TOWERS WATSON

2012 Health Care Changes Ahead

Survey

Executive Summary

With another significant, if slightly lower, rise in health care costs projected for 2013, companies must aggressively oversee their health care programs to control costs, increase workforce accountability and engage workers to lead a healthier lifestyle. Against this familiar backdrop, however, they also face imminent deadlines related to health care reform, notably the launch of insurance exchanges in 2014 and the onset of a rapidly changing health care delivery system. To overcome these complex challenges and take advantage of the emerging opportunities created by these changes, the need for a clear and strategic response has never been greater.

Towers Watson's 2012 Health Care Changes Ahead Survey results shed light on how employers are navigating both current cost concerns and their future health care strategy. The responses of 440 midsize to large U.S. companies confirm a strong commitment to health care benefits for active employees but reveal a shift for retiree medical plan sponsorship. They also provide a preview of the actions and programs that employers are planning or considering for 2013 and beyond.

Key Findings

- Health care costs are projected to increase by 5.3% in 2013 (down from the 5.9% projected for 2012). Without changes to medical and pharmacy plan designs, vendors, provider networks and other programs, the increase would have been 6.5% for 2013. Total per-employee costs are expected to be $11,507, representing an employer cost of $8,911 and an employee cost of $2,596. In addition, employee cost sharing for active employee plans continues to rise, albeit slowly, reflecting modest reductions in subsidization for employees and dependents. Over 80% of employers are likely to take additional steps to reduce costs so they fall below the regulatory threshold that will trigger the excise tax launching in 2018.

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- Most employers (88%) have affirmed their commitment to offer health care benefits to their active employees in 2014. However, a full 24% report they will very likely follow the path taken by other industry leaders.
- There is a continuing trend toward exiting retiree medical plan sponsorship. Nearly six of 10 companies with a program are somewhat to very likely to discontinue their programs for post-65 retirees, and 64% are considering the same for pre-65 retirees.
- More than three-quarters (77%) view health care benefits as core to their employee value proposition (EVP) over the next several years, and more than one-third will examine their health care benefits in a total rewards framework by 2013, with another 39% considering doing so by 2014 or 2015.
- Concerns about costs are also fueling the rise in account-based health plans (ABHPs), with over 60% of employers planning to offer an ABHP in 2013, likely rising to 80% by 2015. Total replacement ABHPs have almost doubled since 2010.
- Health care delivery and treatment settings continue to evolve, leading to the acceleration of alternate network strategies, including high-performance networks, third-party providers and telemedicine. For example, 17% plan to offer telemedicine by 2013, and another 27% are considering it for 2014 and 2015.
- Large numbers of employers are also considering new plan strategies for 2015. More than one-quarter (27%) are considering adding reference-based pricing (e.g., offering a defined level of reimbursement for a procedure), and 40% are considering adding value-based benefit designs (e.g., providing a different level of coverage based on cost or quality) by 2015.

Detailed Findings

Employer commitment remains strong

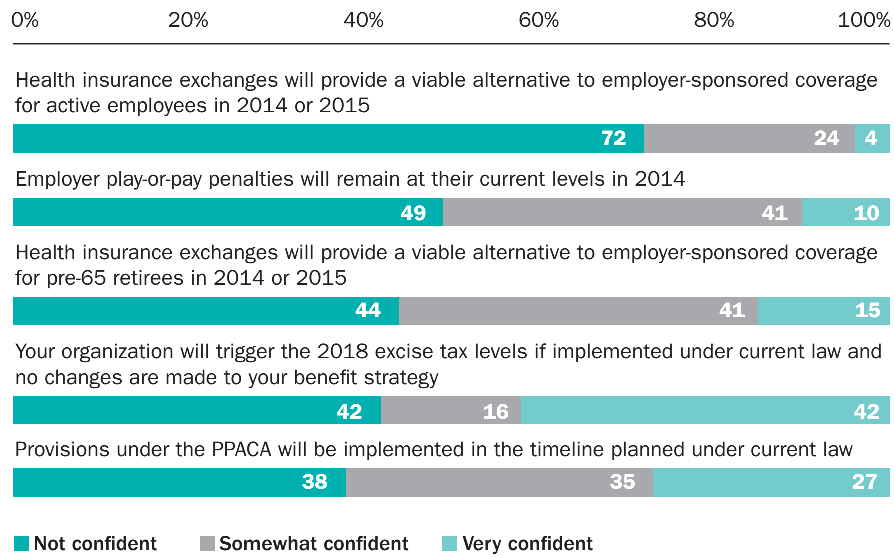
Two-thirds of employers expect the U.S. Supreme Court decision in late June to uphold health care reform to have a moderate to significant impact on their overall health care strategy. Also, employers now say they expect to shift their attention from compliance to rethinking their long-term strategy for active employees and retirees in 2013 *(Figure 1)*.

