hospital may limit the average fee increase in a new contract to the specified 6%.

But the hospital can then roll out a **big advertising campaign** extolling the virtues of its cardiac care, and performing many more cardiac procedures within the term of your next contract.

This can cause your payouts to increase dramatically, since the biggest percentage increase falls on some of the most costly services.

This strategy is hard to detect just by looking at one number for the overall inflation rate allowed in the contract.

Tough question #2:
How much of this contract will be paid on billed charges, and how much on fixed rates?

The cost of any claim paid at a fixed rate is much easier to predict than the cost of a claim paid at a discount from the hospital's billed charges. Under this contract, what portion of your payments will be calculated at a fixed rate?

The cost of claims paid at a discount from billed charges is hard to predict, and impossible to control.

Background

The single best metric for controlling your costs is the **percentage of total dollars paid at a fixed rate** to a hospital.

Knowing this number helps protect you against strategic price increases that are clearly in the hospital's best interests.

As you know, most contracts set a **fixed price** for certain hospital services such as delivery, cardiac catheterization, and observation services. Your team works hard to peg these services at a fixed rate. These costs are fairly predictable, since the only variable is how many times each service is delivered.

But in many contracts, nothing else is fixed. So services like chemotherapy, dialysis, implantables, and high cost drugs are paid **at a discount from the hospital's charge master**.

This introduces a second variable not specified in the contract: How much does the hospital charge for each service?

So the cost of claims paid at a discount from billed charges is much harder to predict, and impossible for you to control.

Clearly, the more services you insure at a fixed price, the less risk of your costs spiraling upwards, and the fewer options for a hospital to enhance its revenues simply by increasing charges.

Tough question #3:
Does this stop-loss clause capture only the true outliers, or does it also enhance the hospital's revenues?

The purpose of a stop-loss clause is to protect a hospital from losing money on the most seriously ill people. But does this contract allow a hospital to move many more patients into the stop-loss category?

It's clearly in the hospital's interest to classify as many admissions as possible as outliers.

Background

At a certain threshold, an admission becomes an outlier, generally paid at a discount against billed charges. This threshold is generally a specific number in the stop-loss clause, most often around $60,000.

The rationale for this is clear: Hospitals want to protect themselves against losing money on a few patients who are gravely ill and need a lot of services over a long stay. Fair enough.

But **why should hospitals profit on those same cases**, at the expense of insurance companies? Don't you deserve some protection as well? Why not negotiate to prevent the hospital from moving many more admissions into the outlier category, at your expense?

If the hospital continuously bumps up its charge master—but the stop-loss threshold never moves—over time these increases will push more admissions past the threshold to become outliers.

Then the game changes, so the hospital is paid on a discount from billed charges.

It's clearly in the hospital's interest to classify as many admissions as possible as outliers. **As profits on outliers mount for the hospital, losses mount for the insurer**.

Medicare expects that outliers make up 5.1% of total inpatient costs. But that 5.1% is applied across the entire system, not on a hospital-by-hospital basis; after all, the worst cases are seldom distributed equally among hospitals.

So an insurer should evaluate outlier costs the same way.

Don't try to limit outliers to 5.1% of admissions to any one hospital; but do check the percentage across all the hospitals in a region to make sure it's not wildly out of proportion.

Tough question #4: Is this hospital profiting unreasonably from outlier admissions, or are you reimbursing it near cost?

Is the margin a hospital makes on outlier cases through the stop-loss clause higher than its margin on all other services? Is this part of the contract fair and reasonable?

If a hospital tries to illegally "game" Medicare, wouldn't they do the same to you?

Background

Profit is not a dirty word. But should hospitals be making an exorbitant, unreasonable profit... or a justified, predictable profit?

Almost everyone in the healthcare system would agree that **outlier cases should be paid at close to cost**... so that the emphasis for these admissions is on saving lives, not making money.

But MedPAC reported unusually large increases in hospital charges in 2002 and 2003, and suspected some hospitals of "manipulating Medicare outlier payments." In 2003, Medicare updated its outlier policy to curb this practice. [1]

Numerous lawsuits have been launched to recover illegal outlier claims against Medicare.

For example, one consulting firm in New Jersey paid $2.9 million after encouraging hospitals to inflate charges to squeeze more out of Medicare outlier payments. [2] Other settlements with individual hospitals have totaled $5.3 million, $3.85 million, $2.5 million, $1.9 million, and $1.75 million.

