

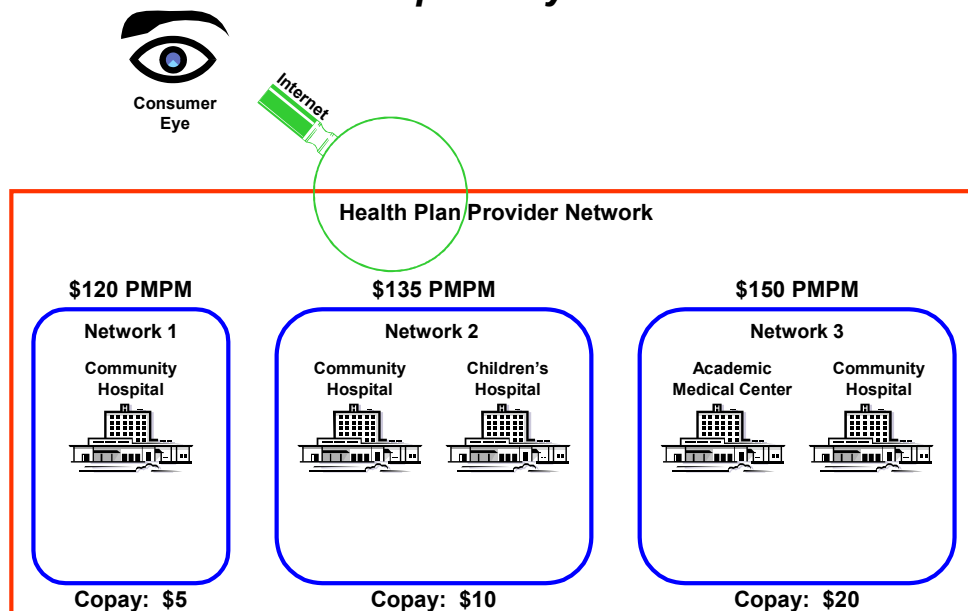
DEFINED CONTRIBUTION

Rapidly rising healthcare premiums are causing many large employers to consider implementing defined contribution programs for healthcare benefits, similar to the move from defined benefit pension plans to 401(k) programs. However, widespread implementation of defined contribution programs has not occurred due in part to:

- A robust economy – A tight labor market and strong unions have forced many employers to reconsider actions that are viewed as “reducing” healthcare benefits.
- Tax implications – Employers who purchase a base level of healthcare (e.g., lowest cost benefit plan) and ask employees to pay for “richer” packages lose tax deductions for both the employer and the employee.
- Adverse selection – As employees self select their benefits (e.g., basic catastrophic coverage versus full scale packages), it is likely selected benefit packages will become prohibitively expensive as only a “pool” of high utilizers will choose this option.
- Societal concerns – Concerns are being voiced that employers may not be upholding their fiduciary duties by delegating healthcare decision-making to employees.

Nevertheless, health plans are continuing to explore alternatives to assure that additional value is being received in return for higher premiums. As depicted in the following illustration, many health plans are beginning to reveal the costs of alternative provider networks.

Cost Transparency Illustration



Source: BDC Advisors, LLC

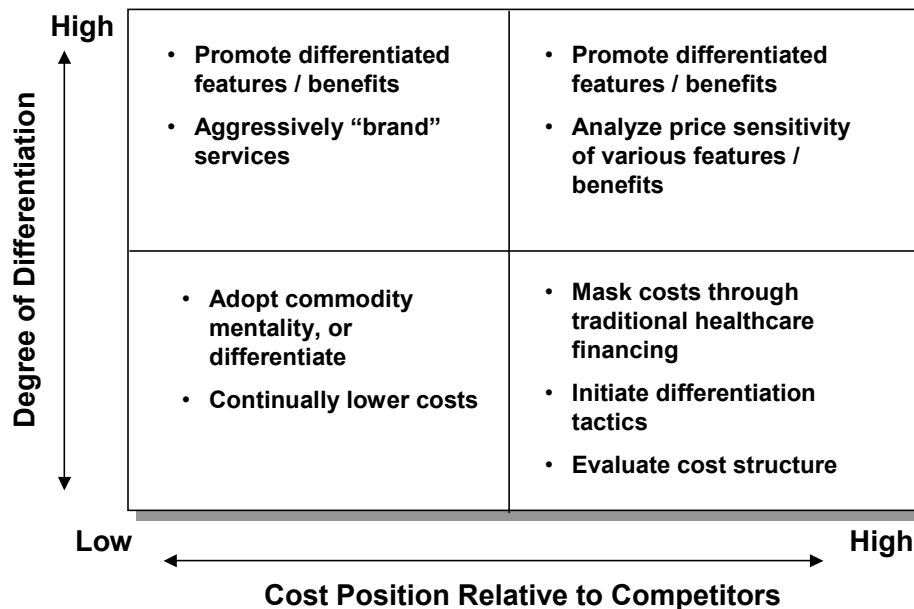
In the past, employers whose employees selected “higher-end” providers were often funding the costs of employers whose employees selected less expensive providers. Given the growing trend by health plans to expose individual provider costs, provider systems should prepare for the potential implications of cost transparency, including:

- Reduced ability to maintain high margins
- Creation of a commodity mentality (i.e., commodity pricing)
- Weakening of customer loyalty to brands

In response to the rise of cost transparency, we suggest that providers consider the following key questions:

- To what extent are cost transparency tactics being implemented in your market (i.e., employer receptivity, health plan initiatives)?
- How are consumers likely to respond, and what is the price elasticity of various healthcare product features and benefits?
- How is my organization positioned vis-à-vis competitors in cost position, differentiation, and ability to provide customized products (see evaluation framework below)?

Evaluation Framework



Source: BDC Advisors, LLC

For further information, please contact us at (415) 247-1030, or www.BDCAdvisors.com.