



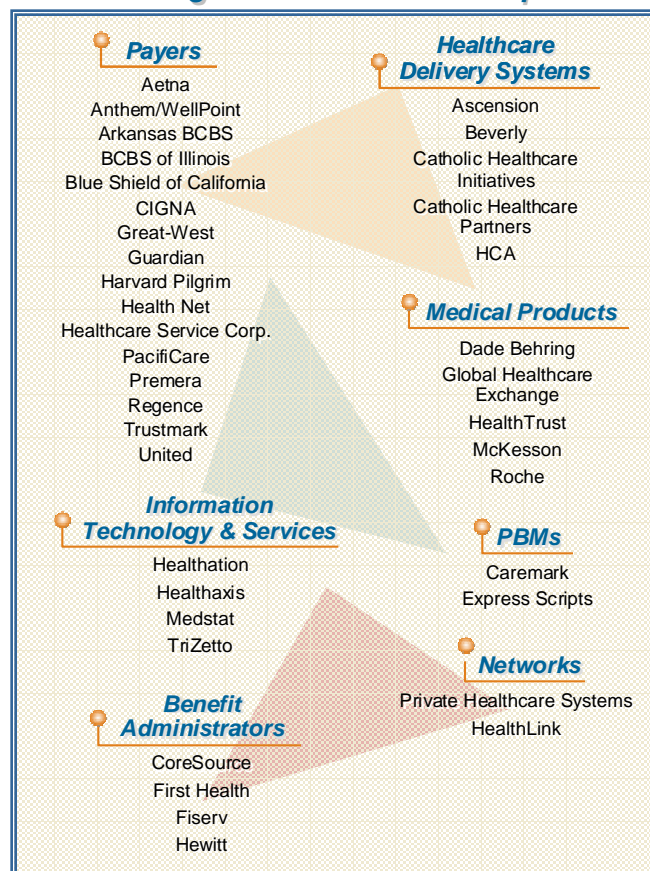
Brokers Predict Big Market Shifts

2006 NAHU ~ ChapterHouse
Benefit Buying Trends Study

ChapterHouse Overview

- Healthcare strategy firm
- Founded in 1997
- Strong bias toward grounding strategy in data and market analysis
- Focused on all corners of the market
- Mix between pre-IPO companies and high profile established players
- Over One Hundred and Fifty healthcare clients since inception
- Specialize in strategy, top line growth, and market analysis
- Over five hundred and fifty client engagements completed
- Dynamic team environment—everyone has real experience
- Client relationships—based on trust and earned through real work
- ChapterHouse value equation— knowledge transfer, outcomes focused, direct/candid communication, analytic and innovative

Working the Total Healthcare Space





Executive Summary

NAHU broker members predict that massive change is coming to the US healthcare industry. The 2006 NAHU/ChapterHouse Buying Trends Survey suggests that unprecedented market shifts will occur in healthcare over the next five to ten years. Past studies have accurately predicted incremental healthcare change and foreshadowed gradual small group adoption of CDH products. 2006 represents a significant shift in thinking – brokers see widespread government intervention and private sector innovation as likely outcomes. This report details brokers perceptions of (1) Macro Forces Driving Change, (2) Industry Efforts to Control Costs, (3) Consumer Driven Healthcare (CDH¹) adoption and (4) Value Drivers for Employers and Brokers. The 2006 survey of NAHU's national membership is augmented by extensive primary and secondary research conducted by ChapterHouse in conjunction with its healthcare strategy consulting practice.

