

What's driving the high cost of health care in New England ... and how can we steer a better course?



I NCREASINGLY, THE RISING COST OF HEALTH CARE is becoming a front-and-center issue on the national stage. While researchers, policymakers and the media continue to focus on the mega trends that are driving costs from a national perspective, there has not been as much discussion around a major point of concern for New Englanders—why are our costs higher than the rest of the nation?

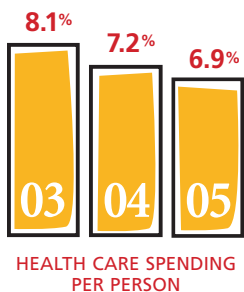
What can be done to alter this alarming trend? And what is Harvard Pilgrim Health Care doing to make a difference? Here's a look at some of the pivotal circumstances—and opportunities—at hand. ▶

Nationally Speaking

The national picture holds some relatively good news. While health care costs continue to climb, they've been increasing at a slower rate over the past few years. For example, according to the Office of the Actuary at the Centers for Medicare and Medicaid Services (CMS):

- ▶ **Health care spending in 2005 in the United States—including private health insurance, out-of-pocket sources, Medicare and Medicaid—was \$6,697 per person and \$1.988 trillion in total. This is an increase of 6.9 percent, less than the 7.2 percent increase in 2004, and significantly less than the 8.1 percent growth in 2003. The '05 rate represents the lowest growth rate since 1999.**
- ▶ **The growth in prescription drug spending slowed significantly in 2005, increasing at 5.8 percent compared to 8.6 percent in 2004.**
- ▶ **Medicaid spending declined by 1.4 percent in the first nine months of 2006 compared to the same period in 2005, representing the first decrease since 1965.**

THE SLOWED GROWTH
IN U.S. HEALTH CARE
SPENDING

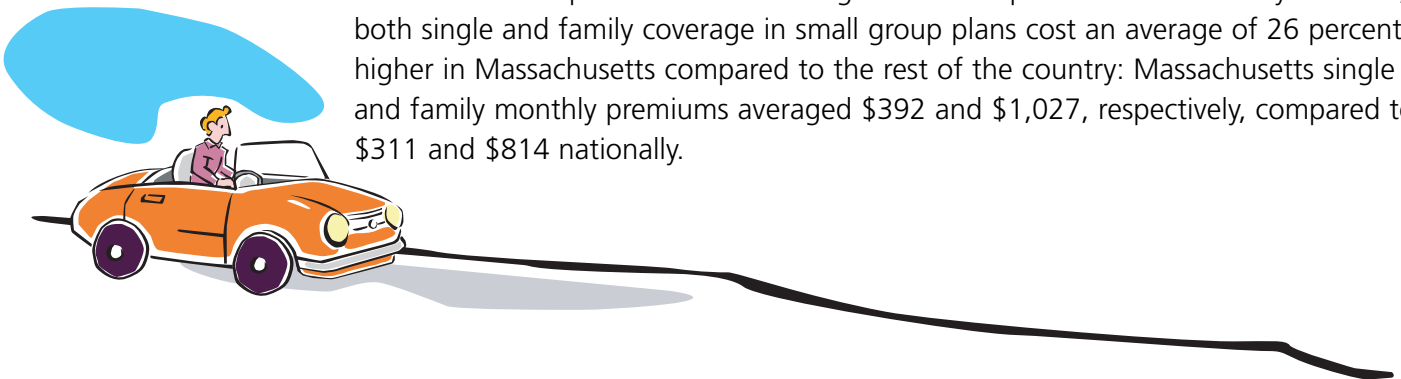


Despite these positive signs, health care remains prohibitively expensive for families and employers: The cost of health insurance has doubled since 2000, and the average annual cost of health insurance for a family is \$11,480. Premium increases have outpaced increases in wages by four to five times as much. And employer costs are expected to increase on average by 7.7 percent in 2007, slightly less for PPOs, slightly more for HMOs and more than a percentage point greater for POS plans.

