

The Regents of the University of California

COMMITTEE ON HEALTH SERVICES

March 20, 2014

The Committee on Health Services met on the above date at UCSF–Mission Bay Conference Center, San Francisco.

Members present: Regents De La Peña, Feingold, Island, Makarechian, Pattiz, Reiss, and Zettel; Ex officio members Lansing, Napolitano, and Varner; Advisory member Gilly; Staff Advisors Barton and Coyne

In attendance: Regents Flores, Gould, Kieffer, Newsom, Schultz, and Sherman, Regents-designate Engelhorn, Leong Clancy, and Saifuddin, Faculty Representative Jacob, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice President Stobo, Vice Presidents Andriola, Beckwith, Duckett, Lenz, Mara, and Sakaki, Chancellors Block, Blumenthal, Desmond-Hellmann, Drake, and Wilcox, and Recording Secretary McCarthy

The meeting convened at 10:40 a.m. with Committee Chair De La Peña presiding.

1. APPROVAL OF MINUTES OF PREVIOUS MEETING

Upon motion duly made and seconded, the minutes of the meeting of January 22, 2014 were approved.

2. SCALE FOR VALUE: BRIEFING ON THE UC HEALTH CLINICAL ENTERPRISE

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Committee Chair De La Peña thanked Chancellor Desmond-Hellmann on behalf of the Committee for her extraordinary performance as Chancellor of UCSF, with leadership and integrity that would always be remembered.

Committee Chair De La Peña recalled that, two years prior, UC's student health centers were reviewed by the Marsh USA, Inc. and interventions were implemented to address the concerns outlined in its report. To follow up, activities in the student health centers would be reexamined using a two-pronged approach. Keeling and Associates had been engaged to review activities related to clinical documentation, and UC's internal audit group led by Senior Vice President Vacca would examine activities related to governance, credentialing, and medical records. Both reports would be completed by the

end of the current month and would be shared with the Board. Point and Click Solutions, Inc., is the provider of the medical record software used at the ten student health centers. Beginning shortly, a new reporting system would be used consistently by the ten UC student health centers, increasing their quality of care even further.

Senior Vice President Stobo presented an update on efforts to maintain UC Health's financial vitality by employing a systemwide approach to reducing costs across its clinical enterprise. These efforts have been ongoing for the past two years, and were a result of an examination of the effects the Patient Protection and Affordable Care Act (PPACA) and the current healthcare environment would have on UC's clinical enterprise. Historically, the year-to-year increase in UC medical centers' operating revenue, the amount UC's clinical enterprise in the aggregate was reimbursed for clinical services, was approximately ten percent. This increase contrasted to a year-over-year increase in expenses of approximately six percent. The resulting operating margin, or difference between revenue and expenses, was used for capital renewal of equipment and programmatic support for UC's health professional schools. In any given year, roughly 50 percent of the operating margin supports programs and personnel associated with the clinical enterprise, and is critically important to sustain the programs in UC's health professional schools, mainly its schools of medicine.

In the future, rather than a ten percent year-over-year-increase, Dr. Stobo anticipated that UC Health would receive a five percent year-over-year revenue increase. Commercial contracts that had provided ten percent year-over-year increases in the past were now being negotiated with a five percent increase. When these three-year contracts expired in 2017 or 2018, year-over-year increases would likely be reduced to four percent. In that environment, a six percent year-over-year increase in expenses would be unsustainable; expenses would outweigh revenues in 2017, eliminating funds for capital renewal or for support of programs in the schools of medicine.

Dr. Stobo noted that Committee Chair De La Peña had been extremely helpful in convening a UC health summit meeting with several Regents, the CEOs of UC's medical centers, and the CEOs of three other large health systems, University of Michigan, Barnes Jewish Christian HealthCare, and Vanderbilt University. The outside CEOs were asked whether they considered UC Health's financial forecasts to be accurate and for their recommendations on how best to succeed in the new healthcare environment. The CEOs agreed with UC's forecasts, since their health systems' markets were roughly two years ahead of UC's, and they were currently experiencing three to four percent annual increases in clinical revenue. They all recommended that in order to succeed UC must take advantage of its scale to reduce expenses.