Macro Forces Driving Change

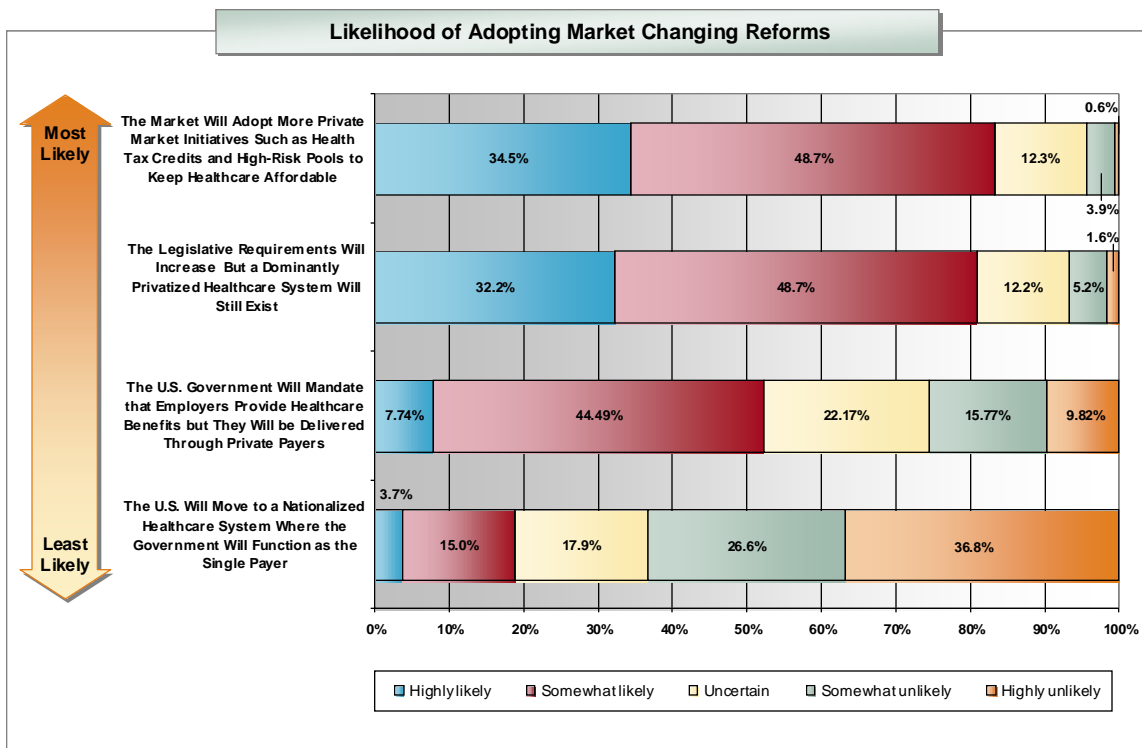
Accelerating Change is Inevitable

Change in the current U.S. healthcare system has been borne out of necessity. Study responses describe significant unmet need in the current healthcare market. Medical inflation is consuming US productivity. Small groups are abandoning healthcare coverage at alarming rates. Ranks of uninsured are growing. Macro forces are accelerating what is becoming an unsustainable economic spiral. NAHU broker members confirm there are significant gaps in the current US healthcare system and the possibility of government intervention has increased dramatically.

Macro trends are not new. In the last three years double digit premium increases have led to small group (2-199) insurance coverage offer-rates to drop from 58% to 50%. The US uninsured population has risen from 40M to 46M over the last five years. Yet previous Buying Trend Studies showed only a slight belief that government intervention was likely. By contrast, the 2006 Study shows that brokers believe massive market change is coming. Forty five percent (45%) of respondents believe that the market will look significantly different within five (5) years. Eighty eight percent (88%) believe that the market will look significantly different in the next ten (10) years. Over half (52%) believe that the US government will mandate that employers provide healthcare benefits to their employees. Almost one in five respondents (18%) believe that the US will move to a single payer system.

With medical costs moving above fifteen percent (15%) of Gross Domestic Product (GDP) and employers increasingly desperate for solutions – brokers are signaling their frustration with the lack of private solutions and their recognition of the political juggernaut gaining speed. Respondents believe that legislated employer mandates are more likely than a single payer system. This belief may be the result of: (a) perception that employer mandates would be less disruptive to the nation's healthcare system, (b) evidence that states can pass significant reform – e.g. recent Massachusetts' legislation or (c) efforts to nationalize healthcare have failed in the past. In either case, brokers believe there is no one solution to the current healthcare problem.

¹ CDH defined as the combination of a High Deductible Health Plan (>\$1000 deductible) and a funding account such as an HSA or HRA

