2007 Segal Health Plan Cost Trend Survey

Further Declines in Health Plan Cost Trends Expected for 2007

The 2007 *Segal Health Plan Cost Trend Survey* — The Segal Company's tenth annual survey of managed care organizations (MCOs), health insurers, pharmacy benefit managers (PBMs) and third party administrators (TPAs) — forecasts continued declines in trends for 2007. Despite this projected deceleration, medical *and* prescription drug plan costs are expected to significantly outpace general inflation and wage increases.

Survey Highlights

Notable findings from this year's survey include:

- All medical plan types are forecasted to see cost increases in 2007 that are more than twice the increase in the consumer price index for all urban consumers (CPI-U), which was 4.1 percent as of July 2006 *and* the annual increase in real average weekly earnings, which was also 4.1 percent as of July 2006.[1]
- For the first time in several years, trends for prescription drug coverage are projected to decelerate in 2007 to levels that are close to trends for medical coverage.
- Compared to trend rates for retail prescription drug coverage, prescription drug mail order trend rates are projected to decrease at least three percentage points for both actives *and* retirees in 2007.
- Very similar 2007 trend rates are forecasted for preferred provider organizations (PPOs) and health maintenance organizations (HMOs): 11.6 percent and 11.1 percent, respectively. However, projected increases for high-deductible PPOs are expected to be higher: 12.0 percent.
- The survey found some slight regional variances that suggest regional providers may be able to negotiate deeper discounts in their local markets than can national providers. Compared to the forecasts for PPOs and point-of-service (POS) plans by national MCOs

[1] These statistics, both of which were released on August 16, 2006, were the most recent available at the time this survey report went to press.

What Is Trend?

Trend is the forecasted change in health plans' per-capita *claims cost* determined by insurance carriers, MCOs 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 2007 survey reports projections obtained from a survey of major insurance carriers, managed care organizations — including PPOs, POS plans and HMOs — TPAs and PBMs conducted by Segal in the summer of 2006. Segal received more than 65 responses.* Survey participants were asked to provide the trend factors they will be applying to historical claims to predict expected claims for 2007.

* The following participants agreed to disclose their names: Aetna, Altius Health Plans, Arkansas Blue Cross and Blue Shield, Arnett Health Plans, BeneCare Dental Plans, Blue Cross Blue Shield of Kansas, Blue Cross Blue Shield of Tennessee, Blue Cross of Idaho, Blue Cross of Northeastern Pennsylvania, Capital District Physicians' Health Plan, CareFirst Blue Cross Blue Shield, Catalyst Rx, CIGNA, ConnectiCare, Delta Dental of Arizona, Delta Dental of California, Delta Dental of Colorado, Delta Dental of Massachusetts, Delta Dental of Michigan, Delta Dental of New Jersey, Delta Dental of Virginia, Delta Dental of Wisconsin, Employers Dental Services, Excellus Blue Cross Blue Shield – Rochester Region, Express Scripts, Great West Healthcare, Group Health Incorporated, Guardian Life Insurance, Health Alliance Medical Plans, Health Net of the Northeast, Health New England, Horizon Blue Cross Blue Shield of New Jersey, Humana Insurance Company, Kaiser Foundation Health Plan, Inc., (including Kaiser Permanente Health Plans of California, Colorado, Georgia, Hawaii, the Mid-Atlantic States, the Northwest and affiliate, Group Health Cooperative), MCA Administrators, Medco Health Solutions, Medica Health Plans, Medical Mutual of Ohio, MedImpact HealthCare Systems, Metropolitan Life Insurance Company, MMSI – a Mayo Health Company, Mutual of Omaha, MVP Healthcare, Lincoln Financial Group, National Medical Health Card Systems, Nippon Life Insurance Company of America, Northeast Delta Dental, ODS Companies, Security Health Plan of Wisconsin, The Union Labor Life Insurance Company, Trustmark Group Insurance, United Concordia, United Health Group, UPMC Health Plan, and WellPoint NextRx.

