

2008 Segal Health Plan Cost Trend Survey

Projected Declines for 2008 Represent Fifth Consecutive Year of Lower Medical Trends, Second Consecutive Year of Rx Trends Approaching Medical Trends

The 2008 *Segal Health Plan Cost Trend Survey* — The Segal Company's eleventh annual survey of managed care organizations (MCOs), health insurers, pharmacy benefit managers (PBMs) and third party administrators (TPAs) — forecasts continued declines in trends for 2008. This marks the fifth consecutive year of declining medical trends. The most surprising finding is that trends for prescription drug coverage are projected to decelerate most — to levels similar to trends for medical coverage for the second consecutive year.

More Survey Highlights

Other notable findings from this year's survey include:

- Prescription drug projected trends have declined dramatically, by nearly nine percentage points, since their high of 19.5 percent in 2003.
- Similar 2008 trend rates are forecasted for all managed care plan types, ranging from 10.5 percent to 10.9 percent.
- Price inflation appears to be the biggest element of overall medical plan trend, accounting for approximately 60 percent of overall projected preferred provider organization (PPO) trend in 2008.
- Although brand drug utilization is rapidly shifting to generic drugs

due to patent expiration and PBM efforts, brand drug inflation continues to be a major trend driver due to ongoing focus on development and marketing of biotechnology or specialty drugs.¹

¹ Specialty drugs, which require special handling, support and delivery, address a number of complicated conditions, including osteoporosis, arthritis, multiple sclerosis and cancer. This category contains genetically engineered, injectable therapies with costs greatly exceeding those of most traditional therapies. The Centers for Medicare & Medicaid Services now informally defines specialty drugs as those regularly costing \$500 or more for a 30-day supply.



What Is Trend?

Trend is the forecasted change in health plans' per-capita claims cost determined by insurance carriers, MCOs, PBMs and TPAs. Many factors influence trend:

- Price inflation,
- The leveraging effect of fixed deductibles and copayments,
- Cost-shifting,
- Utilization increases due to aging, promotion and improved diagnostic services,
- The availability and use of more expensive treatment and drug therapies, including biotech drugs,
- Government-mandated benefits and other legislative changes, and
- Technological changes and their effect on the intensity of care.

Although there is usually a high correlation between a trend rate and the actual cost increase assessed by a carrier, *trend and the net annual change in plan costs are not the same*. Changes in the costs to plan sponsors can be significantly different from projected claims cost trends, reflecting such diverse factors as plan design changes, employee contribution rate increases, group demographics, carrier retention, margins, stop-loss coverage and artificial rate relief from the effects of competitive bidding.

The *Segal Health Plan Cost Trend Survey* focuses on claims cost trend — before changes in plan designs or participant contributions are considered. The 2008 survey reports projections obtained from a survey of major insurance carriers, MCOs, PBMs and TPAs conducted by Segal in the summer of 2007. Segal received more than 70 responses to the survey.* Survey participants were asked to provide the trend factors they will be applying to historical claims to predict expected claims for 2008.

* The following participants agreed to disclose their names: Aetna, Altius Health Plans, Amalgamated Life Insurance Company, Arkansas Blue Cross and Blue Shield, Assurant Employee Benefits, BeneCare Dental Plans, Blue Cross and Blue Shield of Kansas, Blue Cross and Blue Shield of Minnesota, Blue Cross & Blue Shield of Rhode Island, Blue Cross Blue Shield of Tennessee, Blue Cross of Idaho, Blue Cross of Northeastern Pennsylvania, Blue Shield of California, CareFirst BlueCross BlueShield, Care-Plus Dental Plans, Inc., Catalyst Rx, Cigna, ConnectiCare, Inc., CVS/Caremark, Delta Dental, Delta Dental of Arizona, Delta Dental of California, Delta Dental of Colorado, Delta Dental of Illinois, Delta Dental of Massachusetts, Delta Dental of New Jersey, Delta Dental of Virginia, Delta Dental of Wisconsin, Employers Dental Services, Inc., Excellus BCBS, Express Scripts, Great-West Healthcare, Group Health Cooperative (Kaiser Foundation Health Plan, Inc.), Group Health Incorporated (GHI), Guardian Life Insurance, Health Net of Arizona, Health Net of California, Health Net of the Northeast, Inc., Health New England, HealthTrans, Horizon BCBSNJ, Humana Inc., Kaiser Foundation Health Plan of Colorado, Kaiser Foundation Health Plan of Ohio, Medica Health Plans, Medical Mutual of Ohio, MetLife, MMSI, Inc., Nippon Life Insurance of America, Northeast Delta Dental, Preferred Health Systems, Prescription Solutions, Principal Life Insurance Company, RxAmerica LLC, Security Health Plan of Wisconsin, Inc., The ODS Companies, Trustmark Group Insurance, UnitedHealth Group and UnitedHealthcare.