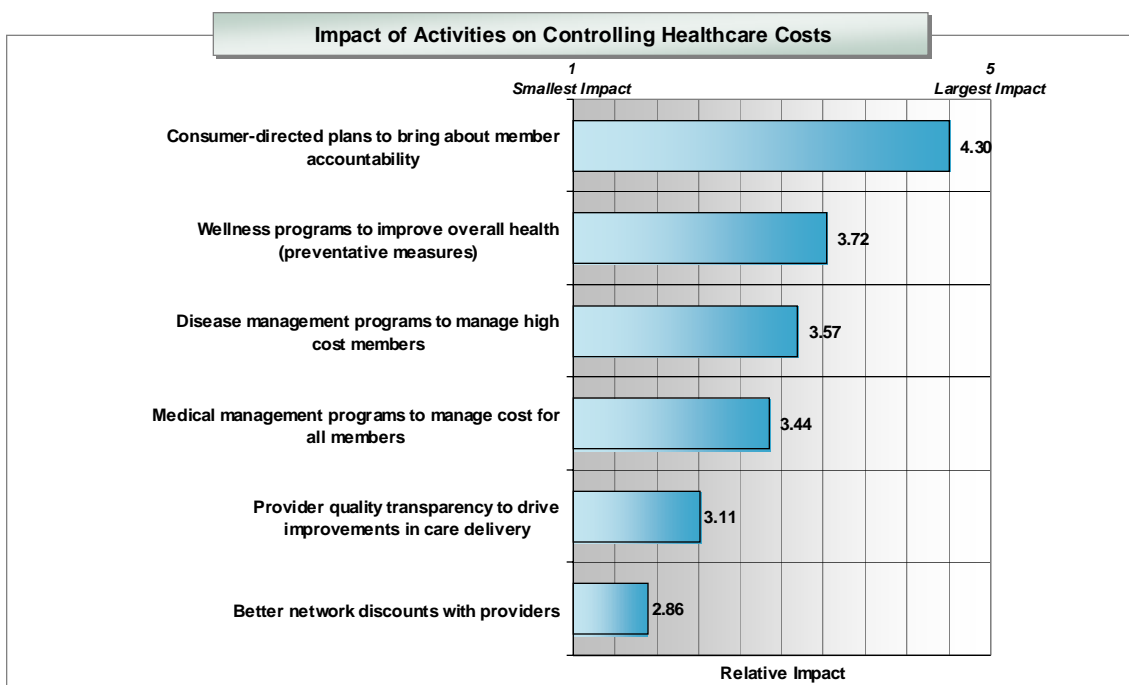


Direct interviews with brokers across the country support the view that few options promise to control medical cost in a sustainable way. It could be that traditional broker models based on “shopping the best rate” year over year and providing intermediate service support to employers doesn’t go far enough. To wit, new intermediary models are emerging: Defined Contribution Models, Vertical integration at points of convenience (Costco, Wal-mart) and many Internet oriented options to name a few. The implications of these changes are articulated later in this document as important shifts in broker’s carrier selection criteria, beliefs around CDH, and market demands to maintain a private US healthcare system.

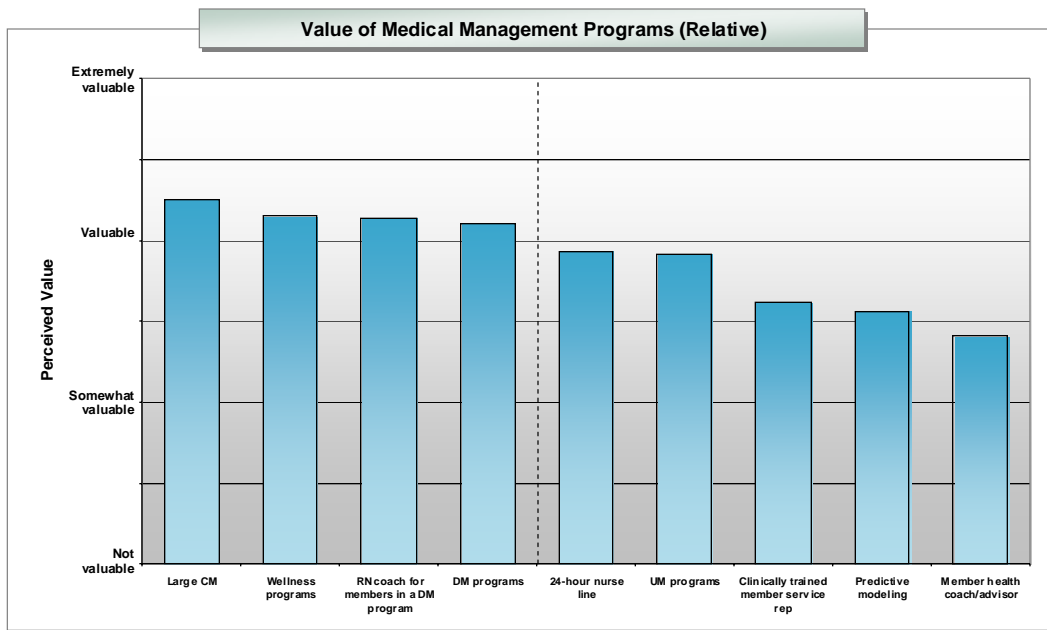
Current Industry Efforts to Control Costs—Report Card

Respondents believe new solutions are necessary to contain medical costs

Brokers report that traditional strategies to contain costs are having less impact than desired. While traditional strategies are still valued – including health plan design changes such as adding/increasing deductibles and co-pays, improving network discounts, and utilization management – brokers report that employers are increasingly interested in novel solutions to control medical costs. Solutions such as consumer directed healthcare, wellness programs and disease/population management are anticipated to have greater impact on controlling medical costs going forward. As we will later see, these beliefs and actions are sometimes in conflict. For example CDH is perceived to have the greatest impact on controlling healthcare cost, but adoption has flattened in 2006.

