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BENEFIT INFORMATION RELEASE
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The Heart of the Matter

MEDICAL COSTS WILL CONTINUE TO INCREASE IN 2010, ALBEIT AT A SLOWER RATE THAN IN PREVIOUS YEARS.

Even after the US economy recorded its worst contraction in a quarter-century in late 2008 and early 2009, medical costs continued to grow. The perplexing contrast of health spending growing amid a deflated general economy will present employers with unique challenges for their 2010 healthcare benefits strategies. The following are what employers can expect to see:

- Growth in medical costs for 2010 is expected to be 9 percent, slightly lower than in previous years; however, it will still outpace inflation and increases in worker earnings.
- The recession and the prospect of health reform will help temper medical costs, impacting the pricing, utilization and behavior of both industry participants and consumers.
- As the recession pounded corporate profits in early 2009, employers surveyed said they were ready to push more of the costs of health insurance to their workers in 2010 while expecting more responsibility from workers for managing their personal health. Regarding which strategies employers were planning to implement over the next two years, improving wellness and increasing cost sharing led all responses.

— More than two-thirds of employers are expecting to expand wellness and disease management programs, although few are convinced that they are very effective at mitigating healthcare costs.

— Forty-two percent of employers surveyed said they would increase employee contributions, up from 38 percent in 2008.

— In addition, 41 percent said they expect to increase medical cost sharing through plan design changes.

- Increased cost sharing could squeeze workers, many of whom took wage cuts in 2009 because of the recession. In the last five years, health insurance premiums have increased four times faster than wages, a trend that is expected to continue in 2009 and



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2010. If employers follow through on plans for increased cost sharing, the affordability gap could grow even larger.

- The economy is creating both positive and negative pressures on medical costs.
 - An unprecedented number of workers are in high-deductible health plans (HDHPs), which are expected to see lower utilization among cash-strapped workers who lack the resources to pay for medical procedures. This trend is expected to slow the rate of medical cost increases.
 - The workers who have retained their jobs, but are fearful of losing them, may be using more services while they still have health insurance. Health plan executives interviewed indicated they are not seeing a reduction in overall utilization.

• Although health reform will have a major impact on the industry, its effect on medical costs likely will not be felt until 2011 or later. However, the prospect of health reform may have a dampening effect on overall healthcare price increases at it did during the Clinton health reform years.

Medical Cost Trend

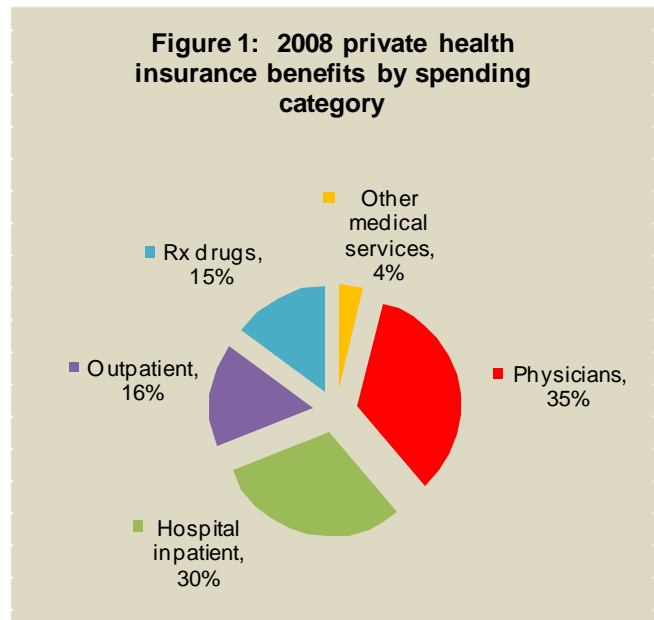
What are the influences

Medical cost trend is the projected increase in the costs of medical services assume in setting premiums for health insurance plans. Insurance companies use medical cost trends to estimate what the same plan would cost in the next year. For example, a 10 percent trend indicates that a medical plan that costs \$8,000 per employee one year would cost \$8,800 the next year. Medical cost trend is influenced primarily by:

- Unit cost inflation, or changes in the intensity, and changes in the unit price of medical products and services.

- Utilization increases, or changes in the volume of services used, which may be affected by demographic changes, advertising, and the use of new technology.

At 35 percent, the biggest portion of the private health insurance benefit is spent on physician services, according to PricewaterhouseCoopers' analysis. The next biggest portion is inpatient hospital services at 30 percent followed by 16 percent on outpatient services and 15 percent on prescription drugs. (See Figure 1.) In recent years, spending has increased for outpatient services as more surgeries and treatments move to less intense settings. In addition, physicians are doing more services and testing in their offices. The portion spent on each category can change from year to year, depending on volume, pricing, and consumer reaction to cost sharing.