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- Utilization rates of services continue to show more modest rate increases.
- The survey found some regional variation in medical trend projections. Survey respondents forecast trends ranging from a low of 9.4 percent in the Midwest to a high of 11.7 percent in the West.²
- Dental trends for 2008 are projected to decline modestly from

² Projected trends in the South and Northeast are 9.7 percent and 10.9 percent, respectively. These regional trends represent all medical plan types.

2007 levels. Fixed-scheduled plans and dental maintenance organizations (DMOs) have the lowest forecasted rates: 4.3 percent.

- The projected trend rate for scheduled vision plans is expected to decline by more than one percentage point from 2007 levels, to 3.6 percent.

Table 1 summarizes key findings.

Trend Ranges

Table 2 shows trend *ranges* for medical PPO coverage and retail prescription drug carve-out coverage.

Nearly one-quarter of survey respondents forecasted PPO trend rates of under 10 percent for 2008. This represents a significant increase from four years earlier when only 3 percent of respondents forecasted PPO trend rates of under 10 percent for 2004.

More dramatically, nearly one-third of survey respondents reported prescription drug trends for 2008 of less than 10 percent, up from 3 percent of respondents in the 2004 survey. Conversely, 86 percent of respondents projected prescription drug trend rates of 15 percent or greater for 2004. This compares to only 7 percent of respondents forecasting 15 percent or greater trend rates for 2008.

Trends for Active Participants & Retirees

Notable findings about trends for active participants and retirees include the following:

- Projected trends for point-of-service (POS) plans and health maintenance organizations (HMOs) peaked in 2003 for actives and retirees under age 65 and have declined steadily since then.
- Trend rates for active and early retirees are slightly higher than for Medicare-eligible retirees for most medical and prescription drug plan types.
- Medicare Advantage HMO plans have the lowest projected medical trend for 2008: 8.8 percent.
- High-deductible health plans (HDHPs) are forecasted to be at similar levels to other managed care plan types.
- The forecasted trend rate of 10.7 percent for retail prescription drug coverage for actives and retirees under age 65 is comparable to the 2008 projected trends for managed medical plans, which range from 10.5 percent to 10.9 percent.

Table 1: Projected Medical, Prescription Drug, Dental & Vision Trends: 2007 & 2008

	2007 Projected		2008 Projected	
	(without Rx)	(with Rx)*	(without Rx)	(with Rx)*
Medical (Actives & Retirees < Age 65)				
Fee-for-Service (FFS)/Indemnity Plans	13.7%	13.3%	12.5%	12.1%
High-Deductible Health Plans (HDHPs)**	12.0%	12.0%	10.9%	10.9%
Open-Access Preferred Provider Organizations (PPOs)/Point-of-Service (POS) Plans***	11.6%	11.7%	10.6%	10.6%
PPOs/POS Plans (with PCP gatekeepers)	11.0%	11.1%	10.5%	10.5%
Health Maintenance Organizations (HMOs)	11.1%	11.3%	10.7%	10.7%
Medical (Retirees Age 65+)				
Medicare Advantage (MA)**** FFS Plans	8.7%	9.8%	9.7%	9.8%
MA HMOs	8.6%	9.8%	8.8%	9.2%
Prescription Drug (Rx) Carve-Out (Actives & Retirees < Age 65)				
Retail Network		11.9%		10.7%
Mail Order		11.5%		10.6%
Rx Carve-Out (Retirees Age 65+)				
Retail Network		12.0%		10.1%
Mail Order		11.1%		10.7%
Dental				
Scheduled Plans		5.0%		4.3%
FFS/Indemnity Plans		7.5%		6.8%
Dental Provider Organizations (DPOs)		6.2%		5.8%
Dental Maintenance Organizations (DMOs)		5.2%		4.3%
Vision				
Scheduled Plans		5.1%		3.6%
Reasonable & Customary (R&C) Plans		5.5%		4.6%