SEGAL

and TPAs, forecasts by MCOs and TPAs in the Midwest are two percentage points lower, and forecasts by MCOs and TPAs in the East are one percentage point lower. In contrast, MCOs and TPAs in the West forecasted medical trends comparable to those of national MCOs and TPAs.[2]

- Forecasters make no distinction in cost increases for Medicare Advantage fee-for-service plans and Medicare Advantage HMO plans that include prescription drug coverage (9.8 percent) and virtually no difference in those plans that do not include prescription drug coverage (8.7 percent and 8.6 percent, respectively).
- Projected dental trends for 2007 are mixed. Although projected trends for managed dental networks are expected to remain the same in 2006 as in 2007, dental fee-for-service trends are projected to be 7.5 percent in 2007 (a half percentage point increase over the 2006 projection). Consequently, the gap in cost inflation between these types of dental plans is expected to widen.
- Vision plans, which are included in the survey for the first time this year, are expected to have the lowest projected trend for 2007 of all the coverages: around 5 percent.

Table 1 summarizes key findings.

[2] The number of MCOs and TPAs from the South that participated in the survey was not large enough to make similar comparisons.

Trends for Active Participants & Early Retirees

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

- Prescription drug trends have declined dramatically, by nearly eight percentage points, since their high of 19.7 percent in 2001.
- As a group, MCOs and TPAs projected prescription drug trend rates to be significantly higher than PBMs' projections. As shown in Table 2, the difference for actives and early retirees was more than three percentage points for retail drugs and more than four percentage points for mail order drugs.
- The forecasted trend rate of 11.9 percent for retail prescription drug coverage for actives and retirees under age 65 (down from a projected increase of 13.8 percent for 2006) is comparable to the 2007 11.6 percent projected trend for

Table 1: Projected Medical, Prescription Drug, Dental & Vision Trends: 2006 & 2007

	2006 Projected (without Rx)	2006 Projected (with Rx)*	2007 Projected (without Rx)	2007 Projected (with Rx)*
Medical (Actives & Retirees < Age 65)				
Fee-for-Service (FFS)/Indemnity Plans	14.4%	14.3%	**13.7%**	**13.3%**
Preferred Provider Organizations (PPOs)	12.4%	12.7%	**11.6%**	**11.7%**
Point-of-Service (POS) Plans	11.8%	12.2%	**11.0%**	**11.1%**
Health Maintenance Organizations (HMOs)	11.6%	12.0%	**11.1%**	**11.3%**
High-Deductible PPOs**	12.6%	12.8%	**12.0%**	**12.0%**
Medical (Retirees Age 65+)				
Medicare Advantage (MA)*** FFS Plans	9.5%	11.2%	**8.7%**	**9.8%**
MA HMOs	8.8%	10.7%	**8.6%**	**9.8%**
Prescription Drug (Rx) Carve-Out (Actives & Retirees < Age 65)				
Retail Network	13.8%		**11.9%**	
Mail Order	14.5%		**11.5%**	
Rx Carve-Out (Retirees Age 65+)				
Retail Network	14.2%		**12.0%**	
Mail Order	14.3%		**11.1%**	
Dental				
Scheduled Plans	****		**5.0%**	
FFS/Indemnity Plans	7.0%		**7.5%**	
Dental Provider Organizations (DPOs)	6.3%		**6.2%**	
Dental Maintenance Organizations (DMOs)	5.2%		**5.2%**	
Vision				
Scheduled Plans	****		**5.1%**	
Reasonable & Customary (R&C) Plans	****		**5.5%**	

* Trend projections were derived by proportionally blending medical plan trends and freestanding prescription drug trends.
** High-deductible plans are defined as those where the deductible is at least the minimum health savings account (HSA) level required by the Internal Revenue Service ($1,050 for participant-only coverage and $2,100 for family coverage in 2006).
*** MA plans, part of the Medicare program, can be FFS plans, HMOs, PPOs or special needs plans.
**** 2006 projected rates for dental scheduled plans and vision plans are not available because this data was not collected in last year's survey.

