Workers’ Compensation Overview

November 2013
The Medical segment of the workers’ compensation (“WC”) industry represents an attractive ~$37.0 billion market opportunity.

- A $64 billion total market, WC is influenced by favorable macro-economic, political, and segment specific themes.
- WC claims expenses are divided into two segments: Indemnity and Medical.
  - Indemnity ($27 billion): Employee reimbursement for lost wages while recovering from a work-related injury
  - Medical ($37 billion): Expenses covering all aspects of recovery from a work-related injury, including prescription benefits; 100% of costs covered

$64 billion Total Workers’ Compensation Market

For the year ended 2012

- Indemnity 42%
- Medical 58%

Source: NASI.

$37 billion Workers’ Compensation Medical Market

For the year ended 2012 ($ in billions)

- Pharmacy (Rx) $7.5
- Surgery/Anesthesia $5.6
- Diagnostic Testing $3.0
- Emergency Services $0.7
- Other $6.5
- Hospital Services $6.3
- Ancillary $7.5

Source: NASI and industry research.
1) Includes DME, home health, physical therapy, transportation, and miscellaneous other.
WC medical costs have risen materially due to secular factors.

- Medical costs are outpacing indemnity costs due to strong underlying healthcare and WC specific growth tailwinds.
  - U.S. healthcare / prescription drug inflation
  - Aging U.S. population
  - Lack of financial incentives for claimants to avoid expensive medications or procedures
  - Increasing prevalence of obesity
  - Chronic injuries that result in long duration claims
  - Opioid / narcotic use
- WC medical costs continue to rise on a total and per-claim basis despite the fact that total WC claims have steadily declined over the last decade due to the shifting composition of the labor force and greater safety awareness.

### Workers’ Compensation Medical Costs Have Outpaced Indemnity Costs

<table>
<thead>
<tr>
<th>Year</th>
<th>Medical Spend</th>
<th>Indemnity %</th>
<th>Medical %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>$17</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>2001</td>
<td>$23</td>
<td>54%</td>
<td>46%</td>
</tr>
<tr>
<td>2011</td>
<td>$34</td>
<td>44%</td>
<td>56%</td>
</tr>
<tr>
<td>2021P</td>
<td>$48</td>
<td>36%</td>
<td>64%</td>
</tr>
</tbody>
</table>

Note: Graphic size representative of total market size.
Source: NASI. 2021P assumes continuation of historical growth rate.
Out-of-network WC medical claims have been a focus for payors because of their disproportionate cost burden.

- While only a relatively small proportion of WC medical claims are out-of-network, they drive nearly half of costs.
  - 15% of claims
  - 40% of costs

- Network providers augment payors’ existing physician and provider networks to expand in-network coverage.
  - Highly scalable and flexible as one network provider can fill “holes” in networks of multiple payors

Source: Industry research.
WC’s unique characteristics and higher complexity necessitate specialized programs, processes, and techniques to manage costs and influence injured worker outcomes.

| Market Size | Healthcare | $1.9 trillion  
Pharmacy: ~$220 billion |
|            | WC Medical | $37 billion  
Pharmacy: ~$7.5 billion |

| Benefit Structure | Healthcare | Defined benefit plan  
Eligibility determined prospectively  
Varying levels of coverage  
Offer closed network |
|                   | WC Medical | Undefined benefit plan  
Eligibility determined retrospectively  
100% medical cost coverage  
Open network with freedom of choice |

| Pain Medication Mix | Healthcare | 3% of total drug spend |
|                     | WC Medical | 75% of total drug spend |

| Clinical Focus | Healthcare | Primarily medical issues  
Chronic disease  
End of life care  
Health and wellness |
|               | WC Medical | Primarily physical injuries  
Pain management  
Appropriate use of narcotics  
Claimant return to work |

| Key Customer Issues | Healthcare | Healthcare reform  
Mandated benefits  
Administrative efficiency  
Utilization management |
|                    | WC Medical | Narcotic use and diversion  
Limited ability to direct care  
Increasing severity of injuries  
Network / utilization management |

| Regulatory Dynamics | Healthcare | Heavily influenced by federal government  
Subject to uncertainty of healthcare reform |
|                     | WC Medical | State-based legislation  
Insulated from federal changes / budgetary issues  
Limited reimbursement / government budgetary risk; stable WC regulatory environment |
WC Rx is a ~$7.5 billion market yet only $2.9 billion is captured in-network by WC PBMs.