In fact, 37% of employers say long-term strategy for active employees will become their primary focus in 2013, up dramatically from 13% in 2012. In contrast, only 27% view compliance as their primary focus in 2013, down substantially from 61% in 2012. While most companies understand the need to act now, one-third still plan to wait for the November 2012 elections or the opening of the insurance exchanges before making any changes. Only 12% of employers have no plans whatsoever to recalibrate their strategy in response to the federal reform law. Most employers (88%) have affirmed their commitment to offer health care benefits to their active employees for the foreseeable future, yet with so many uncertainties, some are also hedging their bets through 2015. Nearly one-quarter (24%) admit they will very likely follow the lead of other large employers in their industry regarding ongoing sponsorship. Most (72%) lack confidence that exchanges will provide a viable alternative for active employees by 2015 *(Figure 2)*. The next few years will be very telling.

Figure 1. Companies plan to turn their attention to long-term strategy in 2013

	2012	2013	Percentage-point change 2012 to 2013
Managing cost of new mandates, fees and taxes (e.g., age 26 dependents)	17%	16%	–1%
Rethinking long-term strategy — for active employees	13%	37%	+24%
Rethinking long-term strategy — for retirees	7%	17%	+10%
Compliance with current and emerging regulatory guidance	61%	27%	–34%
Other	1%	2%	+1%

Figure 2. Few employers are confident that the exchanges will provide viable alternatives to employer-sponsored active coverage in 2014



"While most companies understand the need to act now, one-third still plan to wait for the November 2012 elections or the opening of the insurance exchanges before making any changes."

There was a good deal more certainty among employers about health care benefits continuing to be an integral part of their EVP. A clear majority (73%) believe health care benefits will be very important to their EVP in 2013, although the percentage decreases to 58% for 2014 and after *(Figure 3)*.

Beyond 2013, it is also interesting to note that the number of "not sure" responses increases significantly. The survey responses also showed that employers are thinking about health care benefits more holistically within the broader context of total rewards. More than half of employers are planning or considering examination of their health care programs within a total rewards framework by 2015. Given strong employee concerns about their compensation and benefit packages, it makes sense that employers embrace this broader view as they seek a balance between the sometimes competing demands of cost and talent management.

Employers Maintain Focus on Cost Controls and Avoiding the Excise Tax

The rate of health care cost increases for active employee coverage is expected to slow slightly in 2013, to 5.3%, from 5.9% this year *(Figure 4)*.

That translates into a projected per-employee health care cost of $11,507 in 2013 (up from $10,925 this year), representing a per-employee cost of $8,911 for employers and $2,596 for employees *(Figure 5)*.

In paychecks, then, employers will pay 5%, or $422, more in 2013 and employees 6.6%, or $160, more than this year if projections hold. While the actual dollar increase for employees appears modest, the 6.6% uptick — far outpacing the average merit increase of 3% — could be a meaningful difference for employees.