Table 2: Comparison of Projected Rx Carve-Out Trends for 2007: PBMs vs. MCOs/TPAs

	PBMs	MCOs/TPAs
Actives & Retirees < Age 65		
Retail Network	9.1%	12.5%
Mail Order	7.9%	12.3%
Retirees Age 65+		
Retail Network	11.3%	12.2%
Mail Order	7.5%	12.3%

PPO plans. This convergence represents a dramatic shift from only a few years ago. The 2004 survey, for example, found a five percentage-point spread between these two projected trend rates.

- Like prescription drug trends, projected trends for *all* MCOs — PPOs, POS plans and HMOs — peaked in 2003 and have declined steadily since then. Consequently, 2007 will mark the fourth consecutive year of lower projected trend rates for these medical plans.
- Not surprisingly, the 2007 projected trend for indemnity plans exceeds the projections for all other medical plan types — a finding that has remained consistent throughout every year Segal has conducted this survey.

Graph 1 shows the decline in projected trends over the latest surveys. Although this news is positive, it is important to keep in mind that most projected trends rates remain in the double digits and, as noted in the opening of this report, continue to outpace overall inflation and wage increases by wide margins.

Moreover, although the welcome overall decline in prescription cost increases can be attributed to the increased availability of generic-equivalent drugs in the marketplace and efforts by benefit plans and PBMs to maximize generic drug utilization, it is important to recognize that the projected trend for biotechnology or specialty drugs[3] is increasing at a rapid rate, as discussed in the Trend Components section which begins on this page.

Trend Ranges

Table 3 shows trend *ranges* for medical PPO coverage and retail prescription drug carve-out coverage. Nearly 80 percent of respondents reported 2007 PPO trend projections in the range of 10 to 14.9 percent. The concentration of respondents within that range is consistent with findings from the last five survey years.

Over half of survey respondents reported prescription drug trends for 2007 in that same range. Another 30 percent reported projected trends under 10 percent. These findings are remarkable compared to projections for recent years. For example, 54 percent of respondents to the 2005 survey projected trend rates of 15 percent or higher. And, more than 80 percent of respondents to the 2004 survey projected trend rates of 15 percent or higher.

The convergence of these rates is likely the result of changes in prescription drug benefit design and increase in availability of generic drugs.

Table 3: Projected Trend Ranges for PPOs & Retail Network Rx Carve-Out Coverage: 2004 – 2007

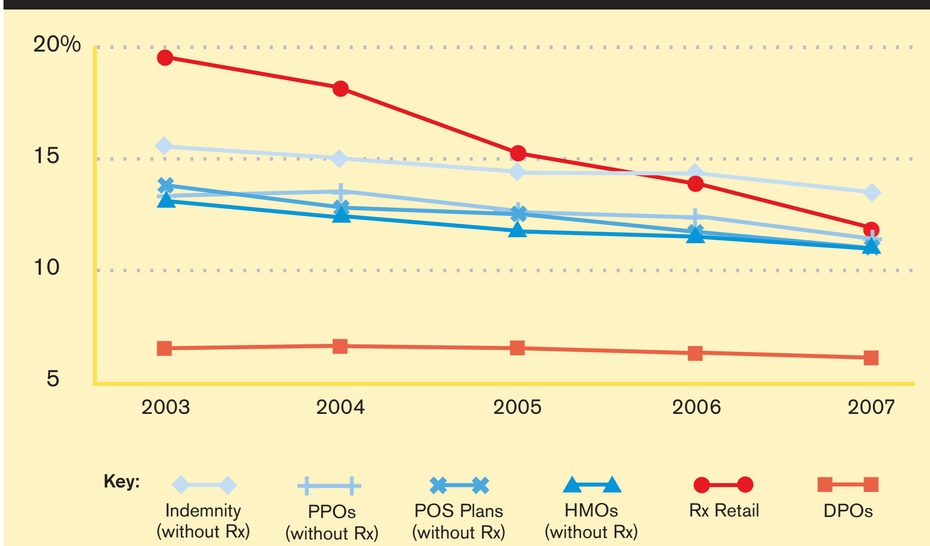
		Percentages of Respondents*			
		2004 Survey	2005 Survey	2006 Survey	2007 Survey
PPOs (without Rx)	<10%	3%	14%	16%	19%
	10–14.9%	69%	69%	78%	78%
	15–19.9%	28%	17%	3%	3%
	≥20%	0%	0%	3%	0%
	Average	*13.5%*	*12.6%*	*12.4%*	*11.6%*
Retail Rx Carve-Out	<10%	3%	10%	7%	30%
	10–14.9%	11%	37%	55%	53%
	15–19.9%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