* Trend projections were derived by proportionally blending medical plan trends and freestanding prescription drug trends.

** HDHPs are defined as those where the deductible is at least the minimum health savings account (HSA) level required by the Internal Revenue Service (\$1,100 single, \$2,200 family in 2008).

*** Open-access PPOs and POS plans are those that do not require a primary care physician (PCP) gatekeeper referral for specialty services.

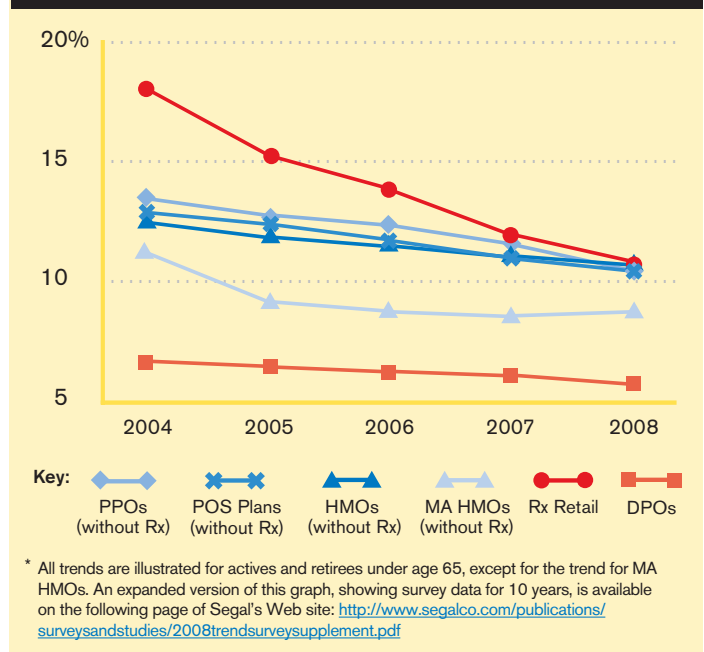
**** MA plans, part of the Medicare program, can be FFS plans, HMOs, PPOs or special needs plans.

Table 2: Projected Trend Ranges for PPOs & Retail Network Rx Carve-Out Coverage: 2004 – 2008

	Percentages of Respondents*				
	2004 Survey	2005 Survey	2006 Survey	2007 Survey	2008 Survey
PPOs (without Rx)					
<10%	3%	14%	16%	19%	24%
10–14.9%	69%	69%	78%	78%	76%
15–19.9%	28%	17%	3%	3%	0%
≥20%	0%	0%	3%	0%	0%
Average	13.5%	12.6%	12.4%	11.6%	10.6%
Retail Rx Carve-Out					
<10%	3%	10%	7%	30%	31%
10–14.9%	11%	37%	55%	53%	62%
15–19.9%	58%	37%	36%	16%	7%
≥20%	28%	17%	2%	0%	0%
Average	18.1%	15.2%	13.8%	11.9%	10.7%

* Some totals do not equal 100% due to rounding.

Graph 1: Selected Projected Medical, Rx Carve-Out & Dental Trends: 2004 – 2008*



➤ Prescription drug trend for Medicare-eligible retirees dropped nearly two percentage points from prior year projections for retail networks.

Graph 1 shows the decline in projected trends over the last five surveys. Although this news is positive, it is important to keep in mind that most projected trends rates remain in the double digits and continue to outpace overall inflation and wage increases by wide margins. All medical plan types are forecasted to see cost trends in 2008 that are more than twice the consumer price index for all urban consumers (CPI-U), which was 2.4 percent as of July 2007, and the annual increase in average weekly earnings, which was 3.6 percent as of July 2007.³ This implies that price inflation in the health care sector of the economy is still much greater than price inflation in the economy as a whole.

