Testimony to the Joint Economic Committee of the U.S. Senate

Early Experience with Consumer-Centric Health Plans

By

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Thank you for your invitation to present early experience with consumer-centric health insurance products from Humana Inc. and additional observations relating to the experience of the health insurance industry. My name is John Bertko and I am the Vice President and Chief Actuary for Humana Inc. Humana is one of the country's largest regional health insurers and is a leader in design and implementation of consumer-centric health products. With over 6 million total members and 3 million commercial members in 15 major states, Humana has a cross-section of the country's insured consumers in its variety of traditional and consumer-centric products.

Today, Humana has over 200,000 under-65 members enrolled in our consumer-centric products, roughly 7% of our total non-governmental business. This number has grown dramatically in one year from the roughly 40,000 enrolled as of January 1, 2003. From our market research, we believe that Humana ranks second in membership in true consumer-centric products, if defined as products with a spending account. Overall, we estimate that there are roughly 1 million Americans enrolled in some form of consumer-centric product with a spending account. [This number at least doubles if various choice products with multiple options but no spending accounts are included in the total.]

We expect that this number will at least double again during 2004, perhaps growing even faster as more employers and consumers become interested in consumer-centric products and more insurers enter the market. At this point, we believe that most employers that offer these products are the "early adopters." By January 1, 2005, we expect Humana will have from 400,000 to 500,000 members enrolled in its consumer-centric products.

The good news, at least from Humana, is that the consumer-centric concept succeeds by giving individuals incentives to choose health care services and options that are right for them in a total replacement solution by providing the information and tools to make their choices easier. Before providing a summary of our early experience, let me give a very brief description of the Humana consumer-centric solution.

Humana's Consumer-Centric Solution – SmartSuite℠

First, Humana believes in the social contract of insurance--that the healthy must subsidize the sick. It is critical that all employees, those who use few or no services (the healthy) and those who use many services (the high users) remain in the same risk pool for insurance coverage. In order to maintain the integrity of this risk pool, the employer must provide a subsidy for the high use employees and blend these funds with contributions from employees with average, high or low utilization of services.

Based on this premise, Humana, unlike its competitors, markets a "total replacement" solution. Employers choose from a variety of bundles of products containing traditional

products (i.e., HMOs and PPOs) and high deductible or "consumer-centric" products for which we create rates to maintain affordable coverage for all products. **Each employee then chooses his or her own option from the products offered in the bundle.**

Humana's consumer-centric options typically have an allowance or spending account of between $500 and $1000 for the employee to "choose and use" health care services. Each employee has control over those dollars, to spend on preventive care, office visits, imaging or lab tests or other services. After this allowance is exceeded, the employee must meet a deductible, generally in the range of $1500 to $3000. Expenses above this deductible are then covered by true catastrophic insurance with low cost-sharing (generally 10% or less).

Employee Choice

Experience shows that today most employees do not make an active choice of health insurance coverage each year. Most employees default to the coverage they had the previous year. Humana experience reveals that when employees have to make an active choice each year, they make more meaningful choices if given good information and tools. In the Humana scenario, each employer is strongly encouraged to have a "positive open enrollment" for its employees during which time employees examine all options. Employees use a "wizard" to help them learn about their plan choices and estimate cost of services they or their family might use in the coming year based on previous year's claims' experience. Then, based on this information, the employee or family makes a

decision as to whether they would prefer to pay for their coverage through lower payroll deductions and higher costs at the point when they need services or choose higher payroll deductions and lower costs at the time they seek services.

Importance of Communications

Initial and ongoing educational communications are critical to the success of the consumer-centric approach. In our approach, employees and dependents are provided with Web-accessible decision-support tools that show how much they have spent, different cost levels and, to the extent available, quality information about providers. We want our members to think about what services they obtain, at which site of care they want to seek services and the quality and efficiency of their providers.