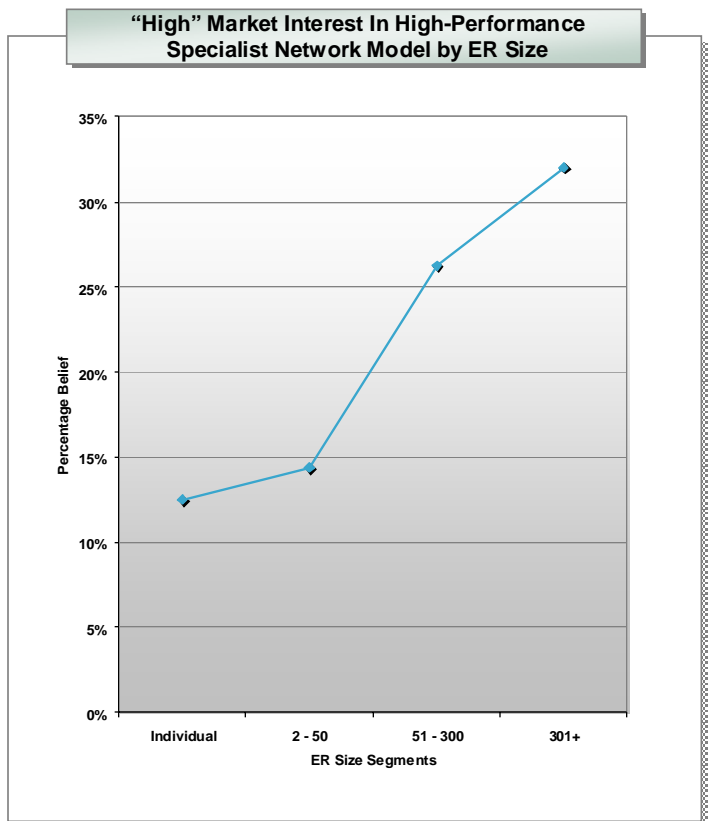


Similarly, the chart below indicates that “member health coaches” are least valued option from the menu presented, yet employee education and the member’s lack of ability to navigate the CDH are the biggest needs to move more membership to consumer driven plans.



High Performance Specialist Networks are receiving interest from brokers and employers. The study showed that 80% of respondents had a moderate or high level of interest in these programs. Brokers working with larger employers had the highest levels of interest (with 32% of respondents who work in the 300+ segment reporting “high interest”) contrasted to 12% of brokers who primarily work in the individual market. This result is consistent with the view that smaller employers do not think their employee populations are large enough to benefit from these programs. Brokers are however eager to see the cost savings, promised by these types of initiatives, be reflected in lower premiums. As such, specialty networks can become a point of differentiation in the smaller market when they are applied to an entire pool of small group employers and coupled with competitive rates.

It is ChapterHouse’s view that many programs (Wellness, DM, Medical Management and Provider Transparency) will begin to influence decision making as payers are able to tie their benefits to lower premiums and moderated trend.

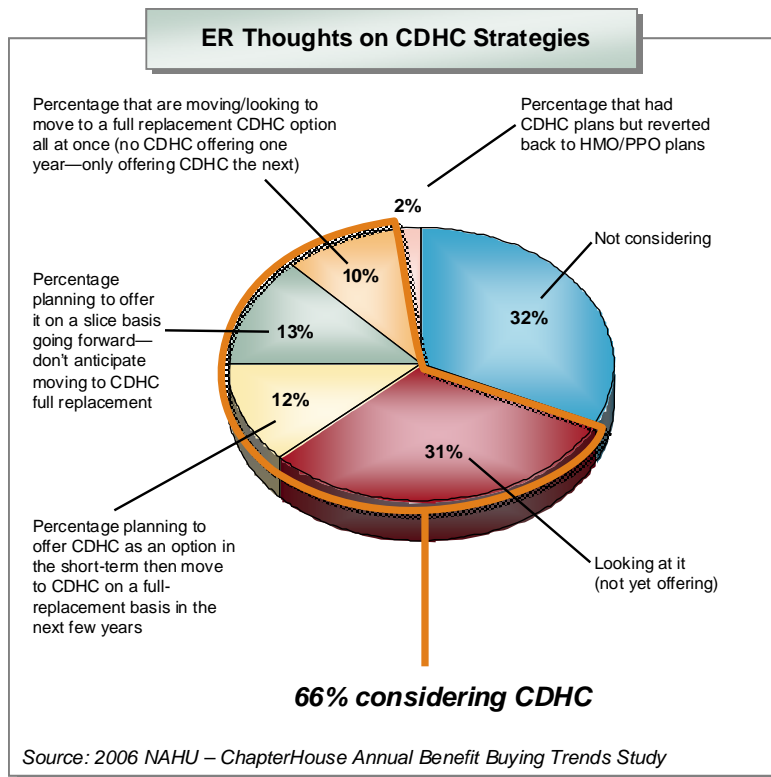


Consumer Directed Healthcare Adoption

Likely Plan Design and Consumer Engagement Activities

Respondents report that a majority of employers (66%) are considering CDH, with 43% currently quoting CDH plans. At the same time, the anticipated adoption rate is consistent with past surveys (29%). When employees are given a choice of CDH and a traditional benefit design, about 1 in 5 employees select CDH.

Most notable in these results is the flattening adoption curve. While still growing, CDH does not appear to have reached a “tipping point”. Brokers indicate that because of incremental increases in co-pays and deductibles, it is increasingly difficult to achieve significant savings by moving to CDH. Employers are still resistant to eliminating co-pays and low-cost drug coverage that employees expect.



