CASTLIGHT HEALTH

Closing the Gap: Reducing Price Variance in Health Care with Reference-Based Pricing

White Paper

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Introduction

Skyrocketing health care costs are a major concern today for both employers and their employees. One of the key factors responsible for healthcare costs spiraling out of control is the lack of standardized pricing for routine services and procedures. For example, the cost to an employer of a service such as a MRI can range from a few hundred dollars to several thousand dollars—for exactly the same test. Reference-based pricing (RBP) is an innovative medical benefit design that helps employers control costs while preserving choice and access to care for employees.

By setting a fair reference price, or a cap, on the amount that an employer agrees to pay for a given health care service, RBP incentivizes employees to seek reasonably-priced, high-quality providers. Typically, under a RBP benefit design, the employee pays the difference between the reference price and the provider's price. Market pressures encourage providers not to charge beyond what the reference-based market will bear.

Background

Studies have demonstrated that RBP policies for both pharmaceuticals and limited medical services have resulted in cost savings and patient behavior change.

History of Reference-Based Pricing

RBP is not a new concept. While RBP has only been recently implemented in a limited capacity for medical services, in the last two decades RBP has been a mechanism to control pharmaceutical costs, initially in Europe, and later in North America.[1,2,3] In particular, RBP has been used to encourage patients to switch to generic versions of therapeutically equivalent drugs, which offer the same benefits and name-brand drugs at significantly lower prices. In most implementations, the reference price is set just above the price of the generic drug, and costs above this price for name-brand drugs are the responsibility of the patient.

Typically, patients choose the generic option to avoid excess spending for no clinical benefit. Indeed, reference pricing pharmaceuticals has resulted in significant aggregate shifts in patients' drug purchasing choices over time. A recent Cochrane review of ten studies of RBP for pharmaceuticals found that, overall, drug expenditures dropped significantly associated with a 60 to 200% increase in the purchase of drugs below the reference price.[4]

Reference-Based Pricing Example

A 55-year old man requires regular lipid panels after being diagnosed with high cholesterol. At least once a year, his employer will pay a certain yet unpredictable amount for his lab tests. Wild price variations can be observed in the market for a lipid panel — in some geographic areas, as much as 500% or more. With RBP, his employer sets a fair reference price typically based on the average price for the service in the area, and does not pay costs above the reference price. If the man chooses to go to an expensive lab provider, he will pay the full amount of the costs above the reference price. Studies have shown that most employees gravitate towards providers at or below the reference price to avoid additional spending. However, some employees, may be willing to pay extra for the convenience of going to a somewhat higher cost provider. With reference pricing, this choice is preserved for them.

Impact of RBP

In Theory: Massachusetts Health Care Mandate

The likelihood that RBP can generate massive savings for risk bearing entities is very real, and has been recognized by numerous organizations who are actively considering and implementing RBP programs. For example, following the groundbreaking Massachusetts health care mandate of 2006, which ensured coverage for all state residents, healthcare spending in the state was expected to rise significantly. In an effort to identify potential areas for reaping large-scale, systemic savings, a study was undertaken by the RAND Corporation. The RAND researchers found that implementation of a RBP program for selected hospital services could save the state between $500M to $8.6B over a ten-year period.[5] The evaluators noted a two-fold charge difference for a variety of services between the state's academic medical centers, which were the most expensive, and community hospitals, which were less costly for patients, particularly for routine care. By setting the reference price in accordance with prevailing prices for given services from the lower-cost community hospital rates, significant savings could be possible. While the recommended program has not been implemented in Massachusetts, the analysis nonetheless pointed towards significant potential for reigning in healthcare costs by leveraging RBP.

In Practice: CalPERS & Elective Inpatient Surgery

In 2011, the California Public Employees' Retirement System (CalPERS) implemented a value-based purchasing program for hip and knee replacement surgeries. CalPERS and its insurance carrier noted that the hospital costs for hip and knee replacement surgeries in California ranged from less than $15,000 to over $90,000.[6] CalPERS set a reference price of $30,000 for hospital costs per surgery for members enrolled in their commercial PPO insurance plan. If a member had surgery at a facility below the reference price, the member would be responsible for 10% of the costs up to a maximum of $3000. However, if a

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member chose to receive surgery at a facility above the reference price, the member would be responsible for the same $3000 as well as any costs over $30,000.[6]