Here in New England

Amidst the national good news/bad news scenario, an especially troublesome set of circumstances is looming in New England, and particularly in Massachusetts. A 2006 CMS report notes that health care spending for Massachusetts residents exceeded the national average by more than \$1,500, or 33 percent in 2004. The national average for annual health care spending per resident was \$5,313, while in Massachusetts it was \$7,075.

And, according to a recent survey by America's Health Insurance Plans, Massachusetts health insurance policies ranked among the most expensive in the country. In 2006, both single and family coverage in small group plans cost an average of 26 percent higher in Massachusetts compared to the rest of the country: Massachusetts single and family monthly premiums averaged \$392 and \$1,027, respectively, compared to \$311 and \$814 nationally.



The Cost-of-Living Equation

The high cost of living in New England is well documented. For instance, a 2005 report by the Boston Foundation and the Citizens' Housing and Planning Association found that a family of four living in the Boston area needed \$64,656 to cover its basic needs, ahead of all other major cities including New York City and San Francisco, and more than \$15,000 greater than cities such as Austin, Chicago, Miami and Raleigh.

This in turn impacts health care costs in a number of ways:

- A leading industry employer in New England is the health care sector, which must pay its employees higher wages than health systems in other parts of the country in order to recruit and retain them. Wages greatly impact how efficient a provider can be and what it must charge its consumers—New England residents and health plans—to recover its costs.
- New England has a higher-than-average concentration of the wealthy. Research has shown that those with increased discretionary income have greater access to the health care system and use more of its services.
- The high cost of living in New England is forcing many college graduates and young workers—those who typically require less care—to leave New England and seek employment in less expensive areas. This trend is leaving New England with a higher percentage of older adults who typically use the health care system frequently and often need expensive intervention to manage chronic and serious disease.

Limited Cost Sharing

Businesses outside of New England appear to be more comfortable with employee cost sharing. For several reasons, including the desire to attract and retain a shrinking pool of top talent, a high percentage of New England companies has resisted employee cost sharing. They've been much slower than their peers nationally to encourage employees to move to high-deductible or consumer-driven health plans, which in turn encourage employees to take greater control of their health care expenditures.

In fact, according to the U.S. Census Bureau, the penetration of consumer-driven health plans in 2006 was over three times greater nationwide compared to New England—3.0 percent vs. 0.9 percent, respectively. And from 2005 to 2006, the enrollment in consumer-driven health plans grew a robust 89 percent, while increasing just 8 percent in New England.

In addition, New England lags the rest of the country when it comes to shifting to higher copayments. For example, according to a Kaiser employer benefits survey, in 2005, 63 percent of New England copays for doctor visits were still just \$10 or \$15, compared to 46 percent nationwide. And, only 33 percent of New England copays were at the higher \$20, \$25 or \$30 levels (including 0 percent at \$30), compared to 49 percent countrywide (including 12 percent at \$30).

2005 COVERED EMPLOYEE COPAYMENTS FOR DOCTOR VISITS			
	\$10 & \$15 copays	\$20 & \$25 copays	\$30 copays
New England	63%	33%	0%
U.S.	46%	37%	12%

The Proliferation of Specialists

Massachusetts has the most physicians per capita, nearly 50 percent higher than the national average. The state also has a large proportion of physician specialists such as cardiologists, dermatologists and gastroenterologists; according to a 2005 AARP study, Massachusetts had 75 percent more physician specialists per capita than the U.S. average.

There's a strong correlation between the supply of medical resources and the frequency of their use, according to the Dartmouth Atlas Project (DAP), which works to accurately describe how medical resources are distributed and used in the U.S. In its 2007 brief, "Supply-Sensitive Care," DAP notes that this capacity-driven principle accounts for a wide variation among regions, and that the frequency of visits to a medical specialist varies by a factor of more than six times.