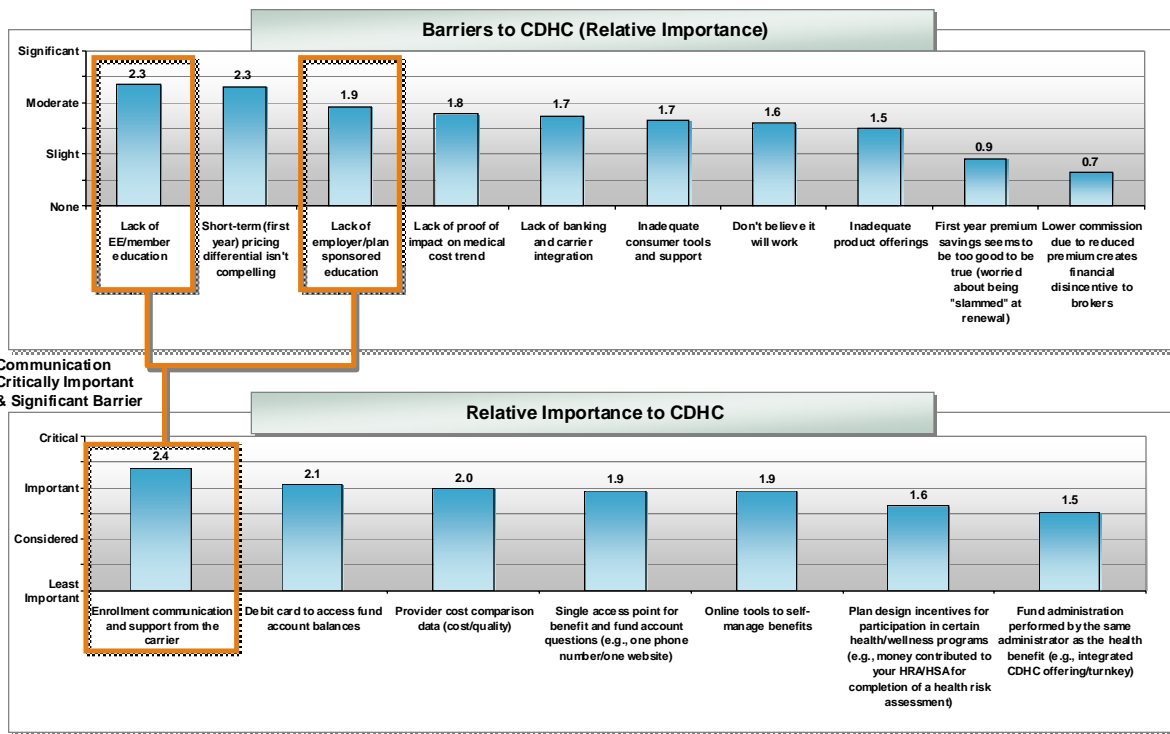
Significant Barriers to Adoption of CDH remain

The disparity between employers interest in CDH versus their purchase of CDH plans demonstrates that there are still significant barriers to adoption. These barriers are on both the employer and employee side.

Summary of Perceived Barriers	
Employee	Employer
Do not fully understand CDHC	Price differential not compelling
Believe it is a “skinny” or reduced benefit	Fear employee backlash
Afraid Out of Pocket costs will increase	Health plans do not have adequate tools to allow “consumer shopping”
Do not know how to shop for healthcare	Do not believe it will lower costs

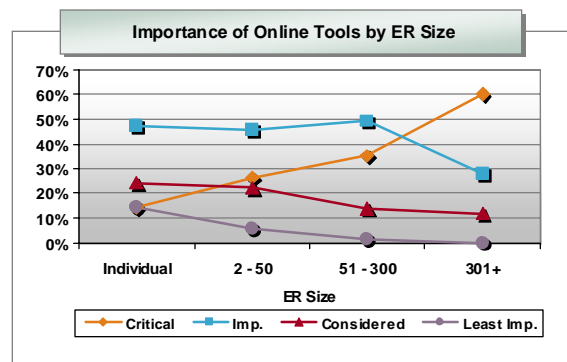
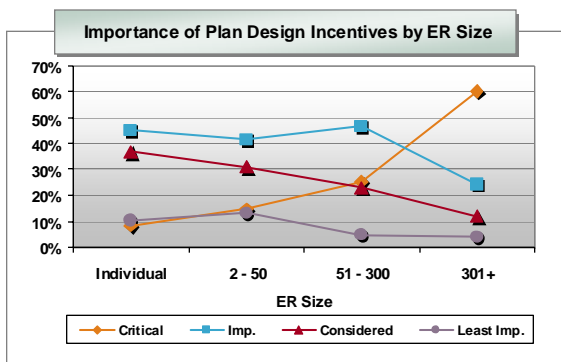
According to brokers, the biggest barrier to adoption is communication. Both employers and employees need to develop a better understanding of the CDH concept. Health plans must change the payment structure for physicians, paying for quality vs. quantity of services and offer the tools that allow consumers to “shop smarter”. Thrusting an unwilling consumer into the market will only lead to confusion and dissatisfaction. Brokers must either “Teach the Teacher” giving the employer the tools to educate their employees or must partner with health plans to teach the employees how to better manage their care and benefits. Simply providing a list of benefits and a link to a health plan website is not sufficient. Employers and employees need a “trusted partner” to guide them through the transition and provide unbiased, easily understood information. While health plans seek to become that trusted partner, many employees are reluctant to trust a health plan, recalling the days of onerous medical management and care rationing of HMOs. While health plans are struggling to redefine themselves from being the entity that holds the purse strings and pays claims to the entity that educates and assists employees in making decisions about their healthcare, it will take time for that transition to occur. Brokers have the ability to solidify their role in the value chain by filling the gap in trust and guidance.