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

Trend Components

The survey captured data about components of trend. Price inflation for service and supplies appears to be the biggest element of medical trend, as utilization rates increase at more moderate levels. For example, price inflation is driving medical trend at a rate of 7.3 percent for PPOs and 5.3 percent for HMOs, as shown in Graph 2.

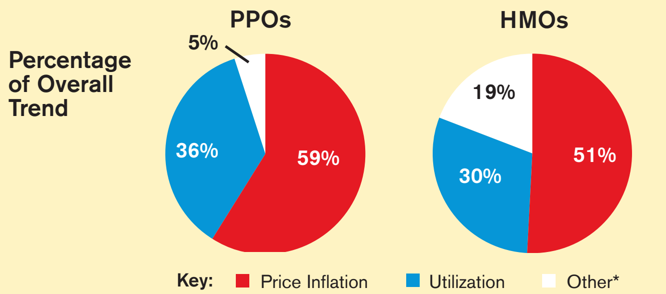
Graph 1: Selected Projected Medical, Rx Carve-Out & Dental Trends for Actives & Retirees under Age 65: 2003 – 2007*



* An expanded version of this graph, showing survey data for 10 years, is available on the following page of Segal's Web site: http://www.segalco.com/publications/surveysandstudies/2007trendsurveysupplement.pdf

[3] Specialty drugs address a number of complicated conditions, including osteoporosis, arthritis, multiple sclerosis and cancer. Specialty drugs differ from more traditional medications by requiring special handling, support and delivery. This category contains genetically engineered, injectable therapies with costs greatly exceeding those of most traditional therapies. The Centers for Medicare & Medicaid Services (CMS) now informally defines specialty drugs as those regularly costing $500 or more for a 30-day supply.

Graph 2: Components of 2007 Projected PPO & HMO Trends

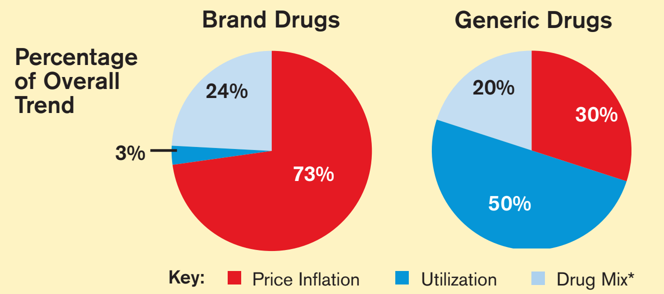


Trend Rate	PPOs	HMOs
Price Inflation	7.3%	5.3%
Utilization	4.5%	3.2%
Other*	0.6%	2.0%
Total Trend**	11.6%	11.1%

* This includes factors such as impact of cost shifting, adverse selection, government mandates and technology changes.