Figure 3. Health care benefits will continue to be core to the EVP in the next few years

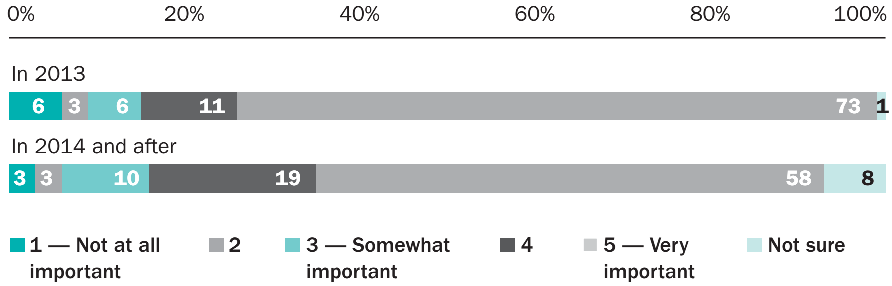


Figure 4. 2013 health care cost increases for active employees are projected to slow (slightly)

Medical and pharmacy cost combined

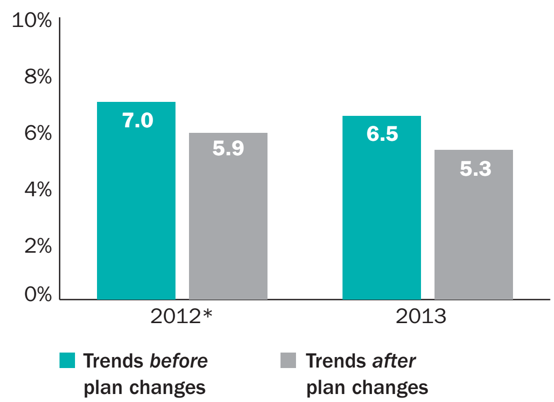
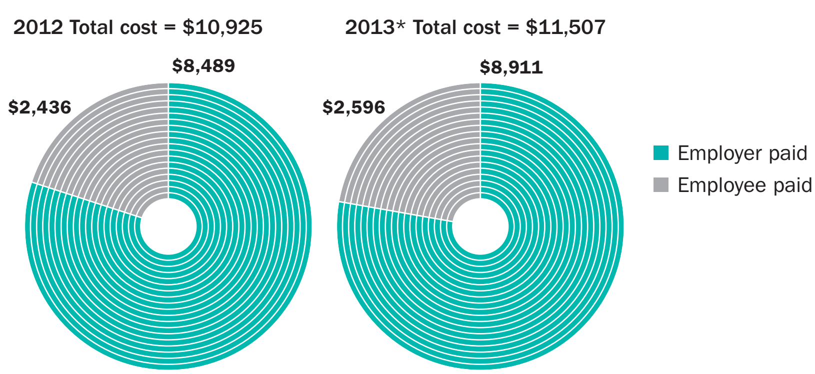


Figure 5. Affordability gap widens



*Projected

Source: Towers Watson's 2012 HC360 Study and 2012 Health Care Trends Survey

Across the board, fewer employers plan to increase single-only employees' share of premiums for 2013 (55%, versus 66% in 2012) *(Figure 6)*.

However, employers are continuing to increase required premium contributions for dependent coverage at a higher rate than for single-only coverage. While 43% of employers will not change employees' share in 2013 for single-only coverage, only 36% will hold the line on dependent coverage. On the other hand, there are still a considerable number of employers that will increase employees' share by five or more percentage points next year for both single-only (13%) and dependent (21%) coverage *(Figure 7)*.

Despite the overall moderation in cost increases, a majority of employers (58%) expect they will trigger the health care reform excise tax in 2018 if they do not make changes to their current benefit strategy. As a result, more than 80% of employers are likely to take steps to bring costs below the regulatory threshold in order to avoid the tax. About half are planning or considering using spousal waivers or surcharges when other coverage is available. Employees are also likely to see increased cost sharing in the area of prescription drugs, with companies significantly increasing the employees' share of costs for brand versus generic drugs, along with possible channel management strategies, including pharmacy benefit management and mail order for chronic disease drugs. While employers are not anticipating significant changes in workforce composition to mitigate the cost of health care reform, there could be exceptions in select industries, with a high number of part-time employers (e.g., retail, hospitality) looking to reduce costs by limiting the number of employees receiving health care coverage.