A few brokers describe their efforts to deliver value by shifting their role to focus on “change management” – fulfilling the role of employer coach and cultural change agent to help overcome these obstacles. The majority of brokers however have not been able to make this adjustment for a variety of reasons (commission vs. time investment, beliefs about long term CDH cost savings, etc).



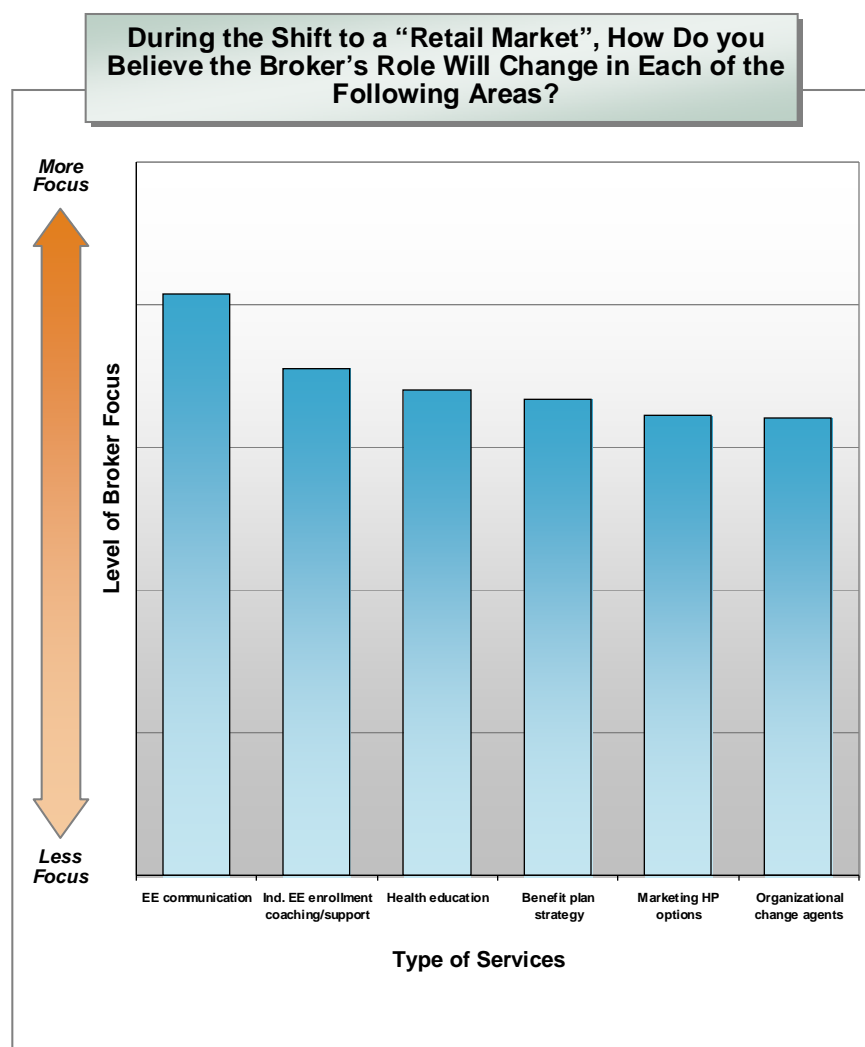
In the study, tools that educate employees, making it easy to access funds and empower them to make decisions, were rated most important. Areas of administrative detail were less critical. Surprisingly, plan incentives were not scored highly for importance in this study. Interviews suggest it is the combination of these items in the right culture that is most effective at changing member behavior and moderating medical inflation.

It must be noted that employers view the importance of CDH capabilities very differently based on their size. Large employers tend to more highly value tools that smaller employers do not. These differences might be attributed to employers' ability to influence cost, awareness of available options or market support / personal attention from the payer or broker – all of which tend to favor larger groups.



Shift to Retail Market would impact brokers significantly

Almost a quarter of respondents (23%) report a belief that the U.S. will move to an individual insurance model. Brokers report that their role will change significantly, if a retail market becomes the industry standard. To maintain their position within the healthcare value chain, brokers will need to focus more on employee communication, coaching, and health education. To capture membership, brokers will need to deliver value beyond delivering the lowest priced policy. Brokers focusing solely on cost will struggle when competing with organizations that might have greater economies of scale. Absent substantial value creation by the intermediary, consumers will shop for convenience and low cost (Costco/Wal-mart) or more efficient web-only services (esurance.com). Today, brokers maintain an advantaged position in the payer – employer – member relationship. Time will tell how many brokers will modify their business models to address the emerging needs of employers and members.