³ These statistics, both of which were released on August 15, 2007, were the most recent available at the time this survey report went to press.

Trend Components

The survey captured data about components of trend. As noted in the survey highlights, price inflation for services and supplies appear to be the biggest element of overall medical plan trend. Price inflation is driving medical trend at a rate of 6 percent for PPOs and HMOs.

The survey also examined medical trends by service type. For example, price inflation per hospital admission is expected to increase by 7.7 percent in 2008 for open-access PPO plans, as shown in Table 3. Prescription drug price inflation is projected to be 6.5 percent. In contrast, price inflation for physician services is forecasted to be at 4 percent.

Changes in utilization rates (another key component of trend) are increasing moderately for hospital services at 3.2 percent and more significantly for physician services at 5.5 percent. The higher physician utilization rates underscore demand management's⁴

⁴ Demand management involves providing plan participants with information to help them use medical care more appropriately.

Table 3: Components of 2008 Projected Trends

Trend Component	Hospitals*	Physicians*	Rx
Price Inflation	7.7%	4.0%	6.5%
Utilization	3.2%	5.5%	4.3%
Total Trend**	11.3%	9.9%	10.7%

* Hospital and physician trends are for open-access PPO plans.

** The components do not add up to total because there are other components of trend not illustrated, reflecting such factors as impact of cost-shifting, technology changes and drug mix. Also, not all participants provided a breakdown of trend by component.

importance in helping to eliminate excessive utilization that comes from gaps in care and poor treatment compliance.

Graph 2 on page 4 summarizes trends broken down by brand and generic drug types. Utilization of more affordable generic drugs is increasing much faster than brand drugs. This is the result of more generic alternatives in the marketplace due to patent expirations, and changes in plan design, including coinsurance provisions,

and mandatory or incentive mail order plan design.

The increase in use of biotechnology or specialty drugs and direct-to-consumer advertising has contributed to an increase in brand utilization from 0.3 percent forecasted last year to 2.6 percent forecasted for 2008.

The 2008 projected trend for specialty drugs, a segment of brand drugs, is 20.5 percent, almost 10 percentage points above aggregate retail trend. This is significant because specialty pharmaceuticals account for 17.9 percent of total drug trend. The high cost and trend-driving impact of these drugs will continue to be felt in coming years as research and new drug approvals continue.

As a group, MCOs and TPAs projected prescription drug trend rates to be significantly higher than PBMs' projections. As shown in Table 4, the difference for actives and early retirees was more than five percentage points for retail drugs and more than four percentage points for mail order drugs. Interestingly, many MCOs and TPAs utilize carve-out PBMs to administer prescription drug coverage. This difference can be

attributed to several factors, including PBMs having access to more detailed data, MCOs/TPAs using more margin, differences in design options offered and group size differentials.

Survey participants were asked how they expect administrative expenses on a per-member, per-month-basis to increase relative to the overall CPI. A majority of the respondents (55 percent) expect administrative expenses to be at or below the CPI, and 25 percent indicated it would be above the CPI. The remaining respondents indicated they did not know.

Accuracy of Projections

To assess the accuracy of projections, Segal compared the average 2006 trend forecasts by national and regional insurers, MCOs, PBMs and TPAs for group medical, prescription drug benefit and dental plans to the actual average trend rates experienced by the health plans covered by those underwriters for the same 12-month period. Comparing past projections to actual increases reveals that insurers tend to make conservative projections for medical cost increases. Those forecasts are generally higher than the actual