Also critical in the educational process is the public availability of comparative cost and performance data. States like Pennsylvania, New York and Wisconsin have taken the lead in publishing this kind of consumer information on their Web sites. The Centers for Medicare and Medicaid Services (CMS) has begun to publish some data for health plans, nursing homes and home health agencies. Just as they do in all other areas of their lives, consumers make better choices when they can compare cost and quality information. We encourage you to advocate for faster disclosure of this kind of information at the federal level.

Early Evidence of Success

Through our experience, first with Humana employees as a pilot group, and now with customers and their employees, we've learned many lessons. We have provided a significant amount of this information to health services researchers as part of outside independent assessments of our data. However, I need to point out that it is still "early" and the data should be viewed as good indicators rather than fully credible proof that the concept works.

From Humana's perspective, we view our results as representing the effects on "health systems in miniature" – using an employer as a risk pool and measuring what happened from year to year. The following evidence represents a summary of the last 2-1/2 years of experience, for both Humana's pilot initiative for its own employees and then for Humana's "early adopter" customers.

Adoption and Enrollment in Consumer-Centric Options

As of mid-February 2004, Humana has 125 employer customers, with over 200,000 members in consumer-centric solutions and products of all kinds. These customers are evenly distributed across our major states and in a variety of industries, from financial companies to hospitals to school districts to restaurant industry companies.

As I previously mentioned, in Humana's solution, individual consumers choose between traditional products and consumer-centric options. While early enrollment in the

consumer-centric option was a low percentage at both Humana and its competitors in 2001, by 2003 nearly 28% of members were enrolled in consumer-centric options, with other employees remaining in traditional options. Humana believes that most employers will want to continue offering both traditional and consumer-centric options, while encouraging efficient behavior.

Cost Trend Experience

Cost trends have been significantly reduced by enrollment in these products. And, because Humana views these trends across the whole "employee health system," we've seen a significant impact on traditional as well as consumer-centric options. In our Humana employee pilot, we started with 10,000 Humana Louisville employees and their dependents on July 1, 2001. As measured a bit more than a year later in late 2002, our average health care trend was 4.9% (the year-over-year total increase) versus an average trend in the Louisville market of around 15% (after benefit buydowns). In Year 2, we extended this solution to our 14,000 non-Louisville employees and dependents and achieved a trend of 1.4%, attributable in part to "word of mouth" and a greater 20% enrollment in the consumer-centric option. The same year, Humana offered its Louisville employees a next generation solution with even more customizable features, including Health Reimbursement Accounts. This solution's trend was 2.7%. All of these trends compare to mid-double digit trends in the rest of the traditional marketplace in 2001 through mid-2003.

Similar cost trends are now emerging in our customer block of business. As of January 2004, we have credible claims trend experience on 43 of the 125 employers (many just enrolled as of January 1, 2004), covering 48,000 insured members. The early evidence for these groups points to an average trend in a range between 5% and 8%. We update this experience monthly and the results have been consistent through 2003.

Early Evidence of Utilization and Behavioral Change

All of Humana's detailed cost and utilization evidence is derived from analysis of the experience of our 24,000 employees and dependents. It is too early to look at the results of covered customer members since analysis of actuarially credible data requires 12 full months of data, plus a minimum of three months of "run-out" claims to allow for processing of utilization "in the system."

Based on the Humana experience, we first find that there is significant favorable selection by the "early movers" into consumer-centric options. In Year 1, these "early movers" (6% of employees and dependents) of Humana members had prior claims that averaged only 53% of the average cohort. In Year 2, with now 20% of members in the consumer-centric option, these healthy individuals averaged around 50% of the average cost. They are clearly healthier, although were approximately the same age, on average.

The next question is "Why did claim trends decrease to single digit levels?" Our early experience indicates that several types of behavioral change accounted for most of the trend reduction. First, employees chose themselves to migrate to lower cost options,

thus reducing their payroll deductions, in some cases from approximately $20 per pay period for a single employee to $5 per pay period.