** The components do not add to total trend because not all participants provided breakdown of trend by component.

Graph 3: Components of 2007 Projected Rx Carve-Out Trend for Brand & Generic Drugs



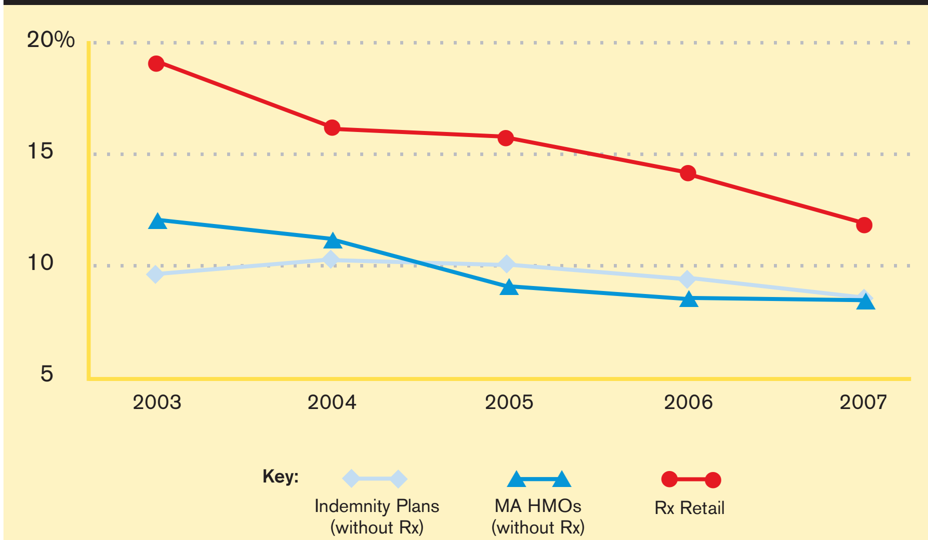
Trend Rate	Brand Drugs	Generic Drugs
Price Inflation	7.6%	4.4%
Utilization	0.3%	7.4%
Drug Mix*	2.5%	2.9%
Total Trend	10.4%	14.7%

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

As it has for years, the survey also examined medical trends by service type. Projected trends for hospital services have consistently exceeded projected trends for physician services, but both service types have experienced a deceleration in projected trends for the past few years. Those patterns are expected to continue for 2007. Nevertheless, the increase in the cost of hospital services in 2007 is projected to average the same rate as prescription drug forecasts across all managed care plan types: 11.9 percent.

Graph 3 summarizes trends broken down by brand and generic drug types. Utilization of more affordable generic drugs is increasing much faster than brand drugs. In fact, health plans experienced a slight decrease in brand drug utilization in 2005 and expect only a small increase for 2007. The shift to generics is offsetting the impact of new drugs in the marketplace.

Graph 4: Selected Projected Medical & Rx Carve-Out Trends for Retirees Age 65 & Older: 2003 – 2007



Brand price inflation, on the other hand, remains high at 7.6 percent in 2007, mostly as a result of patent protections. Manufacturers' price increases of blockbuster brand drugs continue to rise as new sources of revenue decline.

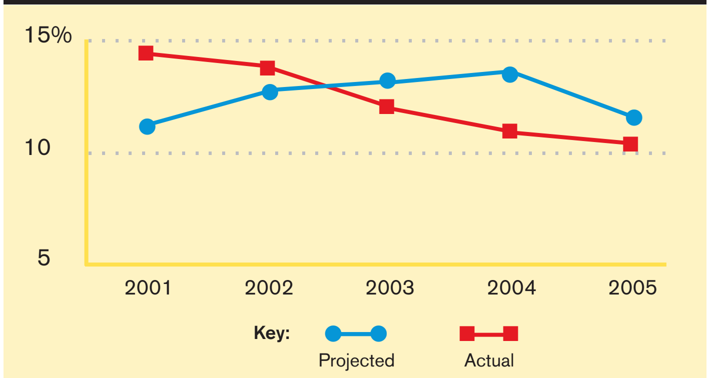
The 2007 projected trend for specialty drugs, a segment of brand drugs, is 19.5 percent, almost eight percentage points above aggregate retail trend. This is significant because specialty pharmaceuticals account for 17.1 percent of total drug trend.

