



Examining Health Care

Demystifying Global Payments - Part 5

Managing the Flow of Funds and Financial Risk

Under a global payment contract that includes performance incentives, a provider group has three sources of income related to patient care: a fixed amount for all of its patients' anticipated medical services, patients' co-pays and co-insurance, and any payments the group earned for achieving predetermined quality targets.

A common misconception about global payment is that the provider group receives a lump-sum amount from which it pays for all of the expenses related to its patients' care. Rather, what typically happens is that the insurer makes estimated advance payments to the group, and then withholds payment on behalf of the group to pay for covered medical services that the group does not provide. Then, periodically, the insurer and group reconcile the estimated, partial payments to the group's global budget, less what the insurer paid to other providers.

If the provider group keeps its spending below the global payment, by becoming more efficient or helping its patients avoid unnecessary hospitalization, for instance, it retains the savings. In addition, it can earn payments for meeting the health plan's performance targets. On the other hand, if the group's costs or its patients' utilization of services are higher than the global payment, it could be faced with a deficit. That's where risk management comes into the picture.

Managing Providers' Financial Risk

The basic idea behind managing financial risk in health care is to reduce, or protect against, the inherent unpredictability of future medical costs for an individual or insured population. There are many kinds of financial risk, but the two broad categories that are most relevant to global payments are: insurance risk, which is related to the number and severity of illnesses or accidental injuries within a population, and performance risk, which concerns clinical decisions and variables like the number and cost of tests or procedures a population receives. Under fee-for-service payment, health insurers assume both kinds of risk and use various underwriting and actuarial methods to increase the chance that their premiums will be set at a level that is adequate to pay for covered services.

Global payment is designed to shift performance risk from the insurer to the provider group by setting a fixed budget and making the group financially responsible for managing the amount, quality, and type of care its patients receive. The provider then has incentives to establish clinical programs to minimize risk, as we discussed in Part 4 of this series. Some large provider groups, including Atrius Health, are willing to accept financial responsibility for insurance risk as well. This means that we are able to manage the consequences of having some extremely high-cost cases – patients who have catastrophic injuries or illnesses that require long-term intensive care, for instance – by purchasing our own reinsurance or stop-loss protection.

Most provider groups will probably want to be responsible only for performance risk – the financial consequences of clinical decisions and variables – and not for insurance risk. One protection, as we explained earlier in this series, is for insurers to base their global payments on past claim expenses and adjust them annually to account for changes in the health status of the provider group's patients. This guards against underpaying or overpaying a provider group if the medical costs for its patient population change dramatically from one year to the next.

In addition, a global payment contract might include reinsurance or a stop-loss provision that protects the provider group from liability for individual cases that exceed a certain annual threshold – \$100,000 for instance – or for total medical expenses above an annual target.

In well-designed global payment contracts, the alignment of financial incentives and risk management strategies should encourage providers to deliver safe, effective, patient-centered care, while also driving out clinical inefficiency and the overuse and misuse of medical services. Over time, as more providers operate under global payment in Massachusetts, the resulting savings will work their way through the health care system and help to moderate future premium increases.

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"Time to take the lead on payment reform" - *Boston Business Journal*, October 2009

"The next chapter in healthcare reform" - *The Boston Globe*, July 2009

"Doctors need bigger role in health reform" - *The Boston Globe*, July 2009

NEXT ISSUE

Moving ahead with Massachusetts payment reform.

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