- Unmanaged Rx spend ($4.6 billion market) represents Rx costs that are not processed / managed by a WC PBM.
  - Significant growth opportunity for PBMs

**WC Rx Market Segmentation**

- **$7.5 billion**
  - Managed (In-network WC PBM) ($2.9, 39%)
  - Unmanaged ($4.6, 61%)

- **$4.6 billion**
  - Non-WC Payor (Spend is not appropriately processed through WC insurance) ($0.6, 13%)
  - No PBM (Payor does not contract with WC PBM) ($1.0, 22%)
  - PBM Out-of-Network (Payor contracts with WC PBM but spend is out-of-network) ($3.0, 65%)

Source: Industry research.
WC Managed (PBM) Rx spend is expected to grow by 12% CAGR through 2017P.

**Total WC Rx Spend: 6% CAGR**
- Drug price inflation
- Employment / economy recovery
- Increasing use of pharmaceuticals as part of medical treatment
- Increasing injury severity

**WC Managed Rx Spend: 12% CAGR**
- Ongoing industry recognition of the benefits of managed care techniques
- Improved network penetration efforts
- Greater adoption of PBMs by government entities and small payors
- Subrogation efforts – WC payors forced to pay for costs of occupational injuries (currently paid by group health providers by mistake)

Source: Industry research.
Ancillary services represents a diverse and growing section of the workers’ compensation medical market.

- Ancillary services accounts for $7.5 billion, or approximately 20% of the total WC medical market.
- Numerous key drivers will continue to increase the size of the ancillary services market.
  - Increase in the severity of claims
  - Rising employment levels
  - Increase in the utilization of healthcare services as it relates to WC claims
- Numerous players are leveraging their existing customer base for cross-selling opportunities in ancillary services.

### $37 billion Workers’ Compensation Medical Market

For the year ended 2012

($ in billions)

Source: NASI, industry research, and management estimates.

### Ancillary Services

For the year ended 2012

($ in billions)

Source: NASI and industry research.
Physical therapy (“PT”) for WC cases has been a key focal area for both providers and payor participants.

- In 2012, PT spend in the WC medical market totaled $3.7 billion, or approximately 10% of total WC medical spend.
- PT is a low cost alternative to more acute settings and is preferred by injured workers, driving growth in PT providers.
- However, because PT is a relatively high proportion of WC medical spending and WC reimburses for PT services at a relatively high rate, it is an area of cost containment focus.
  - Historically, medical payments to physical therapists have outpaced all other healthcare service providers
  - PT can account for up to 50% of costs in the first 90 to 120 days of a claim
  - Concern around overutilization

**WC Medical Payments Growth**

For the years ended 2002 - 2009

<table>
<thead>
<tr>
<th>Area</th>
<th>Average Annual Growth in Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical Therapists</td>
<td>6.3%</td>
</tr>
<tr>
<td>Physical Medicine</td>
<td>4.9%</td>
</tr>
<tr>
<td>Total Medicine</td>
<td>4.5%</td>
</tr>
</tbody>
</table>

Source: Industry research.
While smaller than PT, home health and DME WC spending remain a focus of cost containment efforts.

- Medical services associated with home health and DME account for approximately 7% of WC medical costs.
  - However, home health and DME expenses can account for up to 25% of costs in high-cost WC claims
- Number of services and products in DME make managing optimal reimbursement rates difficult.
  - Approximately 40,000 DME products and services utilized by injured workers
- Relatively high rates of reimbursement for WC home health services and lax certification procedures make home health care an area of vulnerability for abuse by both providers and patients.
  - Focus of utilization control and bill review services

**WC Home Health and DME Spending Overview**

For the year ended 2012
($ in billions)

- Home Health $2.7
- DME $1.2
- Other Ancillary Services $4.8

Source: NASI and industry research.
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