That's **more than $14 million in outlier-related fines in 2008** alone. [3]

Have you fallen prey to the same tactics?

After all, if a hospital will try to illegally "game" the Medicare system—probably the most heavily regulated part of our industry—wouldn't they do the same to an insurance company?

Remember, by definition an outlier is at the most costly end of the spectrum, being paid at a discount against billed charges.

Yet these cases—which are supposed to be only the 5.1% most expensive admissions—routinely generate 15% to 40% of the total billings for certain hospitals in any given year.

Are you protecting yourself against this type of **unreasonable overbilling**?

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1. "Healthcare Spending and the Medicare Program," MedPAC, June 2008, page 91
2. "N.J. consultancy will pay to settle outlier case," Modern Healthcare, March 6, 2008
3. Previous issues, Modern Healthcare, retrieved November 24, 2008

Tough question #5: Is this contract competitive, compared to Medicare rates?

Medicare constantly reviews its payments to stay current with the latest medical practices, and to block unreasonable pricing tactics by hospitals. How does this contract compare to the rates Medicare is paying now?

The difference between what Medicare pays and what you pay is the hospital's profit.

Background

As you know, Medicare is the largest single buyer of health care in the country, representing $387.2 billion of claims in 2006.[4]

To get the most from every taxpayer's dollar, **Medicare's goal is to reimburse hospitals at cost**. Profits are not supposed to flow from the hospital stays of senior citizens under Medicare.

To meet this goal, Medicare researchers constantly review hospital fees and medical procedures, including the latest advances that can shorten hospital stays and reduce costs.

Every quarter, Medicare issues adjusted fee schedules to reflect its latest findings. Over time, many payments go down, especially the newer technologies and procedures.

Checking these Medicare fees can provide you with useful benchmarks, for two reasons.

First, you can consider Medicare fees **an approximation of a hospital's costs**, probably closer than you can get with your own research. So the difference between what Medicare pays for a service and what you reimburse a hospital for that service is roughly that hospital's profit margin.

Second, Medicare fees reflect the latest advances in technology and treatment protocols, which the hospital may not tell you about.

Of course, it's not in the hospital's interest to discuss any **reductions** in Medicare fees. But you will likely hear about any Medicare rates that go up.

For example, did you know that Medicare is projecting just a 3% cost increase for its "market basket" of hospital services in 2009?[5]

As the insurer, it's your responsibility to **stay up-to-date on the latest Medicare research** like this.

Otherwise, you risk over-paying your hospitals for many services.

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4. MedPAC, June 2008, page 5

5. "Report to the Congress: Medicare Payment Policy," MedPAC, March 2008, page 47

Tough question #6: What margins does this contract give to this hospital?

How much margin is this hospital making on your business? How does that compare to similar hospitals in the same market, and to the national averages?

If you don't know how much margin you're giving a hospital, that's like throwing darts at a dartboard.

Background

If you don't know **how much margin** you're giving to a hospital, and how that compares to other hospitals, you don't have much basis for negotiation.

That's rather like throwing darts at a dartboard and hoping the numbers turn out okay.

And just looking at your last contract with that hospital is not enough, especially if you don't know what margin you paid in the previous year.

We've already seen how Medicare fees can help you zero in on a hospital's profit margin.

Wouldn't you like to compare the hospital in question to similar hospitals in the same marketplace?

And to the national averages for hospitals of a similar size and nature?

Knowing these numbers would be a smart way to evaluate any contract, and a **terrific negotiation tactic** to protect you against over-paying.

Tough question #7:
Are you allowing for this hospital's ongoing markups in your discount rates?

For more than a decade, many hospitals have been boosting their markups to help maximize their revenues. Does this contract protect you from increasing markups by this hospital?

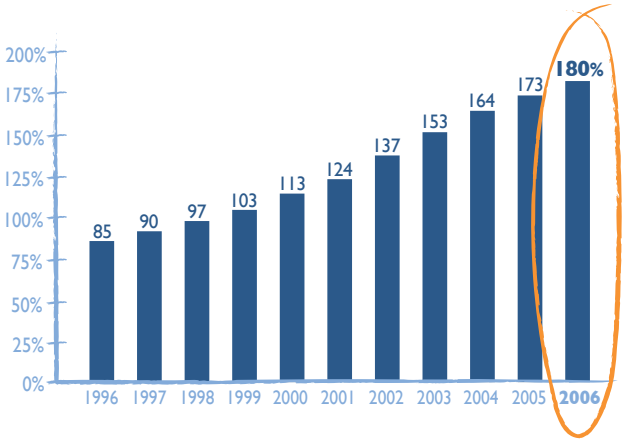
Over time, continuous jumps in markup outstrip any reasonable allowance for inflation.