Another significant factor appears to be a change in site of care for receiving services. Visits to emergency rooms and use of other outpatient services decreased relative to Humana's market averages, while use of physician office visits increased somewhat. In addition, more prescription drugs were used, generally consistent with more office visits. We believe that many of Humana's employees chose to make greater use of their physicians in office settings, where the doctor's knowledge of his or her patient likely leads to better quality care, while eliminating unnecessary costs associated with emergency room visits or other outpatient services. Exhibits 2 and 3 provide a summary of the behavioral changes that shows the consumer-centric solution (SmartSuite^{SM}) vs. Humana's market averages.

In addition, about 200 employees chose to waive coverage. We checked with all of them and all but one had coverage elsewhere (generally through spousal coverage). Reduction of duplicative coverage frequently means that use of unnecessary services is diminished.

Last, there was some element of buydown of coverage in this pilot, since Humana added a hospital copay to all of the traditional benefit options.

Use of Communications and Shared-Decision Making Tools by Consumers

Humana strongly stresses the need for employers to embrace and communicate the message of employee participation in their health care decisions. For the employer, we provide a package of communications materials tailored to explaining the consumer-centric solutions, from messages from senior management to payroll inserts to newsletters to posters.

For employees, Humana makes use of on-line enrollment applications, a wizard to assist employees in making health care option decisions, and a "PlanProfessor[SM]" to provide background information on how to maximize their benefits and options. To date, we have had 102 of our employer customers make use of the wizard and had nearly 100,000 unique users log in. The wizard leads consumers through a series of questions about their prior utilization of services, their preferences for physicians and hospitals and the tradeoffs between lower payroll deductions and lower point-of-service cost-sharing. This tool provides options to:

- "Narrow My Choices"
- "Tailor My Benefits"
- "Balance My Cost"
- "Tell Me How Much Will I Spend?"

The wizard and the on-line application allow specific information to be provided to consumers without overwhelming them with data. Access to the applications can be provided through work desktop computers, home computers, kiosks at work locations or through the Internet at libraries or other public facilities.

The Health Insurance Industry Has Embraced Consumer-Centric Products

In my opinion, the health insurance industry has generally embraced consumer-centric products. Humana and nearly all of our major competitors offer some version of a product with health spending accounts or multi-option choice product. These products come in many variations but all make the point of increasing consumer involvement in the "choose and use" health services process.

Since the Department of Treasury issued a statement clarifying the position of Health Reimbursement Accounts (HRAs) in June 2001, most large insurers have included these accounts in their products. HRAs have considerable flexibility in plan design and generally use "notional" dollars in accounts that are available to employees but allow balances at the end of a year to roll-over to be used in future years. "Notional" dollars are accounting credits, like airline frequent flyer miles, that can be used later but are not cash contributions. Between 30% and 50% of employees have some of their HRA amounts remaining to be rolled over. Use of the rollover amounts depends on the employer's plan provisions, but they may be used for paying down deductibles or coinsurance in future years, for COBRA coverage or for retiree benefits. Generally, I don't believe most employers allow the accounts to be portable.