An Abundance of Teaching Hospitals

Massachusetts, and the Boston area in particular, have a higher concentration of large academic teaching hospitals than most other urban areas in the country. The presence of world-renowned institutions, such as Massachusetts General Hospital, Brigham and Women's Hospital and Children's Hospital, give New England residents unprecedented access to state-of-the-art medical care. However, this access comes at a cost. Harvard Pilgrim data shows that in 2006, the average cost per admission for a Massachusetts community hospital was \$4,800 vs. \$6,500 at a teaching hospital (with case mix adjustment), and Massachusetts residents utilize teaching hospitals more frequently than those in most other states.

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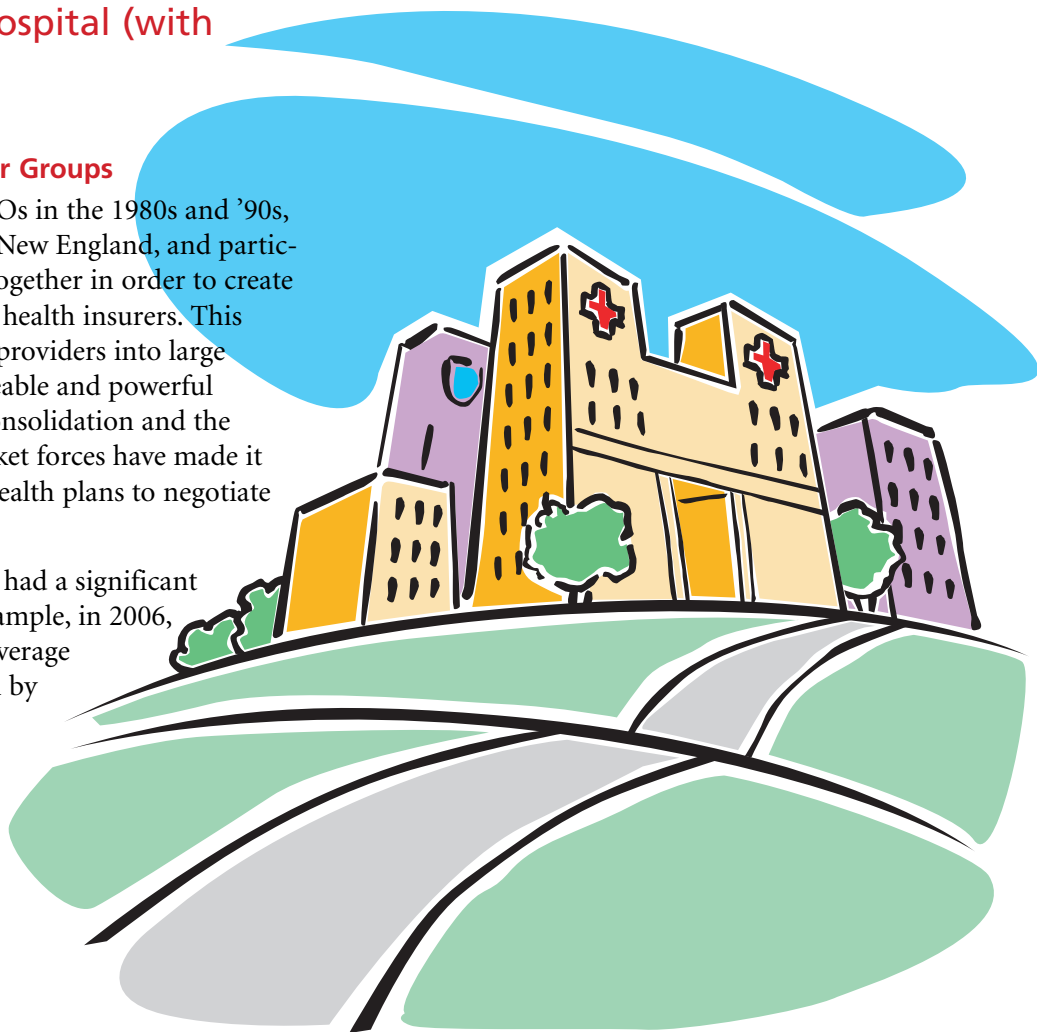
Large, More Powerful Provider Groups

In response to the growth of HMOs in the 1980s and '90s, physician and hospital groups in New England, and particularly in Massachusetts, banded together in order to create increased negotiating power with health insurers. This led to the consolidation of many providers into large provider groups, often tied to sizeable and powerful teaching hospital systems. This consolidation and the resulting lack of competitive market forces have made it more difficult for New England health plans to negotiate contracts on a level playing field.