Source: 2008 Milliman Medical Index



The Recession Impacts Associated with Medical Cost Trends

In late 2008, the US economy suffered its worst contraction in 25 years. Although the health industry has been somewhat resilient to current economic forces, it is not totally unaffected. The recession will have some impact on health industry pricing, cost sharing, utilization, cost shifting, and financial margins. **More importantly for 2010, medical costs will be affected by the reaction of the industry and consumers to the recession.**

Recession triggers a complex healthcare cost environment, with some factors increasing and others decreasing expected medical cost trend, such reactions will typically occur:

Decreases

- Employer groups are increasingly sharing in the costs of the services they utilize.
- Employers are using more incentives to encourage workers to be more accountable for their health related behaviors.
- Slower trend in input price inflation is reducing the need for providers to increase prices as much as in the past.
- Falling demand could create pricing competition in some markets.

Increases

- Rising unemployment causes increasing uninsured and underinsured, drops in commercial membership, and higher percentage of population covered by Medicaid.
- Providers see overall decreased utilization of healthcare services but will create new services to maintain their revenue stream.
- Workers who are expecting to be laid off use more services.
- Providers may raise prices to cover losses on Medicare and Medicaid patients.

Prevention — Higher Medical Costs Employer Healthcare Cost Strategies

The tough economic climate and tighter healthcare budgets have employers working even harder during 2009 to hold down healthcare costs. Most are considering a number of strategies to help mitigate the impact of premium increases for 2010.

ENGAGE EMPLOYEES WHO HAVE INCREASING SHARE OF HEALTHCARE COST BURDEN

As the recession pounded corporate profits in early 2009, nearly half of employers surveyed said they were ready to push more of the costs of health insurance to their workers in 2010. Regarding which strategies employers were planning to implement over the next two years, cost sharing led all responses. Forty-two percent of employers surveyed said they would increase employee contributions, up from 38 percent in 2008. However, employers must understand the financial pressure for workers; thus, there is a shared interest between employer and their workers regarding medical cost containment. For the past 10 years, the increase in health insurance premiums has far outstripped wage growth.

INCREASE MEDICAL PLAN COST SHARING THROUGH PLAN DESIGNS

Cost sharing is not just a cost-reduction strategy for employers, however. They also hope that awareness of rising healthcare costs will influence workers' demand for medical care, sometimes at the point of care. As a result, many employers have increased copays and deductibles.

Employers are increasing in-network deductibles in order to pass more of the cost on to employees. In 2009, 26.7 percent of employees had deductibles greater than \$500. In addition, more employers are conducting



This compared with 21.6 percent of employees in 2008.

USE INCENTIVES TO INCREASE PARTICIPATION AND IMPROVE EFFECTIVENESS OF WELLNESS AND DISEASE MANAGEMENT PROGRAMS

Since insurers have increasingly adopted pay-for-performance programs to reward efficient providers, employers are increasingly introducing incentives to reward employees who better manage their health, whether helping them to stay healthy or helping the chronically ill to better manage their conditions. Sixty-four percent of employers offer incentives related to wellness programs, according to the PricewaterhouseCoopers survey. Participation in these programs is much greater when incentives are offered.

MOVE TO SELF-INSURANCE

Employers are increasingly weighing a move from fully funded insurance to self-insured plans and are consolidating their plans. This enables employers to take more control of their claims data so that they can analyze the results better and put good health care strategies in place to address underlying health risks, conditions and utilization patterns specific to their population.

Rather than adopting the “one-size-fits-all” care and disease management, and wellness programs available through fully insured health plan options (i.e., HMO, POS and PPO), employers can use self-insured plans to customize their medical plan offering to meet their covered employee population.

REFOCUS SUBSIDY DOLLARS AND CONDUCT DEPENDENT AUDITS

Employers are looking at reducing their dependent subsidy dollars and focusing more on the subsidies provided to employees. This reduction is happening through increased payroll contributions for dependent health care coverage and/or by applying surcharges to encourage dependent spouses to take coverage under their employers' plans.

dependent audits, which are designed to assess and remove plan costs for dependents who do not qualify for coverage based on the employer's eligibility requirements.

Preparing for the Challenges

While employers will experience cost trends that are higher than they planned prior to the economic downturn, the difference will be how they execute changes. The employers who are committed to building strong cultures around health, well-being, safety and productivity have the best chance for managing long-term costs, but they need to stay on-point with changes that are consistent with that strategy. Perhaps the employers who are willing to use this time to support bold moves with technology and provider-led patient management will have the greatest success.

*Source:
PricewaterhouseCoopers
/Health Research Institute. (2009). Behind the numbers: Medical cost trends for 2010. Retrieved from <http://www.pwc.com/us/en/healthcare/publications/behind-the-numbers-medical-cost-trends-for-2010.jhtml>.*