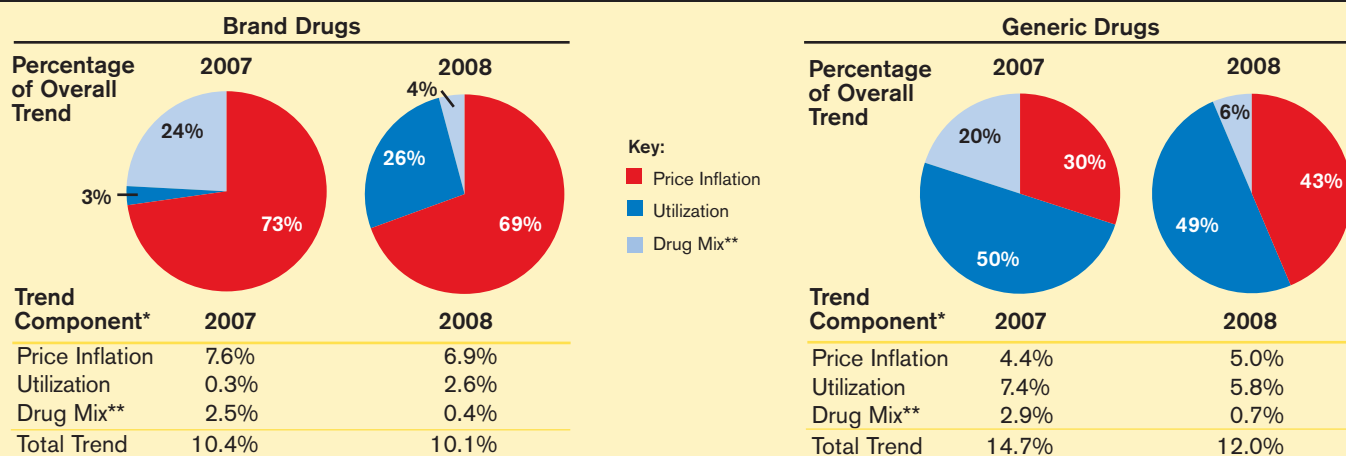
experience. This comparison is shown in Table 5 on page 5.

Graphs 3 and 4 on page 5 illustrate the significant variances between trend forecasts versus actual trends experienced in 2002 through 2006 for PPOs and prescription drug plans, respectively. It should be noted that the accuracy of underwriter projections is subject to a natural lag in the underwriting cycle. In periods where costs are decelerating, forecasters will tend to overestimate trends. Similarly, when costs are accelerating, trend projections will generally be underestimated. Note that 2008 projections are more in

Table 4: Comparison of Projected Rx Carve-Out Trends for 2008: PBMs vs. MCOs/TPAs

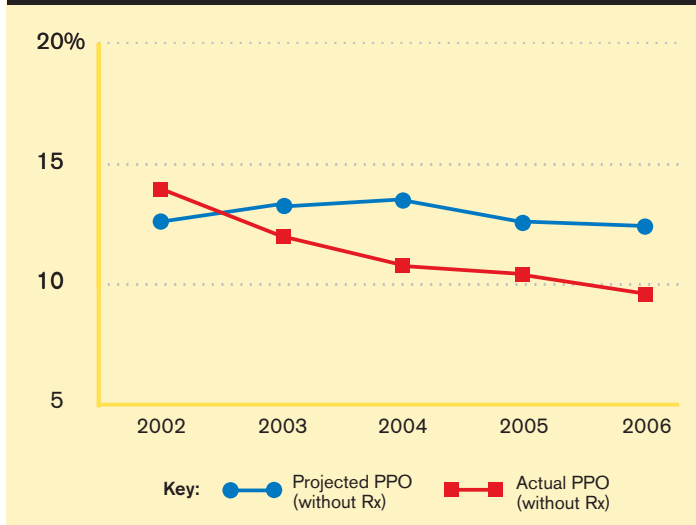
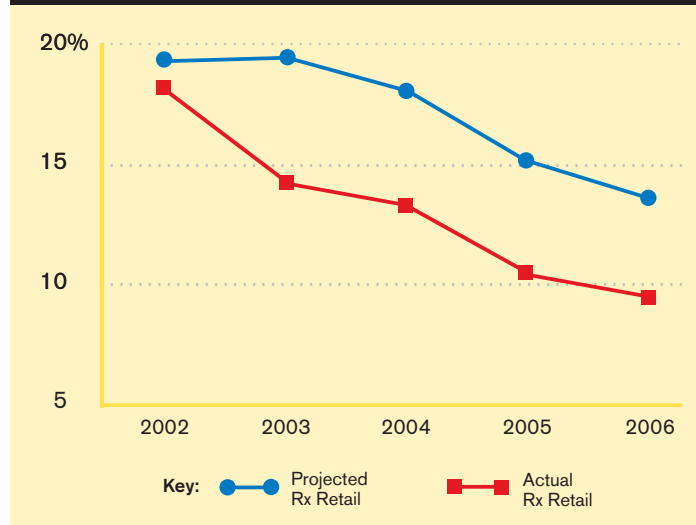
	PBMs	MCOs/TPAs
Actives & Retirees < Age 65		
Retail Network	6.2%	11.6%
Mail Order	6.8%	11.5%
Retirees Age 65+		
Retail Network	7.4%	11.2%
Mail Order	8.2%	11.8%