Background

Figures from the American Hospital Association show that from 1996 through 2006, the actual costs for hospitals increased by 6.5% a year—yet they increased their charges by an average of 11% a year. [6]

A decade's worth of increases add up.

In fact, MedPAC found that the average hospital markup was 180% in 2006.[7] And it's certainly grown since then. In other words, the average hospital is now billing at more than three times its actual costs, as shown in Figure 2.



After more than 10 years of marking up costs beyond the inflation rate, hospitals now charge patients **almost three times** their actual costs.

Figure 2: Hospital Markups Beyond Cost, 1996 through 2006
Sources: American Hospital Association Annual Survey of Hospitals, MedPAC

MedPAC's conclusion is this: "More rapid growth in charges than costs may reflect hospital attempts to maximize revenues from private payers (who often structure their payments as a discount off charges.)"

If the hospital is billing you at three times its costs, you need a 66.6% discount to get back to its true costs.

The difference between 66.6% and your negotiated discount is the hospital's profit margin.

But remember, even a 60% discount off a 180% markup still gives the hospital a 12% profit. Any less discount leaves the hospital even more profit.

As an insurer, your good faith in offering a fair inflation rate can be undermined by continuous jumps in the markups that hospitals charge. Over time, these markups can far outstrip any reasonable allowance for inflation.

If you aren't watching out for these markups, who is?

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6. MedPAC, June 2008, page 91
7. Ibid

How to find the answers you need

This white paper poses some tough questions.
Here are three suggestions for how to find the answers.

Finding these answers will protect your company in all future negotiations.

Finding answers tip #1: Monitor Medicare's market basket

To answer any questions that touch on Medicare, you can check the costs of selected services in what Medicare calls its "market basket." It's a good idea to **assign one analyst to monitor Medicare** and watch for any significant fee changes that affect this market basket.

Finding answers tip #2: Do more research in-house

To answer other questions, you'll need to look through **at least the past year's worth of charges** from the hospital.

You will need to find several factors:

- the ratio of fixed to discounted charges
- the facts about outlier payments
- how your payments compare to Medicare rates
- the overall inflation rate you give to the hospital, in total and on specific services
- the overall margin you give to the hospital, in total and on specific services.

Do your current analysts have the knowledge to carry out this research?

Do they already bring the issues in this white paper to your attention, and prepare analytics to defend your firm?

If not, you may need to hire additional staff to complete this research. And with proper direction, you should expect them to pay for themselves.

Finding answers tip #3: Add automated systems

Or you can bolster your internal resources with **automated systems** that streamline this research process, and produce more of these metrics for you.

Then your experts can spend their time producing evidence and negotiating better contracts, instead of hunting for data and setting up spreadsheets.

You may well do better with an experienced vendor who can deliver a fresh perspective on these matters, rather than asking in-house staff to architect a whole new approach.

In the end, **finding these answers will definitely protect your company** in all your future contract negotiations with hospitals.

Most insurers need a more refined process for reviewing contracts.

Conclusions

This white paper has shown several areas where insurers need a **deeper, more granular analysis** of hospital contracts.

And this analysis needs to percolate up and down through the ranks of your entire company.

You need to accept the fact that **certain hospitals deliberately try to maximize their revenue**, using pricing tactics that most insurers don't guard against.

To protect your firm from these tactics, you need to foster deeper analysis, better communications between your teams, and a more refined process for reviewing contracts.

If you don't, you could end up paying unexpectedly high rates... rates that generate unjustified and unfair returns for certain hospitals, and cut drastically into your company returns.

About Health Plus Technologies

We published this white paper to help health insurance executives understand some of the subtle ways that hospitals try to squeeze more money out of their contracts.

In our experience, these tactics are not well-understood by many of those involved with negotiating contracts with hospitals.

To find out more about how to protect your company in all contract negotiations with hospitals, feel free to contact us at 937.396.8913 or sales@healthplustechnologies.com.

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