Trends for Retirees

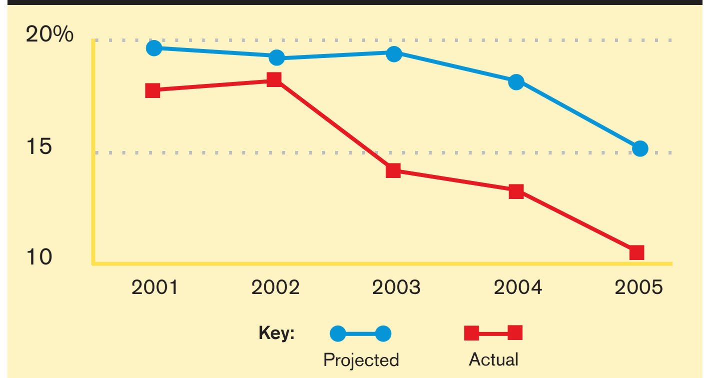
Notable survey findings about trends for retirees include the following:

- As shown in Graph 4, projected trends for Medicare supplemental indemnity plans and Medicare Advantage plans have been converging for the past few years.

Graph 5: Comparison of Projected to Actual Trends for PPOs for Actives & Retirees under Age 65: 2001 – 2005



Graph 6: Comparison of Projected to Actual Trends for Retail Network Rx Carve-Out Coverage for Actives & Retirees under Age 65: 2001 – 2005



- Projected retiree prescription drug trend is expected to be considerably lower in 2007 than in 2006.
- As a group, MCOs and TPAs projected prescription drug trend rates for retirees to be significantly higher than PBMs' projections. The difference is four percentage points for active retail and mail order drugs and close to five percentage points for retiree mail order drugs, larger spreads than for actives and early retirees. (See Table 2 on page 2.)

Lower projected prescription trends for retirees reflect the fact that insurers have been making headway in better managing drug spending in their older populations by directing members to generics. 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. The initial availability of Medicare Part D in 2006 may have also been a factor in the lower trend projections for 2007. CMS has reflected the overall lower trend for Medicare part D in its recent release of the 2007 premiums: $27.35, down from $32.20 in 2006.

Accuracy of Projections

To assess the accuracy of projections, Segal compared the average 2005 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 4.

Graphs 5 and 6 illustrate the significant variances between trend forecasts versus actual trends experienced in 2001 through 2005 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.

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

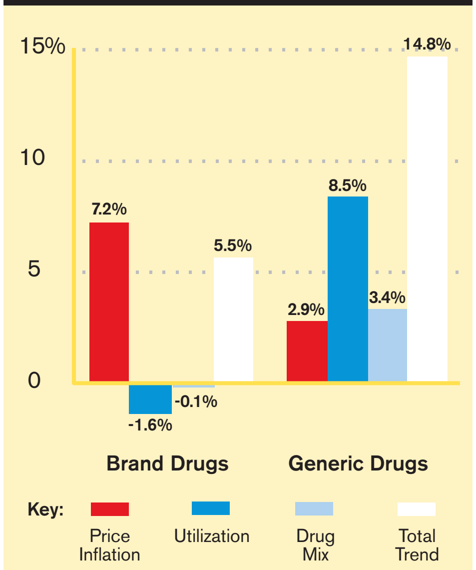
- Actual trends for prescription drug coverage in 2005 were significantly lower than the trends forecasted for that year, diverging by as many as five percentage points. This same gap was seen in 2004 and 2003.
- The increased availability of generic-equivalent drugs in the marketplace and efforts by benefit plans and PBMs to maximize generic drug utilization is supported by the actual generic utilization trend rate of

Table 4: Comparison of 2005 Projected Trends to 2005 Actual Trends

	Projected	Actual
Medical		
(Actives & Retirees < Age 65)	(without Rx)	
FFS/Indemnity Plans	14.4%	13.4%
PPOs	12.6%	10.4%
POS Plans	12.5%	11.1%
HMOs	11.8%	10.6%
High-Deductible PPOs	13.1%	12.3%
Medical		
(Retirees Age 65+)	(without Rx)	
MA FFS Plans	10.1%	11.2%
MA HMOs	9.1%	8.4%
Rx Carve-Out		
(Actives & Retirees < Age 65)		
Retail Network	15.2%	10.5%
Mail Order	15.5%	11.7%
Rx Carve-Out		
(Retirees Age 65+)		
Retail Network	15.6%	10.4%
Mail Order	15.4%	9.9%
Dental		
Scheduled Plans	*	4.5%
Indemnity Plans	7.1%	6.3%
DPOs	6.7%	5.0%
DMOs	4.8%	4.2%
Vision		
Scheduled Plans	*	4.2%
R&C Plans	*	5.4%