Initial results of the CalPERS program have been impressive: CalPERS reported saving an average of 30% on the cost of hip and knee replacement surgeries since program implementation.[7] Moreover, because it is one of the largest health care purchasers in California (spending nearly $7 billion for health care annually), this program has resulted in not only member movement towards providers below the $30,000 reference price, but in at least five higher priced providers lowering their prices to under the $30,000 cap.[8]

Risks & Concerns

Although RBP incentivizes employees to gravitate towards high-quality, lower-cost providers, employers risk employee dissatisfaction associated with a perceived narrowing of options as well as potentially disappointing experiences with unfamiliar healthcare providers. Additionally, getting the most value requires employees to acquire basic RBP program knowledge and actively choose among their options when a service is required. Employers need to consider how to align corporate values and financial realities with their approach to rolling out a RBP benefit design. However, when thoughtfully designed implemented, RBP can lead both to significant cost savings for employers and employees alike.

Key Strategies for Success in Reference-Based Pricing

Setting the Appropriate Reference Price

The setting of the reference price for an RBP program requires balancing two priorities: maximizing employer savings while ensuring convenient access to services for employees. A rock-bottom reference price could result in significant savings for the employer. However, the lower the reference price, the fewer the number of providers available below the reference price in a given geography. Conversely, a higher reference price would increase the availability of providers below the reference price but would result in smaller employer savings from the program. A thoughtful RBP program balances these two priorities and can do so by establishing the maximum distance that employees should have to travel for access to below-RBP providers.

Considering Geographic Differences

A careful approach to setting reference prices also involves consideration of the price variance for any given service in any given geography. For example, national laboratory provider chains such as Quest Diagnostics and LabCorp of America often have low prices. Setting reference prices for lab services in areas where these chains exist can be set lower than in those where these providers are not available. In contrast, in rural areas where there are just a few providers, setting the reference price may be based on the average cost in that area.

Building in Exceptions and Exclusions

It's also important to note that not all services and procedures should be reference priced. For example, laboratory or imaging tests performed as a part of inpatient or emergency room care are not "shoppable" and should not be subject to reference pricing. Additionally, employees with certain clinical conditions that require urgent care on the basis of test results should be exempted from RBP policies for their testing. A well-designed RBP program only includes those services that are shoppable and those populations for whom RBP would not affect the delivery of high quality care.

Assessing the Claims Adjudication Process

Claims adjudication is a complex and critical component of any RBP program, and given its complexity, is often managed and implemented by the employer's insurance carrier. Adjudication for laboratory testing is relatively simple, as laboratory tests typically involve only one billing code. In contrast, adjudication for imaging, colonoscopy, and surgical procedures is more complex. Given the heterogeneity in billing practices for services, it is common to apply the reference price the facility charge for the procedure (rather than the professional or doctor's charge).

Educating Employees

For employees to make informed decisions about RBP providers, they must have robust information about the benefit design, reference prices, and their expected costs for any service from a given provider. Investing in a comprehensive educational campaign to teach employees about reference pricing and implementing a transparency tool such as Castlight, which can provide personalized price, quality, and educational material on the design of the RBP program, play critical roles in creating educated and informed employees.

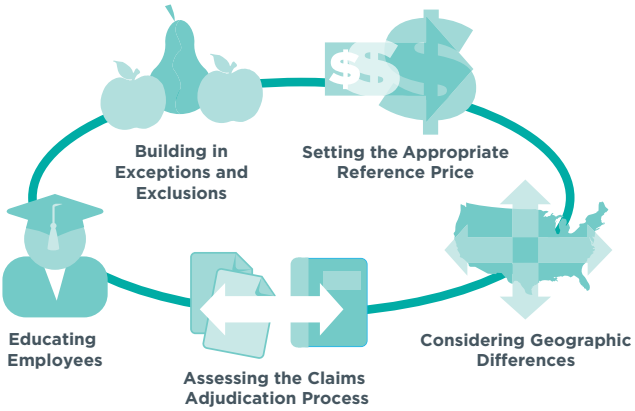

Figure 5: Key strategies for success with RBP

Conclusion

Employers may choose to implement an RBP program for a variety of reasons, including minimizing costs from medical price variation and incentivizing employees to choose higher-value providers. Successfully implementing an RBP program, however, requires careful diligence on the part of both employers and their partners in designing a program that incentivizes the appropriate behaviors, while remaining fair and preserving employee choice. Key best practices involve considerations around price setting, geographic differences, exceptions and exclusions, adjudication assessment, and employee education.

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