

PSILOS GROUP'S NEW HEALTHCARE OUTLOOK REPORT PREDICTS HEALTH REFORM WILL RADICALLY TRANSFORM THE RELATIONSHIP BETWEEN CONSUMERS AND INSURERS

Leading Healthcare Investment Firm's Report Foresees Major Changes in Health Insurance Business Models as Individual Insurance Market Expands Dramatically

Universal Coverage Will Catalyze Consumer Engagement, Alter Insurance Purchasing Dynamics

NEW YORK and SILICON VALLEY, CA (May 3, 2011) – Health reform will have more impact on businesses and consumers than originally predicted, accelerating a sweeping change toward consumer-oriented business models and different distribution channels for insurers, according to a new report, **Psilos Healthcare Outlook**, published today by healthcare investor Psilos Group.

The catalyst for these changes will be guaranteed-issue healthcare coverage for most Americans, effective in 2014 as part of The Patient Protection and Affordable Care Act (PPACA). PPACA states that people will be covered regardless of pre-existing conditions, and without the financial penalties traditionally associated with health status. Many employers will migrate from defined benefit healthcare plans toward a defined contribution plan in which they will contribute a fixed dollar amount toward employees' healthcare coverage but not purchase it on their behalf, as has traditionally been the case. In addition, the majority of the uninsured will enter the insurance system for the first time.

New Private Healthcare Exchanges Will Be Created

As a result, more and more Americans will begin shopping for their own health insurance. This will force health insurance carriers to become much savvier consumer marketers and become efficient at finding new distribution channels to remain

competitive, while forcing consumers to become far more educated about how to choose among health plan options.

A new landscape of Internet and call center-based public and private healthcare exchanges (HIXs) is being established, the **Psilos Healthcare Outlook** said, which function as shopping hubs to connect individual consumers with a choice of insurance products, supported by a broad network of insurance brokers who serve as agents to the consumer. The Congressional Budget office estimates that 24 million people will be buying insurance through HIXs by 2019.

The HIX purchasing model is already taking hold in the retiree healthcare market, where many private companies are successfully migrating retirees over the age of 65 from group model Medicare supplemental plans to individual Medicare supplemental and Medicare Advantage policies subsidized by an employer-funded defined contribution. More than 200,000 retirees today buy policies on the private health insurance exchange developed by San Mateo-based Extend Health, Inc., the largest of its kind so far.

Dramatic Expansion In The Market For Individual Insurance

The result of these changes will be a doubling or tripling of the market for individual insurance as individual coverage grows from about 10 percent of the market today to between 20 to 40 percent of the commercial market post-reform, according to industry experts such as McKinsey & Company. Health insurers will have to shift their approach from a business-to-business sale to a business-to-consumer model in order to garner a share of this new market, and they will need to differentiate their offerings to consumers based on cost, quality, customization and service.

“Insurers will have to learn how to deal directly with consumers in a market economy and to become leaner, more efficient organization,” said Stephen Krupa, a Psilos managing member and co-author of the **Psilos Healthcare Outlook**. “Along the way, new companies will enter the healthcare business by forming new partnerships and collaborations. It would not be surprising to see consumer-facing organizations such as Wal-Mart, Amazon and Google launch branded HIXs,” he added.

The emergence of this new healthcare landscape is not a surprise, the report says, because employers have been eager to get out of the healthcare business for a long time.

It adversely impacts their bottom line, is increasingly expensive and generally beyond their control to change. Moreover, employees are generally dissatisfied with the available offerings and stunned by out-of-pocket costs that continually skyrocket.

Stage Must Be Set To Fix The Broken U.S. Healthcare System

The **Psilos Healthcare Outlook** says that a larger individual health insurance market can help address one of the biggest problems with the U.S. healthcare system, which runs poorly, in part, because it is outside the constraints of a real market economy. “The realities of defined contribution will drive consumers to shop for the best value,” said Lisa Suennen, Psilos managing member and the other co-author of the report. “Corporations will tie the increases in their defined healthcare contributions to overall wage increases, not to traditional increases in insurance rates. Wage increases have recently been in the range of 2 to 3 percent annually while health premiums have been rising at an annual rate of 8 to 10 percent. Consumers are going to be forced to become educated and highly efficient buyers, just as they are with other kinds of insurance,” she added.

Insurers Will Have to Better Manage Risk, Mostly Through Better Technology

Insurers, meanwhile, will have to focus on better managing their risk in this more competitive and highly regulated market. PPACA’s requirement that 80 to 85 percent of insurance premiums be spent on medical care in each and every insurance product line will force insurers to invest more heavily in wellness and prevention techniques targeting high-cost, chronically ill patients in order to preserve health plan profitability. Since many believe that the majority of chronic illnesses, such as hypertension and diabetes, can be avoided through better lifestyle choices, helping consumers live healthier lives and manage chronic illnesses effectively will be of paramount concern to insurers. This is particularly true since chronic illnesses now account for between 70 percent and 80 percent of all healthcare costs.

Technology plays a key role in solving the new healthcare challenge, the **Psilos Healthcare Outlook** says. Some healthcare insurers have already taken steps to adopt broad enterprise systems to improve administrative efficiency, as well as comprehensive

care management programs that provide for more targeted and less costly care of the chronically ill.

Particularly important for health insurers, the **Psilos Healthcare Outlook** says, will be the implementation of more and better technology across the spectrum of health care. Competing intensely for the fickle consumer dollar will require efficiency that can come only from the deployment of state-of-the-art software and technology that does things that current legacy systems installed at insurers cannot do. “Among the most important jobs at any health plan will be the chief information officer and the chief medical information officer because the companies that thrive in this new environment will no doubt be those that make great technology decisions,” Krupa said. “This will be new territory for health insurers, Krupa added, because they have not traditionally been known for their leadership in IT innovation.”

A supplemental but key component of this will be more advanced technology to improve the sharing of meaningful information to allow for active care coordination in emerging Accountable Care Organizations (ACOs), which are affiliations between health insurers, hospitals and physicians to deliver better and more efficient care, particularly to chronically ill patients. Since ACOs will face financial and clinical risk challenges similar to health insurers, they will have to behave similarly to achieve their promise, the **Psilos Healthcare Outlook** report says. “It will be essential for ACOs to adopt sophisticated tools to track, manage, report and refine the care delivered within their systems and to be highly effective at serving and educating the consumers for whom they are responsible, both clinically and financially,” Suennen added.

The Psilos report can be found at <http://www.psilos.com/outlook.html>

About Psilos Group

Psilos Group Managers, LLC (“Psilos”) is a healthcare investment firm focused on providing venture and growth capital to companies operating in the healthcare economy. The firm believes that successful healthcare innovation must reduce cost, improve quality, and align incentives across payers, providers and patients. Founded in 1998, Psilos has \$580 million under management and invests across three core healthcare sectors: healthcare services, healthcare information technology and medical technology. Funds managed by Psilos have invested in companies such as ActiveHealth, AngioScore, Definity Health, HealthEdge,

Extend Health and VeraLight, among many others, which have played, and continue to play, key roles in the transformation of the U.S. healthcare economy. Psilos has offices in New York, the San Francisco Bay Area, and in Santa Fe, New Mexico. For more information, go to www.psilos.com.

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