What is Health Care Cost Trend?

Claim costs typically represent anywhere from 70% - 90% of our health care premium dollars. While fixed costs for services can certainly be re-aligned to provide the highest quality assistance and the lower cost, in order to manage health care claim costs, it is important to understand the various components of what is published as “healthcare cost trend.” And how healthcare cost trend differs from the medical component of the consumer price index (CPI).

Healthcare cost trend is defined as the change in the cost of healthcare. Five components of healthcare trend include:

- **Price inflation** – This is the change in the price of healthcare services. This is a component of trend that represents the healthcare component of CPI.

- **Deductible leveraging** – This is the change in cost to a health plan due to a constant plan design while costs increase at trend rates. A simplified example might be this. In year one, a $1,000 claim is subject to a $500 deductible and then the plan pays $500. In year two, that same $1,000 claim is now 10% higher, or $1,100. The deductible remains the same at $500 and the plan now pays $600. While the claim only went up 10%, the cost to the plan increases 20% ($600/$500).

- **Utilization** – This component reflects an increase in the demand for medical care services in response to factors such as plan design, participant age, and new medical technology and services.

- **Technology advances** – This reflects the change in cost due to new procedures, information, experience, and equipment replacing older techniques.

- **Cost shifting** – This reflects a provider of medical services shifting their revenues from discount payers to reasonable and customary payers. Discount payers include Medicare, Medicaid, and managed care plans including HMOs and PPOs.

Prospective health care trend is a prediction of trend used by insurance companies and actuaries for insured and self-insured plans.

Retrospective health care trend is a measure of the actual change in health care costs experienced.

Prospective trend sources

- Insurance companies based on their own block of business
- Surveys of many insurance companies
- Consulting firms / healthcare actuaries
Retrospective trend sources

- Consulting firm surveys of plan sponsors
- Insurance company data
- Independent surveys of plan sponsors

It is important to note that retrospective trend sources may actually reflect trend that has been offset by benefit reductions implemented by the plan sponsor. Both pre- and post- benefit differential offset trend factors are helpful, but it is important to know what the data reflects.

One typical financial objective for plans that truly professionally manage their health care cost according to a long-term strategy is to “beat” national trend by some percentage. Developing objectives based on relationship to “national trend” introduces a number of challenges including:

- Should actual results be measured against predicted future trend?

- Should plan sponsor results be compared with other plan sponsor results? In doing so, we must recognize that other plan sponsors included in survey data have made different adjustments and changes to plan and premium cost sharing strategy to address rising health care costs. To make a credible comparison, these benefit changes, different plan options, and different cost sharing strategies must be offset with reasonable actuarial assumptions.

- Changes in design, contribution strategy, or participant demographics make a one-time impact to reduce costs, but without further strategic changes (plan design and cost sharing management) in the future, health care trend will resume and quickly move closer to “national trend” rates albeit from a lower starting point.

- Short-term trends (i.e. one year) are more predictable than long-term trends (i.e. ten years).

- What changes from original assumptions are controllable?

- Trend rates for a plan sponsor may vary from “national trend” for a number of reasons, including:
  - Regional cost variations
  - Plan design
  - Demographics
  - Size of participant group

- Insurance company trend rates versus self-insured plans (insurance company trends may reflect their profitability position and be higher or lower than “real” claim cost trend rates)

- Active versus retiree populations (retirees use a higher percentage of medical services and prescription drugs).
Here are some thoughts on how an objective to “beat national trend by 2%, or more, per year” might be measured and monitored.

Predicted trend is in reality “national trend” adjusted for any specific deviations that can be anticipated will impact plan sponsor costs. Health Care Reform benefit mandates provide a current example.

While comparing actual results to budget each year is useful from a financial perspective, deviations above or below budget in any given year are just as likely due to year-to-year volatility as with meaningful behavior change. Additionally, if a plan sponsor’s number of plan participants is relatively small, costs will naturally be subject to more year-to-year volatility relative to larger groups. For this reason, we would suggest that a better approach would be to review a longer time frame than one year. We would suggest that a measure that takes into consideration a rolling four or five years of actual cost, would minimize volatility, and provide a more realistic benchmark over time.

While surveys of historical trend would generally reflect cost changes unmodified for plan design and cost sharing change rather than actual trend, this benchmark for measuring the successful management of a plan sponsor’s cost may be the most practical in terms of quantifiable information. Because survey respondents may also be making changes in plan design and cost sharing to “beat trend”, it may be necessary to adjust a plan sponsor’s objective to reflect this fact.

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