* Projected 2005 trends for dental scheduled plans and vision plans are not available because this data was not collected in last year's survey.

Graph 7: Components of 2005 Actual Rx Carve-Out Trend for Brand & Generic Drugs



8.5 percent, noted in Graph 7. 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 -1.6 percent observed in 2005.

- Actual trends in 2005 for medical PPO plans and prescription drug coverage were 10.4 and 10.5 percent, respectively, for actives and early retirees.
- High-deductible PPO plans reported actual trends to be two percentage points higher than traditional PPO plans in 2005.

Conclusion, Outlook & Cost Management Strategies

Health plan cost trends are still significantly above general inflation. Although utilization and the absence of new blockbuster drugs are helping to mitigate some of the past increases, the recent increase in price inflation is cause for concern for health plan purchasers. Chronic disease and demand for health services are expected to increase as a result of persistent problems, such as widespread obesity, and continuing challenges, such as an aging workforce. It is too early to tell whether wellness, consumerism and disease management programs can reduce demand in the long term.

The plan sponsors with the most success in dealing with health costs have gone beyond across-the-board cost shifts to participants (which only addresses the symptoms) and have taken major steps to understand the underlying dynamics of their health plan, which addresses the root cause of high costs. Increasingly, the most successful sponsors armed themselves with the best data to determine what groups, diseases, conditions, facilities, and treatments are driving cost increases and developing focused tactics and methods to address these issues head-on. Plan sponsors can attack the problem using a comprehensive three-pronged, data-driven approach, which consists of the following strategies:

- ***Plan Management*** An adaptive plan design can offset or even neutralize health cost increases. Elements of innovative plan management may include: cost-effective, cost-sharing strategies that channel patients to the appropriate provider and treatment options, implementing percentage-based coinsurance structure (as opposed to fixed-dollar copayments), and adopting rules that reduce waste and invest in treatments that avoid catastrophic events.
- ***Vendor Management*** Plan sponsors should aggressively seek out vendors and innovative contract terms that keep costs in check and provide competitive pricing and superior service. A growing number of plan sponsors are requiring vendors to put their fees at risk for future year performance through cost-increase caps and achieving clinical results.
- ***Individual Health Management*** This part of the strategy focuses on improving the health of individuals to reduce demand for invasive and costly treatments. Through integrated data mining and medical management strategies, plan sponsors can improve the health of their populations and reduce health trends to manageable levels. Examples of strategies include use of predictive modeling to identify high risk or at-risk participants, organizing targeted interventions (*e.g.*, wellness, patient management, care coordination for high-risk and at-risk patients), empowering members and physicians through access to information technology, and assisting participants with personal advocacy programs.

Plan sponsors that take an active role in managing plan costs can provide their workforce with world-class health benefit programs that are financially sustainable for the long term.

■ ■ ■

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

THE SEGAL COMPANY

Atlanta	678.306.3100
Boston	617.424.7300
Calgary	403.692.2264
Chicago	312.984.8500
Cleveland	216.687.4400
Denver	303.714.9900
Hartford	860.678.3000
Houston	713.664.4654
Los Angeles	818.956.6700
Minneapolis	952.857.2480
New Orleans	504.483.0744
New York	212.251.5000
Philadelphia	215.854.4017
Phoenix	602.381.4000
Princeton	609.520.2700
Raleigh	919.233.1220
San Francisco	415.263.8200
Toronto	416.969.3960
Washington	202.833.6400

www.segalco.com