MARWOOD GROUP

Inflation May Accelerate Trends Reshaping the Healthcare Landscape

Executive Summary and Outline

While inflation has been top of mind to consumers, its impact has been uneven. Nowhere is this more evident than in healthcare, where on the surface inflation appears little changed from the year before. Appearances may be deceiving however as its impact slowly reverberates through contract negotiations and policy. Inflation will impact each step of the healthcare value chain, not only creating challenges, but opportunities in cost containment, cost-efficiencies and additional services which improve member health as we emerge from the pandemic. To that end, we provide perspective on the likely measures and countermeasures of providers and payors, as inflation catches up with the healthcare industry.

I. Inflationary Impact to Healthcare Has Been Muted: Appearances May be Deceiving

The Consumer Price Index for All Urban Consumers (CPI-U) rose 7.5% in the 12 months ending January of 2022, the largest 12-month increase since the 12-month period ending February 1982. Comparatively, the average price of healthcare in the US rose only 2.5% in that same period, after rising 2.2% in the year prior, according to the US Labor Department's Bureau of Labor Statistics (BLS).[1] The prices for prescription drugs continued at an average of 5.8% in the 12 months ending January 2022, noting that in 2021, they went up 5.2% on average.[2] Yet in only the first 3 months of 2022 drug companies have increased prices on 554 drugs with the average price hike of 6.3% and 1 in 4 price hikes exceeded the inflation rate.[3] Meanwhile, even as other industries have seen pay raises keeping up or at least approaching inflation, healthcare remains one of the least likely industries to give a pay raise over 3%.[4] Similarly, cost of medical supplies, despite shortages in PPE and other disposables, have thus far had a muted impact on the BLS average price of healthcare. Thus, not surprisingly, health insurance costs have remained mostly steady-with just a 0.67% ($48/year) increase in average premiums in 2022 compared to 2021.[5]

However, these numbers may be deceiving as the duration of contractual terms, whether payor to provider or provider entity with employee and supplier, introduce an inherent delay before costs are no longer absorbed but passed on to payors and patients. This then reverberates into Medicare rates

[1] www.bls.gov
[2] Drug price increases for 460 drugs in 2022. BioSpace. Jan 4, 2022.
[3] US faces 'critical moment' in pricing reform that won't come again,' nonprofit founder says after tallying 554 new hikes. Fierce Pharma. Jan 14, 2022.
[4] Healthcare workers' pay increases lag behind white-collar raises. Becker's Hospital CFO Report. Feb 21, 2022.
[5] Value Penguin. Nov 22, 2021.

which are reliant on the larger healthcare spending basket to calculate adjustments. Herein we provide perspective on the likely measures and countermeasures of providers and payors, as overall inflation (CPI) catches up with the healthcare industry.

II. Providers Are Under Increasing Cost Pressure

In recent years, commercial health insurer's per-person spending on hospitals' and physicians' services has grown more quickly than analogous spending by the Medicare fee-for-service (FFS) program. Private insurers on average pay nearly double Medicare rates for hospital services, in a range of 141-259%.[6] The difference between private and Medicare rates was greater for outpatient hospital services, which averaged 264% and 189% of Medicare rates overall, respectively.[6] For physician services, private insurance paid 143% of Medicare rates, on average, ranging from 118% to 179% of Medicare rates.[6]

While both commercial and Medicare rates are set in advance, these trends as well as the structure through which Medicare is reimbursement is set, indicate greater flexibility to negotiate higher rates with commercial payors than Medicare. Thus, higher costs including increased pressure from labor contracts (typically indexed to CPI), supplies (witnessing upward pressure from supply chain disruption) and drugs (a continuing trend) will be disproportionately borne by commercial payors which either will accept the costs or develop cost containment strategies to push back on the provider. In the latter case, these negotiations may become more intense as doctors and hospitals simultaneously contend with higher costs and must consider cost containment strategies of their own. Higher inflation would thus not only widen the gap between public and private reimbursement—forcing physicians to charge more from their private sector clients—but also lead both payors and providers to distribute the pain between cost containment and cost transfer through higher insurance premiums and patient out-of-pocket.