Subsequently, provider rates have had a significant impact on premium rates. For example, in 2006, 70 percent of Harvard Pilgrim's average premium rate increase was driven by provider cost increases.

More State Mandates

States have taken a more aggressive position in recent years in establishing mandates for care that must be followed by insurers. According to the Council for Affordable Health Insurance, there are more than 1,500 state mandates for insurers nationwide today, while there were only six in 1965. The Council estimates that 30 to 50 mandates are added each year. New Hampshire and Maine have added numerous mandates over the past few years; Massachusetts has several significant mandates, including coverage for extremely expensive infertility treatments. The Council also reports that Massachusetts had 40 mandates in 2004, placing it in the top quarter among states with the greatest number of mandates. While these mandates have many positive attributes, they also result in increased health care costs in claims and administrative expenses.



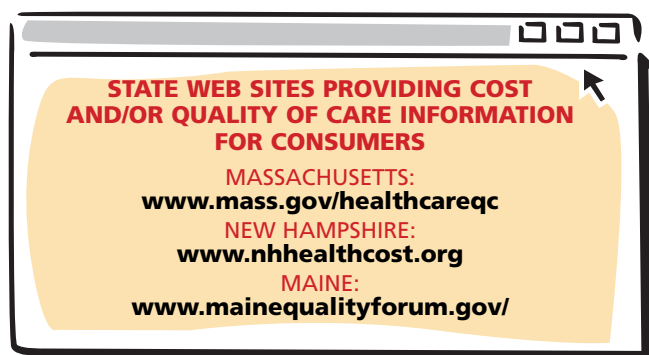
Steering a Better Course

There are, of course, no quick or easy solutions for addressing rising health care costs nationally or in New England. However, like the confluence of factors causing the increases, a collection of initiatives can create positive change. For instance, the federal Bureau of Economic Analysis recently credited the decline in Medicaid spending to “many small cost containment policies” adopted by the states.

Harvard Pilgrim, state and regional leaders will continue to pursue a number of approaches that have shown great promise over the last several years. In addition, Harvard Pilgrim will champion innovative thinking from our employees, employer customers, partners in the health care system and government entities, in order to develop new approaches that make New England a true leader in health care quality and cost control. These include the following:

Transparency of Cost and Quality Data

Harvard Pilgrim continues to lead the call regionally to provide health care consumers with the information they need to most effectively and efficiently spend their hard-earned health care dollars. Harvard Pilgrim encouraged legislators in Massachusetts to post data concerning the cost and quality of health care services and procedures on a free Web site for consumers. New Hampshire has been a national leader in providing its residents with this data.



Currently, most consumers are unaware of the true costs of medical services and have limited information to compare providers on how well they perform a service and how much they charge. Without this knowledge, consumers are inclined to select on brand alone, and cost and quality do not play a role in their decisions. Employers and insurers have expressed a strong conviction that with more information and with more financial “skin in the game,” employees will become better consumers and use health care practitioners who provide the best value. And, according to a recent Harvard Pilgrim survey, over 90 percent of consumers said they’d like more cost and quality information and would use it if available.

With price and performance information, consumers would learn, for example, that:

- Physician fees can vary as much as 30 percent
- Office visits, CT scans and MRIs can vary from 50 to 150 percent

Harvard Pilgrim has taken several approaches to empower our plan members with quality and cost information. For instance, through a Web-based tool, members can review our Physician Honor Roll highlighting top-performing medical groups, or do drug tier cost comparisons.