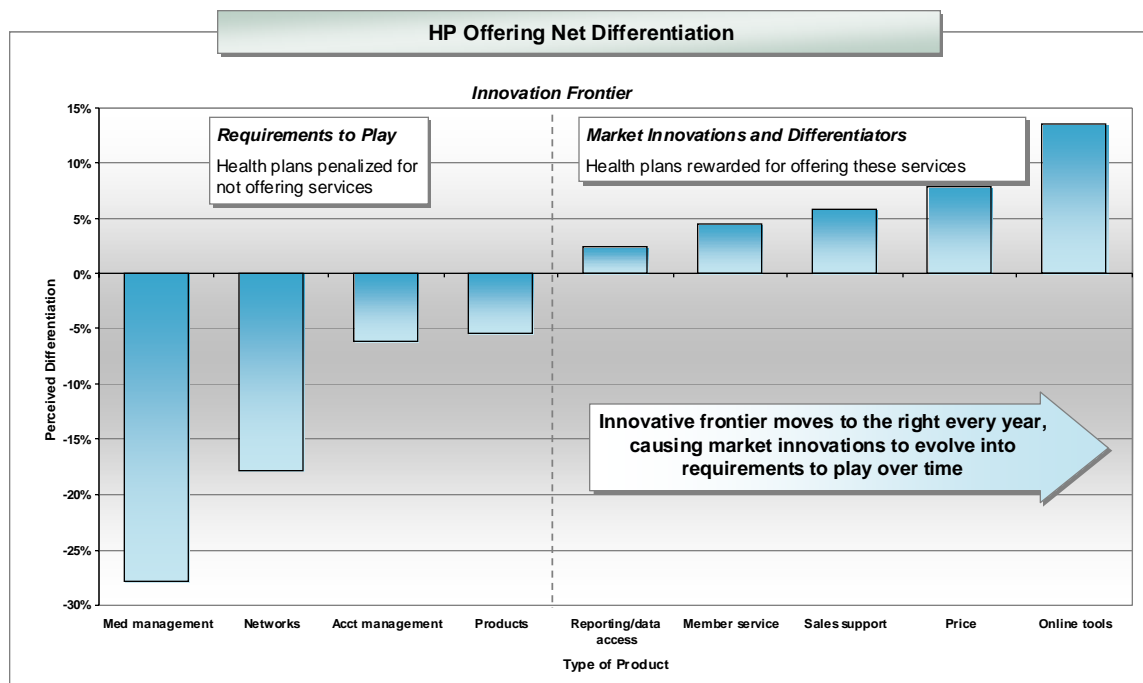


Health Plan Value Drivers and Selection Criteria

Value Drivers for Employers

Health plans and their products are evaluated along many dimensions. While cost frequently rises to the top of the list, there are many factors that ultimately shape the decision. Provider networks are different, medical management may be tight or loose, service levels are not easily compared. Missing a key hospital may be a deal breaker for one employer but not for another.

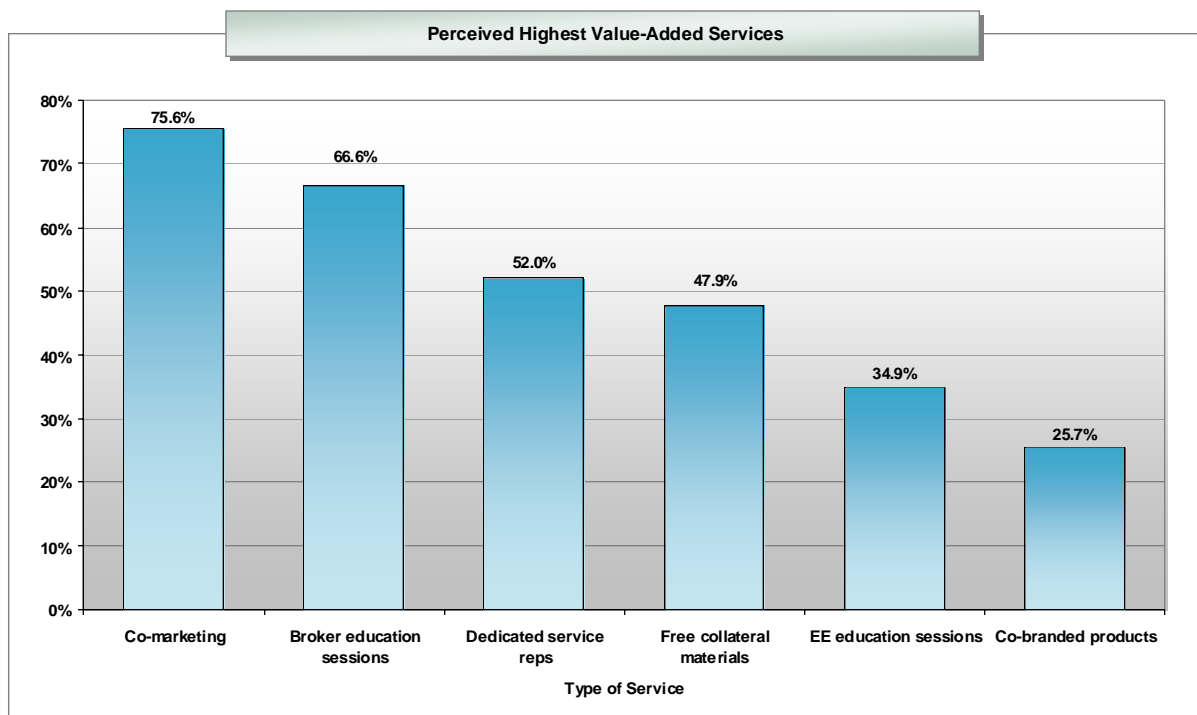
In aggregate, there are a combination of “*Requirements to Play*” (left side of the chart) which a carrier must demonstrate to achieve consideration, and “*Market Innovation and Differentiators*” which allow certain carriers to achieve market rewards. Offering medical management, for instance, will not get you an additional premium, but plans failing to offer these “requirements to play” will be penalized by the market. By contrast health plans may be rewarded for providing *Market Innovation and Differentiators* like superior service or online tools. These rewards could include a higher market share or higher premiums to name a few. As innovation continues, some of these products and services that garner a “reward” will be more broadly adopted by the market and become *Requirements to Play*. Therefore, the innovative frontier will push further to the right.