Graph 2: Components of 2007 & 2008 Projected Rx Carve-Out Trend for Brand & Generic Drugs



* The 2008 survey also measured "Other" as a component of prescription drug trend. "Other" includes items such as leveraging from cost-shifting and government-mandated benefits and other legislative changes. Other trend rates are forecasted to be 0.0 percent for brand drugs and 0.3 percent for generic drugs in 2008.

** Drug mix reflects therapeutic mix, brand/generic mix and new drugs.

Graph 3: Comparison of Projected to Actual Trends for PPOs for Actives & Retirees under Age 65: 2002-2006

Graph 4: Comparison of Projected to Actual Trends for Retail Rx Carve-Out Coverage for Actives & Retirees under Age 65: 2002-2006

Table 5: Comparison of 2006 Projected Trends to 2006 Actual Trends

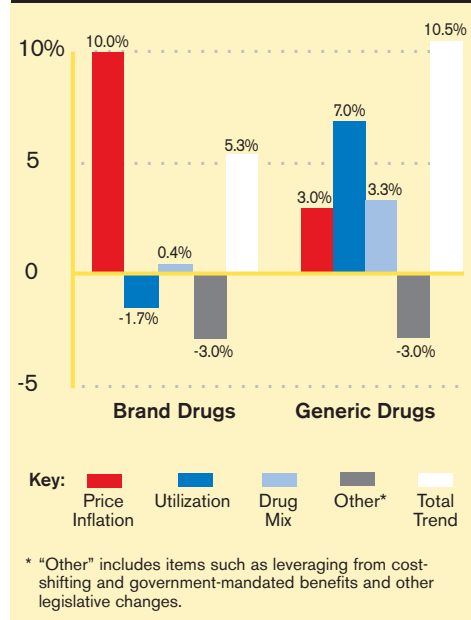
	Projected	Actual
Medical (Actives & Retirees < Age 65) (without Rx)		
FFS/Indemnity Plans	14.4%	11.3%
HDHPs	12.6%	10.5%
Open-Access PPOs/POS Plans	12.4%	9.6%
PPOs/POS Plans (with PCP gatekeeper)	11.8%	10.0%
HMOs	11.6%	10.2%
Medical (Retirees Age 65+) (without Rx)		
MA FFS Plans	9.5%	9.2%
MA HMOs	8.8%	7.2%
Rx Carve-Out (Actives & Retirees < Age 65)		
Retail Network	13.8%	9.5%
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Rx Carve-Out (Retirees Age 65+)		
Retail Network	14.2%	9.2%
Mail Order	14.3%	13.1%
Dental		
Scheduled Plans	*	3.9%
Indemnity Plans	7.0%	6.2%
DPOs	6.3%	5.1%
DMOs	5.2%	4.1%
Vision		
Scheduled Plans	*	3.0%
R&C Plans	*	3.6%

* Projected 2006 trends for dental scheduled plans and vision plans are not available because this data was not collected in the 2006 survey.

line with the latest reported actual experience in 2006.