Select and Tiered Networks

As cost and quality information becomes more readily available, it will be possible to create health plans that have select or tiered networks and are embraced by customers. These plans will reward providers who are effective and efficient, will encourage employees to select high-quality and cost-effective providers, and will give health plans greater negotiating power.

For example, Harvard Pilgrim has a very popular select network product that’s helping to contain costs and offer a more affordable alternative to New Hampshire members. While still providing the choice of thousands of area doctors and hospitals, the product’s network excludes some Massachusetts providers and requires a deductible for certain Massachusetts tertiary hospitals in exchange for lower premiums.

In addition, Harvard Pilgrim developed a tiered copayment PPO plan in 2006 for a large municipal group. Members who choose certain specialists in more efficient

practices are rewarded with lower copayments. The plan design enables members to make decisions early in their specialty care experience, while also providing high-performing hospitals a better chance of attracting patients.

Transparency of information is pivotal to the continued adoption of products such as these. Harvard Pilgrim supports this transparency by providing members with online and traditional directories that show how providers are tiered based on cost and quality data.

Consumer-Directed Plans

The approach of empowering employees as true stakeholders in their health plans is creating strong opportunities to help control health care costs. By offering a variety of high-deductible products supported by Health Savings Account (HSA), Flexible Spending Account (FSA) or Health Reimbursement Arrangement (HRA) programs, employers give employees greater responsibility for cost sharing and decision-making.

CDHPs (consumer-directed health plans) increase consumer awareness of cost and value so consumers are: 20 percent more likely to comply with treatments for chronic conditions, 25 percent more likely to engage in healthy behaviors, 30 percent more likely to get annual physicals, and 50 percent more likely to seek less expensive care.

- MCKINSEY & COMPANY CDHP REPORT, JUNE 2005

Key to the success of this consumerism approach is ensuring that employees are equipped with decision-support tools and information. Armed with this information, they can make educated choices and select the plan that best meets their individual needs. Harvard Pilgrim

members can access an online Plan Cost Estimator that enables them to input data on their anticipated medical needs. The tool then compares what various Harvard Pilgrim plans could cost them in premiums and out-of-pocket expenses.

To provide greater choice and cost savings in the future, Harvard Pilgrim will be looking for ways to improve and vary these types of plan options for employers in New England.

Controlling Drug Spending

Prescription drugs have played a considerable role in fueling skyrocketing health care costs. However, significant progress has been made during 2005 and 2006, with savings realized through increased mail order participation and tiered formularies.

For example, mail order prescription fulfillment for Harvard Pilgrim members has increased from 8 percent to 18 percent over 2005 and 2006. Harvard Pilgrim has also made great strides by setting a comprehensive prescription management policy which includes our Step Therapy program. Through this program, in certain cases, members are required to first try one drug to treat a medical condition before another drug is covered for that condition.

Providers and consumers have also come to accept the use of generics more and have had positive experiences with them. Harvard Pilgrim's three-tier open formulary program has led members to become engaged in discussion about the choice, cost and value of medications. In just over two years, generic use by Harvard Pilgrim members has increased by 10 percent and is now over 60 percent of all prescriptions written for our members. While Harvard Pilgrim's annual pharmacy cost trends used to be over 20 percent, they rose at just 4.5 percent in 2005, compared to 13.1 percent nationally for HMOs, according to a 2006 Milliman Group Health Insurance Survey.

Case and Medical Management

Assisting health plan members with chronic and debilitating diseases is a significant challenge for insurers. Helping these members monitor their health and take preventive steps reduces preventable complications and serious ramifications of their conditions. This is important to the health and well-being of these individuals and saves them and their employers significantly over the long term. As the New England population ages, programs to support seniors will play an even larger role in providing the best and most cost-effective care.

Harvard Pilgrim has been recognized as a pioneer and industry leader in implementing disease management programs featuring an integrated health and benefit services approach providing best-in-class decision support for employees' health care choices. The programs include a wide range of concise clinical information available online, via phone and through face-to-face counseling. In 2005 and 2006, Harvard Pilgrim was one of eight plans nationwide—and the only one in the region—to receive certification for validity in savings measurement by the Disease Management Purchasing Consortium International, Inc.