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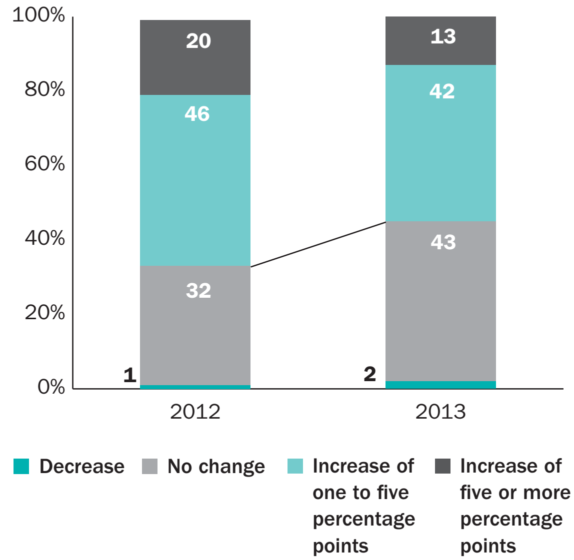
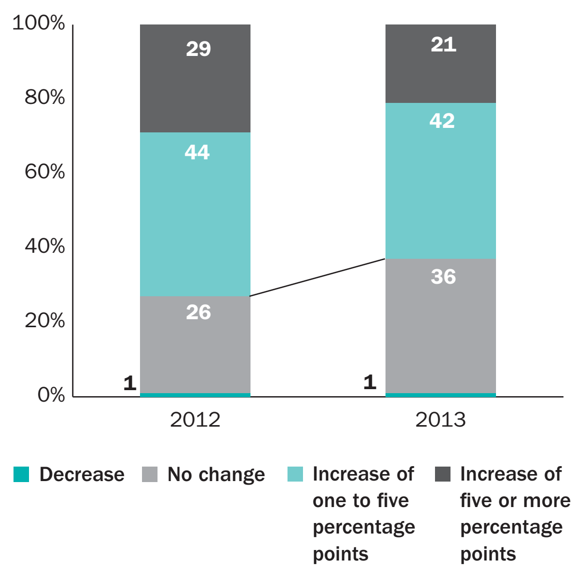
Figure 6. Employee premium contributions for single-only coverage are moderating



Note: Percentages on chart exclude those who responded "not applicable."

Figure 7. Employee premium contributions for dependent coverage are rising at higher rate than single-only coverage



Note: Percentages on chart exclude those who responded "not applicable."

Use of ABHPs Grows

Concerns about cost and workforce accountability continue to fuel the rise in ABHPs. Over 60% of employers plan to offer an ABHP in 2013, likely rising to 80% by 2015. Nearly two-thirds of employers will offer an ABHP with a health savings account in 2013, and an additional 25% are considering such an offering in the next two to three years. This means that as many as nine out of 10 employers may offer this type of plan by 2015. Some employers also continue to offer ABHPs with health reimbursement accounts, which are particularly attractive to employers with large lower-wage populations.

For companies offering an ABHP, median employee enrollment reached 27% in 2012 *(Figure 8)* and is expected to hit 30% by next year. This trend is helped by the growing group of companies (15% in 2013) willing to migrate their entire workforce to an ABHP (total replacement) — nearly doubling since 2010.