III. Payor Efficiencies Continue to Transform the Provider Landscape

From a cost-containment perspective, insurance companies may try to use their growing market power to 1) limit provider reimbursement growth, 2) narrow both provider and pharmacy networks or 3) manage reimbursed access to medical care:

Payors may push back on providers during contract negotiation.

Rural hospitals, which derive a larger share of revenue from Medicare and Medicaid, and thus are reliant on smaller portion of commercial payors to offset losses, may be placed in a more precarious position. Notably, rural hospitals have already been closing at an accelerated rate since the beginning of the pandemic.

Smaller physician practices, with minimal contract leverage, may find the rates challenging in light of CPI increases that impact fixed costs, thus accelerate the trend of provider group consolidation.

Payors may narrow networks while further limiting out-of-network coverage

Narrowing of provider networks will further limit sites of care to those where either the payor has aggressively contracted or where the provider (whether health system/hospital or physician group) has demonstrable leverage in the space. Urban markets are likely under greater pressure, due to

[6] How much more than Medicare do private insurers pay? A review of the literature. KFF. April 15, 2020.

competition, while rural markets may face reduced pressure given fewer payor alternatives to site of care.

Narrowing of pharmacy networks may accelerate the trend toward both integration of health plans around PBM-captive (payor-integrated) pharmacy efficiencies and preferred networks to reduce pharmacy margins. Greater captive pharmacy leverage may also drive greater application of white-bagging, primarily in the hospital setting, to counter the growth of 340B pharmacies and payor-perceived cost inefficiencies therein.

Payors may more aggressively manage patient access to care

Payors may employ greater use of prior authorization not only to limit, but to direct patient access. From a site of care perspective, this may include directing patients away from the hospital outpatient setting, where freestanding facility or even home care can be provided at a significant discount to the payor. From a procedure perspective, greater application of provider attestation may be required where, for example, diagnostic applications, deviate from established lower-cost alternatives.

From a pharmacy perspective, this may translate into increased integration of pharmacy-PBM services not only to establish more rigorous prior authorization requirements or step-edits where alternatives exist, but also impact both site of care and pharmacy selection criteria. Payors may more aggressively steer patients to the ambulatory infusion and even home setting. Integrated PBMs may direct prescriptions to captive pharmacies.

IV. Employer Plans Seek Creative Solutions in a Tight Labor Market

For fully insured group health plans, insurance companies set plan premiums before the start of the year. Employees, however, pay many health costs below the plan deductible out of pocket, and often are charged co-payments after reaching their deductibles, making patients susceptible to inflation.

For self-insured group plans, employers are responsible for all costs for health claims beyond what employees pay under the plan, although reinsurance coverage typically protects employers against unexpected "catastrophic" costs. Payors may raise premiums for employers in the U.S. expect their group health plan premiums to increase, on average, between 4.7 percent and 5.2 percent in 2022, even after taking cost-containment and other cost-transfer initiatives into account.[7] In a tight labor market, employers may need to absorb most of the health care cost increases. In addition, they may be budgeting higher due to uncertainty and the anticipation of members facing health conditions with increased severity due to chronic conditions left unmanaged during the pandemic and increased mental health needs as a result of it.

This may lead employers to consider cost-containment mechanisms including policies associated with specialty drugs and network access as described above, as well as reevaluating partner/spouse surcharges. Premium contribution based on pay may also be on the table. Yet, it may also lead to greater investment in health improvement services that tie together not only the impact of the pandemic to well-being, but the technology revolution accelerated by it:

- Behavioral services via telehealth for mental health services including counseling for alcohol and drug abuse

[7] Health plan cost increases for 2022 return to pre-pandemic levels. SHRM. October 8, 2021.

- Medication adherence services to help ensure that employees take their medications as prescribed, which can help improve health outcomes
- Coverage of health promotions including onsite/worksite health and wellness promoting activities

V. Future Considerations

Inflation impacts each step of the healthcare value chain, not only creating challenges, but opportunities in cost containment and cost-efficiencies including new models of healthcare delivery as well as services aimed at improving member health. Target analysis in this environment requires an understanding of emerging federal legislation to moderate drug pricing and CMS approaches to inflationary adjustment, as well as implications of inflation to both provider and payor. Marwood's services span provider cost-containment, payor dynamics from a Medicare, Medicaid and commercial perspective, as well as a strategic overlay to evaluate emerging opportunities.

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