Since that time, discussions had been held with leaders of other large health systems to learn what systemwide practices would be most beneficial. Another UC Health summit was held in November 2013, including President Napolitano, the UC chancellors of campuses with health-related activities, the CEOs of UC's medical centers, and the deans of its medical schools. President Napolitano asked UC Health to develop a plan that would provide a blueprint for action in the upcoming year to leverage UC's scale to

reduce expenses. The President has approved the plan that was subsequently submitted to her. Additional meetings have since been held, one with the medical center CEOs and medical school deans, and another with those executives, plus the chief financial officers and chief operating officers of UC's medical centers.

Nine areas have been identified in which UC Health could leverage its size to achieve savings, with three areas chosen for initial focus. The first would be supply chain or purchasing. UC Health purchases roughly \$2.4 billion of supplies annually, of which possibly \$150 million could be saved each year by leveraging UC's purchasing power. The second area of focus would be revenue cycle, or securing funds owed to UC Health; the third would be in clinical laboratory fees. UC Health currently sends out \$20 million of laboratory tests to other institutions annually; these tests could be done internally. Other areas such as information technology, administrative services, pharmacy, quality improvement, direct contracting, and clinical innovation also represent opportunities for cost reduction and would be undertaken after savings programs in the first three areas of focus were initiated. The implementation process would be slightly different in each area and it would be important that UC Health personnel feel included in this process. A managing group called the UC Health Shared Services Managing Council, consisting of Dr. Stobo, the Chair of the Committee on Health Services, the medical center CEOs, several medical school deans, several chancellors, outside advisors, and representatives from the Committee would oversee the implementation of the new processes. Dr. Stobo expressed hope that, over the upcoming two to three years, programs could be developed that would save UC Health \$150-\$200 million annually, or one-third of the \$500-\$700 million annual cost savings that must be accomplished in a short time. Each medical center must also achieve cost reductions on its own, but these would have to be combined with systemwide savings to achieve the needed level of expense reductions. UC Health must take advantage of the size and scale it brings to the contract negotiating table. Dr. Stobo said he would report to the Committee on the progress of these efforts over subsequent months.

Regent Lansing thanked Dr. Stobo for his excellent presentation. She recalled prior times when UC hospitals did not earn profits, and noted the rapid pace of current changes in the healthcare environment. While each UC medical center would like to control its own destiny to some degree, the current environment necessitates using the strength of UC Health acting together systemwide. Regent Lansing suggested considering whether each UC hospital should provide every service, or if UC hospitals should specialize in particular services. President of UCLA Health System and CEO of the UCLA Hospital System David Feinberg said that some specialization at UC hospitals was underway. Transfer centers have been set up in Southern California from which complex cases are transferred to UC hospitals that specialize. For example, a consortium had been started and was working well to treat liver transplants; the pre- and post-operative care would be at UC Irvine, and the transplant would be at UC San Diego or UCLA. UC hospitals in Northern California were cooperating in a similar way in their clinical services with laboratory work. Chairman Varner recalled that the Committee had previously discussed having each medical center develop a strategic plan. Regent Lansing added that hospitals giving up certain services would have to be compensated in some way.

