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PwC’s Health Research Institute (HRI) projects a 2015 medical cost trend of 6.8% - a slight uptick from last year’s projection

HRI’s projected medical cost trend over the years

About our report

- Conducted interviews with industry executives, health policy experts and health plan actuaries, whose companies cover a combined 93 million members
- Conducted interviews with 30 internal PwC subject matter experts covering payer, provider, pharma, and employer sectors
- Included results from PwC’s 2014 Touchstone Survey of more than 1,200 employers from 35 industries and a survey of Health Plan Alliance members on their thoughts of medical cost trend
- Analyzed economic trends, Wall Street analyst reports, and industry trend reports
- Evaluated causes of medical cost trend – known as inflators and deflators
### The 101: what is medical cost trend?

<table>
<thead>
<tr>
<th>Definition</th>
<th>Projected percentage increase in the cost to treat patients, or healthcare spending growth rate</th>
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<tr>
<td>Importance</td>
<td>The projection is used by insurance companies to calculate health plan premiums for the coming year</td>
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<td>Influencers</td>
<td>Changes in the price of medical products and services, known as unit cost inflation</td>
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<td></td>
<td>Changes in the number of services used, or per capita utilization increases</td>
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### Why is medical cost trend important?

Health insurers use HRI’s projected medical cost trend to help calculate their premiums for the upcoming year and it reflects changes in technology, industry operations, and consumer behavior.

#### Today

<table>
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<th>Retrospective</th>
<th>Forward-looking</th>
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<td>Other similar health spending measures exist but typically are several years behind</td>
<td>Every year, HRI publishes the only forward-looking medical cost trend projection for the upcoming year</td>
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#### 2012 actual data
- National Health Expenditure (NHE) by CMS
- Employer cost index from Bureau of Labor

#### 2013 actual data
- Employer premium estimates by KFF
- Medical trends by Benefit consultants
- Analyst reports by investment banks

#### 2014 projected
- Milliman Medical Index
**High-deductible health plans and their impact to healthcare spending**

Since enrollment in high-deductible plans has tripled since 2009, consumers have taken a greater stake in the health system: demanding more value for their dollar.

**Employers are increasingly using high-deductible plans to tamp down use of services and increase cost-sharing**

Most employers are considering or already offer a high-deductible plan as the only option for employees. Shifting costs to employees results in behavior changes such as using fewer services or making less-expensive care decisions.

Source: PwC 2014 Touchstone Survey
Inflator 1: The economic upswing finally reaches healthcare five years post-recession

Relationship between growth in Gross Domestic Product (GDP) and growth in National Health Expenditures (NHE), 2004–2019

Because of the lag, we are just starting to see the impact that the recovery will have on healthcare spending

Source: PwC Health Research Institute estimates based on data from the Bureau of Economic Analysis and CMS, and on projections of GDP from the Congressional Budget Office.
Inflator 2: No slowing down for specialty drugs – US specialty drug spending will quadruple by 2020

Projected specialty drug spending from 2012 to 2020
Spending amounts in US$ billions

- 2012: $87.1
- 2016: $192.2 (121% increase from 2012)
- 2020: $401.7 (109% increase from 2016)

Source: PwC Health Research Institute estimates based on data from CVS Caremark

New Hep C therapies have hit the ground running and will have the greatest financial impact in the first few years

2015-2016 is the highest cumulative impact on benefit costs for employer plans

Source: PwC Health Research Institute estimate based on National Health and Nutrition Examination Survey and 2012 Truven claims data from employers
**Inflator 3: Physician-based payments become more lucrative hospital-based payments in acquisitions**

Oncology drugs cost more when administered in a “hospital-outpatient” department

Example oncology drugs and total payment per claim:

<table>
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<tr>
<th>Drug</th>
<th>Physician office</th>
<th>Hospital outpatient</th>
<th>Percent difference</th>
</tr>
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<tbody>
<tr>
<td>Alimta</td>
<td>$5,460</td>
<td>$9,710</td>
<td>78%</td>
</tr>
<tr>
<td>Herceptin</td>
<td>$2,740</td>
<td>$5,350</td>
<td>95%</td>
</tr>
<tr>
<td>Avastin</td>
<td>$6,620</td>
<td>$14,100</td>
<td>113%</td>
</tr>
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</table>

Source: PwC Health Research Institute analysis based on 2012 Truven claims data

**Inflator 4: Provider consolidation and regulatory changes expose need for IT integration investment**

“Being in a hybrid state after an acquisition, where hospital employees are using two different technology systems, is no fun for anyone. Employees are often confused and patients are frustrated when their health information can’t be accessed.”