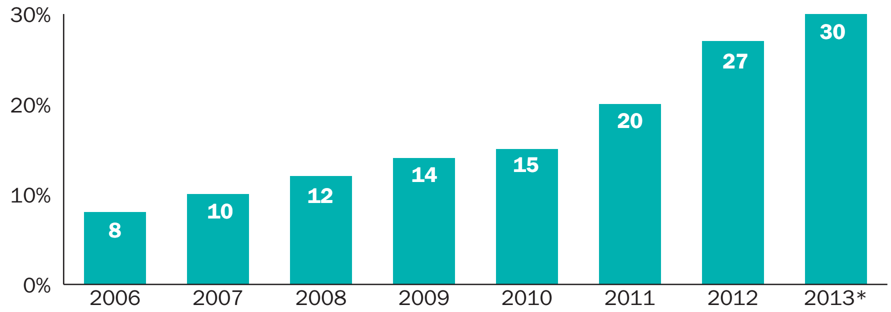
Employers Are Reshaping the Employee Experience to Focus on Accountability

Employers are also maintaining a keen focus on holding employees accountable for their health choices. Three-quarters of employers will use financial incentives to encourage individuals to complete a health risk appraisal or biometric screening, or to participate in health management programs and activities, with an additional 16% considering such incentives in the next two to three years (*Figure* 9 on page 6).

And over half (52%) are considering rewarding or penalizing employees based on biometric outcomes. This is in addition to the 22% taking this approach now or in 2013. Many will also reward nonsmokers and penalize smokers.

To support employees in this effort, employers are looking to help employees access cost-effective, high-quality care. Over half of employers currently provide — or plan to provide next year — their employees with hospital price and quality data via transparency tools purchased from either their health plans or through specialty vendors.

Figure 8. Median ABHP enrollment continues to rise

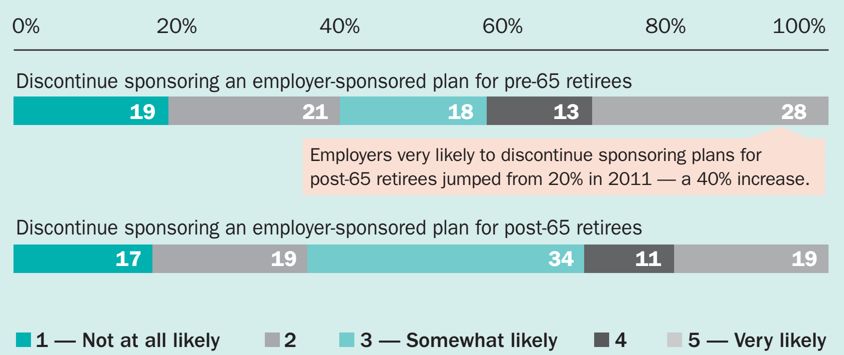


*Projected

New solutions for retirees

While employers are moving cautiously on health care benefit plan changes for active employees, many are moving forward on new opportunities for retiree plans, including redefining their EVP for new hires. Employers recognize the potential value of the exchanges for both employers and individuals, as well as what they expect to emerge in the pre-65 arena. Accordingly, companies continue to move toward the exit of retiree medical plan sponsorship. Almost 30% are very likely to discontinue sponsoring a plan for post-65 retirees by 2015, with nearly 20% considering the same for pre-65 retirees. Less than a fifth report little interest in such actions. Employers are much more confident in the viability of the exchanges as an alternative for pre-65 retirees than for actives in 2014 or 2015, again, probably based on the positive news about existing private exchanges.

Companies continue to push toward the exit of retiree medical plan sponsorship



Note: Percentages on chart exclude those who responded "not applicable."

Even the employee health care delivery experience itself is likely to change as employers offer or consider offering telemedicine (44%), onsite health coaching (48%) or onsite health centers (36%). These services can range from onsite coaching and limited medical services to full centers with pharmacy capabilities. Towers Watson's 2012 Onsite Health Center Survey Report provides insights on how these centers are perceived and used.

Taking Advantage of the Changing Provider Landscape

Employers recognize the need to address the wide variation in provider prices and health outcomes, and are interested in emerging opportunities to align providers with a new proposition based on outcomes and the total value of the care they deliver. And providers are increasingly willing to comply.

All this is occurring in an environment of new value-based provider models, including accountable care organizations, direct contracting, narrow networks and specialty players. As this reshaping occurs, employers are considering offering more incentives within plan design for the selection and use of high-performance networks (44% in the next two to three years).