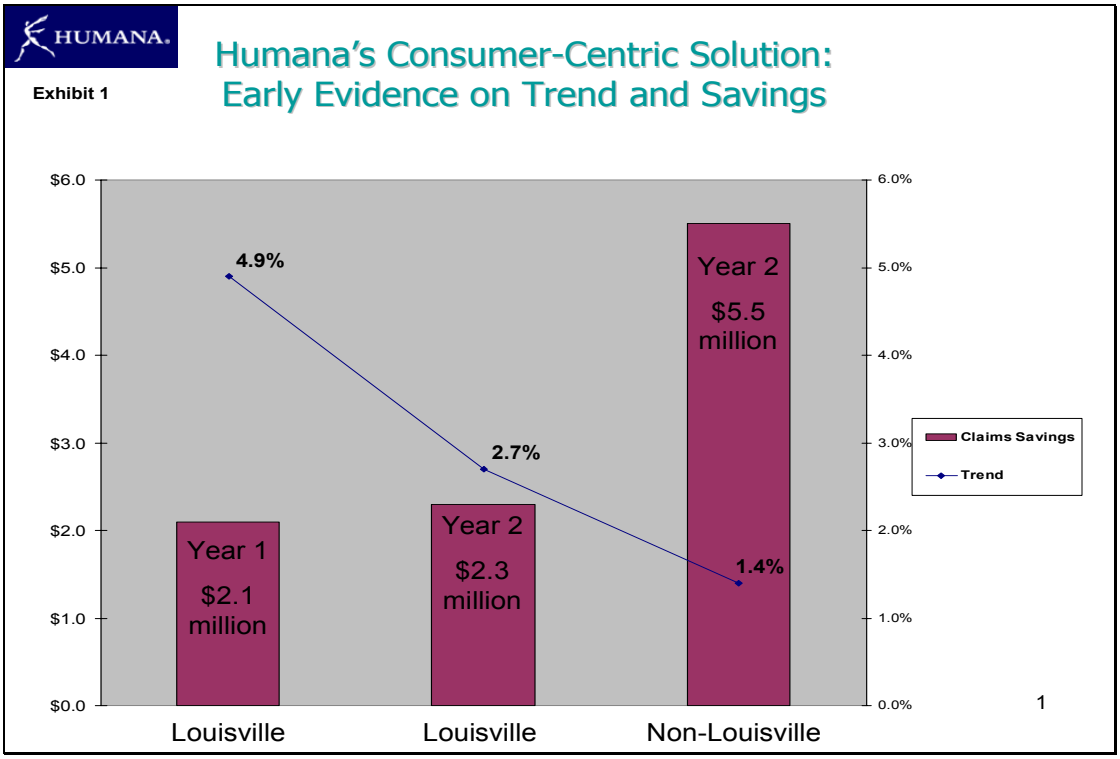
As you know, Health Savings Accounts (HSAs) were included in the Medicare Modernization Act (MMA) signed into law in December 2003. Many health insurers

either already have HSA products on the markets or are in the process of developing and filing these products today. HSAs use actual cash contributions into an account (in contrast to the notional dollars used with HRAs) and are truly portable for consumers. There are, however, certain legislated constraints on plan design that may reduce the appeal to some consumer segments.

In my opinion, HSAs will have enormous appeal in the individual health insurance market where most products sold today have deductibles large enough to qualify as high deductible health plans to meet the HSA requirements. In addition, HSAs are likely to replace the Medical Savings Accounts available to small employers. In the larger employer market, it appears to me that Health Reimbursement Accounts (HRAs) may continue to have somewhat greater appeal, due to their greater flexibility of plan design and the ability of employers to use them to increase employee retention.

Summary

Consumer-centric products will be the focus of attention in employer-sponsored and individual health insurance over the next few years. Getting consumers involved in the "choose and use" decisions about their health care coverage is essential to reducing the health care cost burden. HRAs and HSAs are likely to emerge as common product features available to most American workers and their families and will be a necessary component of a strategy of communication, shared decision-making and choice.



The trend reduction translated to savings of $2.1 million. The trend reduction translated to savings of $2.1 million. More than half of that amount - a total of $1.4 million - was the result of changes in employee behavior.

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SmartSuite Year 1 • Early Evidence

Exhibit 2

Change in Utilization for Louisville Employees/Dependents

Category	Statistic	SmartSuite℠ Change	Market Change
Hospital Inpatient	Adm/1000	-14.4%	2.0%
Hospital Outpatient	Units/1000	-0.1%	8.2%
Physician	Units/1000	16.9%	13.3%
Rx	Scripts/1000	5.5%	1.9%

Note: Preventive Services increased by 14% over the prior year

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SmartSuite Year 2 • Early Evidence of Behavioral Change

Exhibit 3

Change in Utilization for Humana Non-Louisville Employees/Dependents

Type of Service	Utilization Change SmartSuite℠	Utilization Change Market
Inpatient	-18%	-1%
Outpatient	+1%	-1%
Office Visits	+19%	+14%
Physician -- Total	+10%	+11%
Medical – Total	**+5%**	**+13%**
Rx	0%	+4%

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