- John Delano, VP and CIO of Integris Health

Example costs and duration for an end-to-end IT integration:

- Number of beds: 1200 - 1400
- Implementation duration: 2 - 5 years
- Range of costs:
  - Clinical and business software: $15M-$20M
  - Supporting hardware/infrastructure: $5M-$10M
  - Third party/consulting support: $20M-$30M
  - Implementation costs per bed: $70K-$100K

Source: PwC Health Research Institute analysis of IT cost model based on multiple hospital costs.
### Deflator 1: Cutting costs through achieving ‘systemness’

Recently consolidated hospitals are moving towards systemness through the standardization of administrative and clinical processes

<table>
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<th>Administrative Processes</th>
<th>Clinical Processes</th>
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<td><strong>Administrative functions that organizations streamline:</strong></td>
<td><strong>Clinical resource management</strong></td>
</tr>
<tr>
<td>• Hospital management, supply chain and clinical purchasing, revenue cycle, clinical equipment management, HR, IT, service line management</td>
<td>• Clinical purchasing/supply chain</td>
</tr>
<tr>
<td>• Automation and data analytics to reduce labor costs</td>
<td><strong>Clinical pathway standardization</strong></td>
</tr>
<tr>
<td></td>
<td>• Standardized order sets</td>
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<td></td>
<td>• Care protocols</td>
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“By centralizing key support functions, CHRISTUS will be able to save $20M over 5 years in facilities management efficiencies, reduce costs to collect payments by 0.25% per transaction, and will project seven-figure savings by centralizing accounting, procurement, and accounts payable.”

-Paul Generale, SVP and Senior Financial Officer of CHRISTUS Health
Hospital employment growth has slowed – evidence that providers are achieving efficiency with fewer resources

Monthly growth in hospital employment (seasonally adjusted; annualized: January 2012 – April 2014)

Deflator 2: Consumers become cost-conscious healthcare shoppers

“Whether through state governments or the private sector, most purchasers and payers will be offering transparency tools to help consumers shop for care.”

- David Lansky, President of Pacific Business Group on Health

85% of employers have already implemented or are considering an increase in employee cost sharing through plan design changes over the next 3 years

Source: PwC 2014 Touchstone Survey
**Deflator 3: Risk-based contracts are beginning to reduce costs**

“Successful ACOs use clinical data to target particular risk groups and develop appropriate treatment algorithms.”

-David Lansky, President of Pacific Business Group on Health

### Examples of savings from risk-based Accountable Care Organizations

<table>
<thead>
<tr>
<th>Risk-based initiatives</th>
<th>47%</th>
<th>$126M</th>
<th>$95M</th>
<th>600</th>
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<tr>
<td>The percentage of Martinm Shanel Savings Program ACOs that exceeded savings targeted within their first year.</td>
<td>The amount of shared savings generated by 29 Medicare Shared Savings Program ACOs.</td>
<td>The amount of net savings generated by a large commercial ACO in California over 4 years.</td>
<td>The number of public and private ACOs across the nation, covering more than 10 million insured patients.</td>
<td></td>
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Sources: U.S. Department of Health & Human Services; Health Affairs Blog 2014; and Health Affairs 2013

### Insurance executives interviewed by HRI also view risk-based contracts as key to controlling costs
**What this means for your business – Employers**

*What are they doing now?*

Employers continue to pursue cost-cutting strategies through narrow provider networks, investing in wellness programs, contracting directly with center of excellence, or participating in private exchanges.

**Things to consider:**

- Tailor your pharmacy benefit to control drug spending
- Ramp up transparency for your employees
- Evaluate private exchanges

**What this means for your business – Providers**

*What are they doing now?*

Shrinking margins for providers continue to make cost reductions a necessity. HCPs are minimizing redundancies and preparing to take on financial risk and produce better outcomes and lower costs.

**Things to consider:**

- Provide increased price and quality transparency
- Aim for care anywhere
- Standardize mindfully
- Prepare for post-IT integration maintenance
- Embrace innovative care strategies
What this means for your business – Health Insurers

What are they doing now?
To keep premiums low and health costs at bay, insurers focus their efforts on mitigating expensive surprises—Hep C caught a few insurers off guard. Insurers are also getting acquainted with new members via the new healthcare exchanges.

Things to consider:

- Prepare for the drug pipeline
- Emphasize customer engagement with a focus on appropriate utilization
- Partner with independent price transparency companies

What this means for your business – Pharma & Life Sciences

What are they doing now?
After years of focus on blockbuster drugs, the science trajectory has shifted to specialty therapies that deliver costly, high-impact treatments. Industry is still left with the challenge of demonstrating cost benefit and ultimate value.

Things to consider:

- Incorporate value based-outcomes into R&D design
- Understand the impact of increased cost-sharing on consumers
- Consider risk-based relationships
- Partner with disease associations
Questions?

For more information

pwc.com/us/healthindustries
pwc.com/hri
twitter.com/PwCHealth

To download the full report, please visit: www.pwc.com/us/MedicalCostTrend

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