Forty percent are considering using value-based benefit designs (e.g., providing a different level of coverage based on cost or quality, or evidence-based practice), and 30% are considering implementing new financial terms or performance (e.g., clinical) standards for their health plans. Increasingly, employers will be looking for greater value when contracting and reimbursing for health care expenses.

Conclusion

The Supreme Court's ruling on health care reform has made it virtually impossible for employers to delay decisions about their health care programs. As a first step, it is imperative to gain a deep understanding of the law's components not only to ensure compliance but also — with the assistance of modeling — to determine whether to continue providing health care benefits (play), exit the health care system (pay) or select among opportunities in between that enable both the company and employees to benefit from the introduction of exchanges and federal subsidies. While each employer's decision will depend on its own unique circumstances, many will share the common

Figure 9. Momentum toward outcome-based financial incentives continues

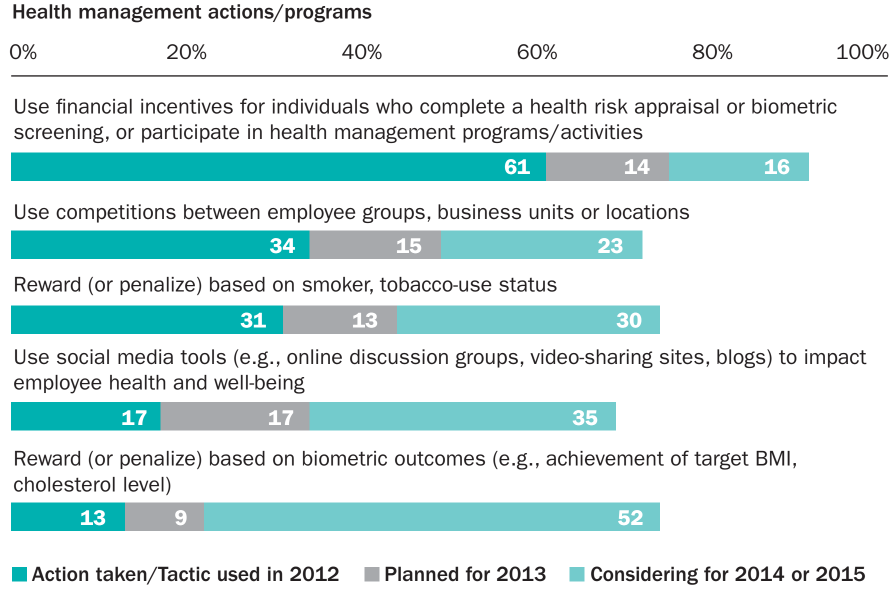
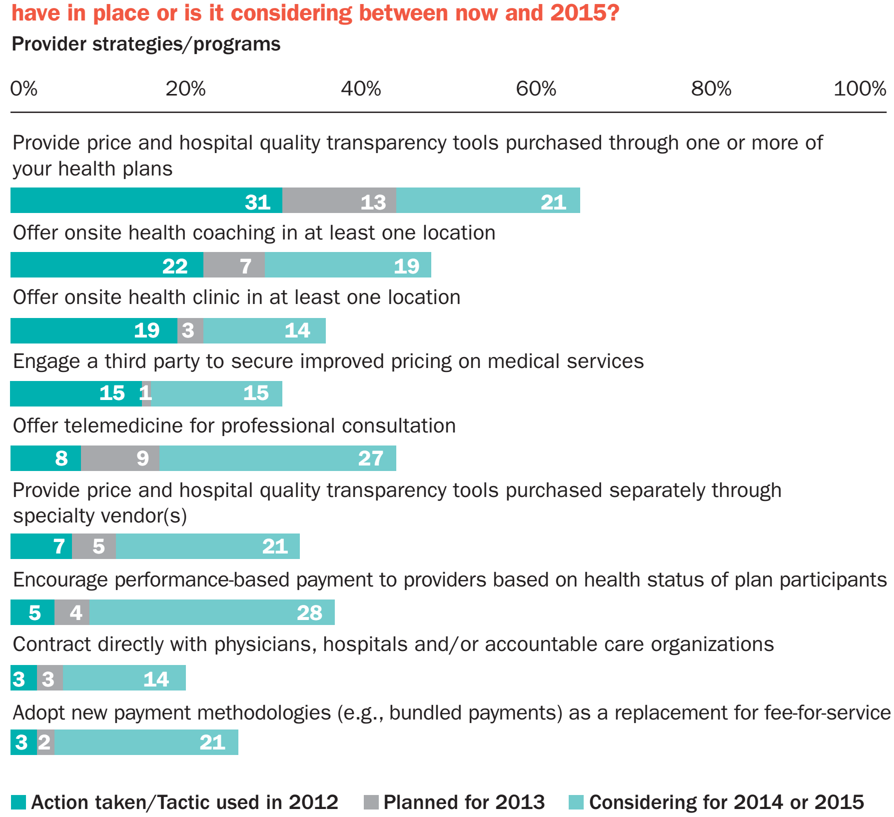