Health plans (and brokers) must continue to innovate or else begin to be penalized by the market.

Value Drivers for Brokers

Services which are most valued by brokers include co-marketing and education sessions. The brokers working with small and individual segments had much greater interest in co-marketing and collateral than did larger focused brokers



Summary

Multiple macro economic and market forces will shape the new healthcare space. One outcome is certain, massive change is coming in the form of (1) legislative mandates, (2) a fight to keep healthcare in the private sector, (3) emergent employer buying criteria, (4) continued incremental adoption of CDH and (5) new intermediary models to support the change. The time horizon for big shifts is within five to ten years. The ability to drive change still resides within the healthcare industry although the time to bring solutions to the market is limited. Tremendous opportunity exists for those who are able to navigate the rapidly changing marketplace. Tremendous risk exists for those who ignore the shift or miscalculate the change.

CDH is being more widely considered in the marketplace, although only a small percentage of employers choose to offer CDH on a full replacement basis. Significant barriers still exist to the adoption of CDH such as better education of employers and members, revised physician payment incentives and tools that are both easy to use and provide quality information for consumers to make informed decisions. In the absence of private market solutions that keep people insured, the government will step in and impose their own “solutions”. Ignoring the market change is not an option. Leading and preparing for the change may be the best course of action for all of us.

Full survey findings are available for purchase through ChapterHouse in conjunction with NAHU. To learn more about the full study or if you have questions or comments, please contact the authors as indicated below.



Appendix: Broker Respondent Characteristics and Research Overview

The 2006 NAHU/ChapterHouse Annual Benefit Trends Buying Study describes the state of the health insurance industry through the perceptions of brokers. The largest number of respondents (72%) was from firms that reported their primary group size was 2–50 lives, while 18% of brokers worked in the 51–301 segment². The remainder worked either with individuals (7%) or with groups of greater than 300 lives (3%). The geographic distribution was diverse and included brokers from all regions of the country and included both urban and rural markets. For those interested, regional distribution statistics are available.

The study is a view of healthcare through the eyes of the broker and is augmented by ChapterHouse strategy consulting work with companies across the healthcare vertical. The collaborative effort of NAHU and ChapterHouse provides insight into current buying trends, emerging dynamics, and the magnitude and pace of change of the healthcare industry.

The foundation of this report is built on the results of the NAHU membership survey. Other research is used to support, contrast and add texture to the broker responses, market trends and shifting dynamics.

² Where survey responses are broken out by case size, the primary case size focus reported by each respondent was used to illustrate response differences by case size for certain questions.

ABOUT THE AUTHORS:

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Chris Simpkins is a strategy consultant specializing in top line growth initiatives, performance evaluation, and strategic marketing. He has over ten years experience in the healthcare industry with an expertise in financial, operational, and strategic analyses. Prior to joining ChapterHouse, Chris worked at several national payer organizations in roles ranging from operational effectiveness to network strategy. Chris' particular area of expertise lies in evaluation of the financial aspects of strategic initiatives. Chris received his MBA from the Wharton School of Business in Philadelphia, PA, with a dual focus in Health Care Management and Finance. He also holds a BS degree in Actuarial Science from Pennsylvania State University.

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Jim Fields is a strategy consultant specializing in growth campaigns, market analysis and segmentation, business plan development, and strategy formulation. He has worked with large payers and providers, and has developed expertise on the brokerage/consulting channel. Prior to joining ChapterHouse, Jim honed his experience in private equity. Jim is an alumnus of Ball State University and received his MBA from the J.L. Kellogg School of Management, Northwestern University.

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As a ChapterHouse Managing Partner, Michael brings 20+ years of industry experience in general management, marketing and sales development. His expertise in sales strategy, top line growth and market sizing and segmentation has helped healthcare organizations make better decisions and achieve their growth and margin objectives. Michael's credentials include, CLU, REBC, and an MBA from the J.L. Kellogg School of Management, Northwestern University.