Technology and Utilization Management

The proliferation of new medical devices and technologies also contributes to the rising costs of health care. Harvard Pilgrim has a steering committee comprised of clinical and administrative staff, headed by a medical director, which performs extensive reviews of new technologies, devices and procedures for clinical effectiveness, appropriateness

and safety, while providing trend analysis and guidance to Harvard Pilgrim's payment policy and utilization management areas. The benefit of this strategic planning and analysis is evidenced by Harvard Pilgrim's high-end radiology quality utilization management program, one of the first in the country. From 2001 to 2003, Harvard Pilgrim high-end radiology procedures (CT, MRI, PET and nuclear cardiology) had per member per month (PMPM) trend increases of over 20 percent, resulting from a combination of high-unit costs and high utilization. Since Harvard Pilgrim instituted our management program in mid-2004, the utilization of high-end radiology services has been flat.

The Road Ahead

While the challenges involved in controlling health care costs are formidable—especially in New England—the future holds promise and opportunity. Harvard Pilgrim has and will continue to take a leadership role as an employer, an insurer and a public policy advocate for consumerism and other cost-containment approaches. Harvard Pilgrim looks forward to working with all interested parties in improving health care access, affordability and quality through increased transparency, a wider array of product options and better decision-support tools for consumers, employers, brokers and providers.

LET'S TALK!

To join an online discussion on this issue affecting millions of health care consumers throughout New England, visit Harvard Pilgrim's interactive Web site, LetsTalkHealthCare.org, which features:

- A blog hosted by Harvard Pilgrim President & CEO Charlie Baker, which engages site visitors in an exchange on a wide range of health care issues
- A resource center providing information on ways to help control health care costs, industry news and more

We encourage you to visit LetsTalkHealthCare.org to voice your opinion and stay informed.

About Harvard Pilgrim

Harvard Pilgrim Health Care is a not-for-profit health carrier that provides a variety of insurance plan options and self-funding arrangements to approximately one million members in Massachusetts, New Hampshire and Maine through a provider network of more than 28,000 doctors and clinicians and 135 hospitals. Harvard Pilgrim's product portfolio includes PPO, POS and HMO plans, consumer-directed plans with HSA, HRA and FSA options, national plan solutions featuring a coast-to-coast network for customers with employees across the country, and Medicare Advantage Private Fee-for-Service plans.

At www.harvardpilgrim.org, Harvard Pilgrim provides innovative approaches to health improvement and disease management, member savings program information, unique online tools that speed and simplify key transactions for employers and providers, as well as personalized health support.

Harvard Pilgrim is the #1 health plan in America according to a joint ranking by *U.S. News & World Report* and the National Committee for Quality Assurance (NCQA).*

The November 6, 2006, edition of *U.S. News & World Report* ranks the nation's best health plans and determined that Harvard Pilgrim continues to lead the country for member satisfaction and quality of care.

In addition, Harvard Pilgrim was ranked highest in the Northeast Region by J.D. Power and Associates in their 2007 National Health Insurance Plan Satisfaction Study. The inaugural study identifies coverage and benefits, choice of doctors, hospitals and pharmacies, and information and communication as the most significant factors in driving member satisfaction.

* SOURCE: *Quality Compass*® 2004, 2005 and 2006 is used with the permission of the National Committee for Quality Assurance (NCQA). *Quality Compass* is a registered trademark of NCQA. NCQA is a private, non-profit organization dedicated to improving health care quality. "America's Best Health Plans" is a trademark of *U.S. News & World Report*. Harvard Pilgrim Health Care of New England, an affiliate of Harvard Pilgrim Health Care, is the #3 plan in America and the top-ranked plan in New Hampshire.



This information refers to products and services offered by Harvard Pilgrim Health Care and its affiliates, including Harvard Pilgrim Health Care of New England and HPHC Insurance Company.

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