Regent Makarechian asked whether commercial insurers offering five percent year-over-year increases were offering lower rates of increase because they had the option to take their business to other hospitals. Dr. Stobo responded that such offers merely reflected the healthcare market. Current contract offers typically contained six percent increases for the first year, five percent for the second year, and three percent for the third year. These commercial insurers could contract with other hospitals at a lower cost. Insurers were narrowing their networks to lower-cost providers and UC must be able to compete in this environment. Regent Makarechian asked why other hospitals could provide services at a lower cost than UC, particularly considering UC's size and buying power. Dr. Stobo pointed out that consideration of year-over-year rates of increase must take into account the fact that UC's rates were initially higher than other providers'. UC's costs were higher, partly because of the social services that UC provides, for example its research and education of healthcare professionals. Regent Makarechian expressed his understanding that these services were paid for with profits from the clinical enterprise. Dr. Stobo confirmed that the medical centers provide funds to subsidize medical education in each of UC's medical schools. Most other providers do not have to support the cost of medical education and providing uncompensated medical care. Regent Makarechian summarized that UC Health's costs are higher because it provides more services to society. Dr. Stobo agreed, and commented that, in the current healthcare environment, society is less willing to pay for the services UC provides. Committee Chair De La Peña added that many health plans accept only certain patients, such as those who are not elderly, uninsured, or high-risk. UC accepts all these patients, who are often more costly to treat. In the past UC was paid about \$700 million annually in Disproportionate Share Hospital (DSH) payments from the federal government to help subsidize uninsured patients, but in the current environment the status of these payments was uncertain.

Chairman Varner noted that the University provided approximately \$650 million annually in public service for uncompensated healthcare which is an important part of UC's public mission. He asked if a systemwide strategic plan would be developed for UC Health. Dr. Stobo said that would be discussed at an upcoming UC Health Council meeting. Dr. Feinberg added that there was grassroots support for these initiatives from personnel at UC's five medical centers.

Regent Gould asked Dr. Stobo for his evaluation of the effect of the PPACA and increased enrollment through Medi-Cal and Covered California, the statewide medical insurance exchange. Dr. Stobo responded that Covered California was very serious about implementing the exchange and the PPACA, and would be the major force in establishing payment policy in California. It was clear that Covered California wanted to have affordable products in the exchange. In order to participate in the exchange, UC accepted rate decreases of 11 to 22 percent. Covered California would be an important driver in reducing costs.

Dr. Stobo observed that it was difficult to predict the effects of the Medi-Cal expansion. Some patients for whom UC had been receiving no compensation would become eligible for Medi-Cal under the PPACA, but Medi-Cal would not compensate the full cost of the

services provided. Dr. Stobo emphasized that healthcare reform would be an ongoing major force in the delivery and cost of healthcare.

Committee Chair De La Peña underscored the importance of being proactive in addressing these changes. The changes in reimbursement levels could eliminate UC Health's operating margin if substantial cost reductions were not achieved.

Regent Kieffer commented that he was impressed by the degree to which UC's medical schools were supported by UC's hospital revenue and how little support came from the State. He asked what percentage of funding for UC's medical schools was from the State. Dr. Stobo responded that roughly four percent of the total budget was from the State and 15 percent from the medical centers.

Regent Newsom asked whether Medi-Cal reimbursements were included in the four percent of support from the State. Dr. Stobo responded that Medi-Cal reimbursements go to the medical centers, not to the medical schools. The four percent State support was from State general funds. Dr. Stobo expressed his view that the PPACA precipitated events that would have happened in any event. For example, the commercial insurers had been subsidizing UC's medical education for years, by reimbursing UC \$1.40 for every dollar in costs. Commercial insurers understood and were willing to support UC's public mission in the past, because there was less pressure on premiums that the commercial insurers charged to employers or individuals. The PPACA precipitated a downward pressure on the cost of healthcare and premiums that probably would have happened two or three years later. Regent Newsom asked what the effect of the reduction in DSH payments would be. Dr. Stobo said he believed the reduction would be significant, probably \$600-\$700 million annually. Implementation of these cuts had been postponed, so their effects were still unknown. Dr. Stobo said that UC had been willing to accept a reduction in DSH payments under the PPACA, because the numbers of uninsured would be reduced; the net effect could not yet be determined.

The meeting adjourned at 11:10 a.m.

Attest:

Secretary and Chief of Staff