The following are the most notable findings about the accuracy of trend projections:

- Actual trends in 2006 for open-access PPO plans and prescription drug coverage were similar, increasing at a rate of 9.6 percent and 9.5 percent, respectively.
- Beginning in 2003, actual trends for prescription drug coverage have come in significantly lower than forecasted for each year with the average gap of nearly five percentage points.
- The increased availability of generic-equivalent drugs in the marketplace and ability by benefit plans and PBMs, to rapidly maximize generic drug utilization is supported by the actual generic utilization trend rate of 7.0 percent, noted in Graph 5. More effective prescription drug plan design and a lack of new blockbuster drugs has also played a part in keeping increases in brand utilization and brand drug spending at manageable levels, as evidenced by the actual brand drug utilization rate change of

Graph 5: Components of 2006 Actual Rx Carve-Out Trend for Brand & Generic Drugs


* "Other" includes items such as leveraging from cost-shifting and government-mandated benefits and other legislative changes.

-1.7 percent observed in 2006. Generic drugs will increasingly play a bigger role in overall drug plan expenditure in the next few years.

- The 10 percent price inflation rate on brand drugs clearly illustrates the impact of high-cost specialty medications.

Commentary & Conclusion

It is undeniably good news that health cost trends are expected to be lower in 2008 *and* that a growing number of group health plans project single-digit trends for 2008. Nevertheless, it is important to keep in mind that health plan cost trends are still significantly above general inflation (2.4 percent as of July 2007).

Because price inflation for treatments and services are the largest component in overall plan cost increases, network managers' ability to keep future increases in reimbursement rates under control should be evaluated closely.

The Power of Total Health Management

To address health care cost increases, increasingly, plan sponsors are adopting a total health management (THM) approach. THM focuses on the development of a multi-year strategy to influence participant behaviors, health care provider efficiency, plan sponsor capabilities and service provider performance.

The most successful sponsors are using detailed claims data to determine what diseases, conditions, facilities and treatments are driving cost increases. Integrated data mining provides the roadmap to plan sponsors in developing targeted intervention strategies to identify gaps in needed treatment for participants, poor quality health care delivery to participants and ways plan sponsors can improve the health and health care consumption of their plan participants and reduce health trends to manageable levels.

Plan sponsors implementing THM should continue using a comprehensive three-pronged approach to health care cost management:

➤ **Individual Health Management**
This critically important element of a THM strategy focuses on improving the health of individuals

through health promotion and wellness, targeted intervention, care coordination and patient management. Through the use of health risk appraisals and predictive modeling, high risk or at-risk claimants can be identified and provided with outreach and support for appropriate evidence-based treatments for acute and chronic conditions. It is also important to introduce health promotion and wellness incentives, and increase transparency by providing participants with access to quality and cost information to empower them to be more engaged in their health care decisions.

➤ **Plan Management** Plan design is an essential aspect of THM. Because passive incentive approaches have yielded little cost savings, some plan sponsors are now taking more aggressive measures, which require participants who show unhealthy behaviors to pay a greater share of their health care cost. At the same time, significant incentives are put into place and barriers are removed to encourage more efficient use of health care services and the benefit plan.

➤ **Vendor Management** To support THM, plan sponsors should aggressively seek out vendors and innovative contract terms that keep costs in check and provide competitive pricing and superior service. They should also use high-performance, high-quality managed care networks and prescription drug programs to optimize cost, quality and the value of benefits. Getting network managers to cap increase on annual reimbursement rates to network providers could be a differentiating factor when selecting PPO and PBM vendors.

Although plan management and vendor management remain important for plan sponsors adopting a THM strategy, they should place greater

emphasis on individual health management. Ever-increasing medical costs will not be reduced effectively with plan design cuts and cost shifting to plan participants. The long-term solutions to rising medical trend will come through reducing health risk factors experienced within a particular plan's population.

To promote individual health management plan sponsors should brand their THM effort and demonstrate ongoing commitment through regular communication with the workforce and their families. Supporting THM may require the development of new in-house capabilities. Plan sponsors that take an active role in developing a THM strategy will maintain financially sustainable health care programs for the long term that improve the value and quality of benefits for plan participants.



For assistance with health care cost management strategies, contact your Segal consultant or the nearest Segal office.

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