Figure 10. Which specific provider strategies/programs does your organization have in place or is it considering between now and 2015?



obstacle of controlling rising health care costs, especially with the excise tax coming in 2018. And although the current commitment to providing health care benefits for active employees is strong, it may not be deep — as the survey response about following industry leaders portends. In contrast, the growth of exchange-based solutions for post-65 retirees is already leading many companies to consider discontinuing their retiree medical care programs.

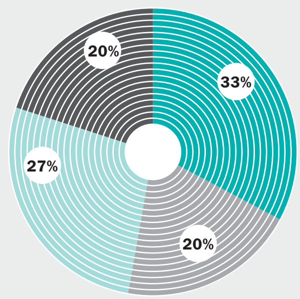
Our survey results show that as we approach 2013, employers are anticipating the magnitude of the changes to come. Their actions are taking many different forms. Some are sharing costs more liberally with employees and their dependents. Others are revisiting dependent eligibility and subsidies through spousal waivers and surcharges. Still others are making specific plan changes to increase worker awareness and accountability, using approaches such as ABHPs and financial incentives to utilize higher-value services or improve personal health, and introducing tools that provide understandable and accessible data on the variations in the price and quality of health care services for various procedures. And a number are taking advantage of new ways to deliver health care, ranging from telemedicine and onsite services, to value-based models that include narrowing or restructuring networks and provider payments.

Affordability and workforce health will remain top priorities, but the ways in which those goals are attained may differ. Each employer will need to assess the various paths and how any contemplated change will affect their EVP and total rewards framework. Transformative change will only accelerate in the coming years: More provisions of the health care reform law will take hold, and new plan designs, programs and networks will evolve. In the end, overseeing these changes will be a significant undertaking for employers; yet those that start the work today will be better positioned for success in the future.

About the Survey

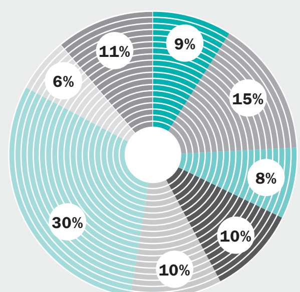
Towers Watson's 2012 Health Care Changes Ahead Survey was conducted online in late July to determine how U.S. employers view the impact of the U.S. Supreme Court's announcement that the PPACA is constitutional and how they plan to respond. More than 440 health care benefit professionals from midsize to large companies across a variety of industries participated in the survey. The survey also includes cost-related data gathered by consultants on behalf of 355 Towers Watson clients.

Employee size groups



- **33%** 10,000+
- **20%** 5,000 to 10,000
- **27%** 2,000 to 5,000
- **20%** Fewer than 2,000

Industry groups



- **9%** Energy and Utilities
- **15%** Financial Services
- **8%** General Services
- **10%** Health Care
- **10%** IT and Telecom
- **30%** Manufacturing
- **6%** Public Sector and Education
- **11%** Wholesale and Retail

About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.

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