WHAT'S DRIVING Health Insurance INFLATION?

By David Leo, President of WMI® Mutual Insurance Company & WMI TPA®

The other day, I was cleaning out a filing cabinet and I came across some 1996 health insurance rate sheets I had collected from a Utah competitor. As I waxed nostalgic at the "good ol' days" of health insurance, I compared those premium rates and corresponding plan deductibles to today's rates and deductibles, and as you might imagine, I could hardly believe how much premiums had risen in the relatively short period of 20 years, despite significant increases in deductibles, coinsurance and copayments.

To give you an idea of what the health insurance market was like back then, consider this … in 1996, a $100 deductible policy, with a strong provider network and maternity coverage cost a 40-year-old just $98 per month. For those invincible 40-year-olds who had a high-risk tolerance and were willing to assume the maximum $1,000 deductible, premiums would set them back a meager $60 a month. (In fairness, according to Saving.org, the present value of $60 in 1996 is $92.45.)

For comparative purposes, I can tell you that in today's insurance market, it's virtually impossible to find a plan with a $100 deductible. In fact, according to the **Kaiser Family Foundation** (KFF), the average deductible in 2016 is more than $1,300! Also, consider this: on the various **Affordable Care Act** (ACA) marketplaces, the most common plans are the mid-range "silver" plans with deductibles of approximately $2,000. More shocking is the fact that the price of a comparable $1,000 deductible "gold" plan on the ACA marketplace is $415 per month for a 40-year-old … more than four times the rate for a similar plan just two decades ago!

Even employers and consumers who have tried to stay ahead of medical inflation by increasing deductibles and assuming more financial risk have struggled to find affordable options. KFF research indicates that even with increased deductibles, the average annual health insurance premium for single coverage nearly tripled from 1999 to 2015, going from $2,196 per year to a whopping $6,251!

I'm no mathematician, but the way I figure it, during the 20 years from 1996 to 2016, annual medical inflation of about 7.5% has caused health insurance premiums to increase 425%. In response to those skyrocketing premium costs, prudent consumers have responded by increasing their annual deductibles by about 12% each year (from about $150 in 1996 to more than $1,300 in 2016), just so they can afford health insurance.

Of course, this begs the question of why health insurance costs have outpaced general inflation by two to three times every year; and at what point this unsustainable system will collapse. Although most people immediately point the finger at evil profit mongering insurance companies, the facts (and the law) just don't support the blame. I assure you I'm not naïve or out of touch with the realities of medical inflation or rising health insurance premiums, nor am I an apologist for the insurance industry or insensitive to the burdens high premiums put on employers and individual families. I've been in the insurance business for a long time, and I'm very aware of the insurance market and the challenges employers deal with every year. I'm also an employer who strives to offer affordable health insurance to my employees, and a consumer who cringes every time I pay my share of my health insurance premium or I receive an Explanation of Benefits (EOB) that shows my portion of the claim. The short answer is that health ***insurance*** is expensive because health ***care*** is expensive.

In order to drill down to the root of this problem, many government and private studies have examined where health insurance premium dollars are spent. In general, most of these studies agree that about 85% of every premium dollar is spent on the actual provision of medical and pharmaceutical care. In fact, the ACA specifically requires that health insurance companies spend $0.85 of every premium dollar on actual health care. (For individuals and small employer plans, this threshold is $0.80.) If an insurance company doesn't meet (or exceed) that threshold, it must rebate the difference to the employer/policyholder.

Here's a general breakdown of health insurance premium spend. Keep in mind, the ACA **medical loss ratio** (MLR) threshold is one-sided, so insurance company profits are capped, but losses are unlimited. For example, if a health insurance company has a profitable year and only spends 75% of collected premium, it must rebate anything in excess of its 15% administrative allowance to policyholders *(i.e., 10% of premium)*. It's important to note that the 15% administrative allowance is <u>not</u> profit, rather it's the entire amount the insurance company gets to use to pay all expenses (including, but not limited to, employee salaries and benefits, independent agent commissions, general overhead costs, building rent, third-party vendor costs, and contributions to policyholder surplus), with the leftover amount (if there is any) being profit.

On the other hand, if the insurance company has a "bad" year and claims exceed the 85% breakeven threshold, it must absorb the losses of that year and pay claims from policyholder reserves. As you can see from the examples below, in an average year, a well-run insurance company can expect to earn 2% profit. In an unprofitable year, the insurer's loss is unlimited (22% in this example), and in a "good" year, the company is limited to 2% of net profit after rebates are paid to policyholders. This is the proverbial "heads we win, tails you lose" proposition.

Health Insurance Breakdown *(in an average year)*		**Health Insurance Breakdown** *(in an unprofitable year)*		**Health Insurance Breakdown** *(in a profitable year)*	
Premium	= $1.00	Premium	= $1.00	Premium	= $1.00
LESS EXPENSES:		**LESS EXPENSES:**		**LESS EXPENSES:**	
Hospital Costs	= $0.40	Hospital Costs	= $0.48	Hospital Costs	= $0.38
Physician Costs	= $0.28	Physician Costs	= $0.38	Physician Costs	= $0.24
Drug Costs	= $0.12	Drug Costs	= $0.15	Drug Costs	= $0.09
Other Medical Costs	= $0.05	Other Medical Costs	= $0.08	Other Medical Costs	= $0.04
Subtotal (gross profit)	$0.15	Subtotal (gross loss)	- $0.09	Subtotal (gross profit)	$0.25
LESS:		**LESS:**		**LESS:**	
Administration Costs	= $0.13	Administration Costs	= $0.13	Administration Costs	= $0.13
				LESS:	
				ACA Rebates Paid to Employers (85%-75%)	= $0.10
2% Contribution to Surplus and Shareholder Value (net profit)	**$0.02**	**22% Reduction of Surplus and Shareholder Value (net loss)**	**- $0.22**	**2% Contribution to Surplus and Shareholder Value (net profit)**	**$0.02**

So what is driving out-of-control health insurance premium inflation? Since the bulk of the health insurance premium dollar (85%) must by law be used to pay medical and prescription drug costs, and a mere 13% goes to pay insurance company administration and overhead costs, and a paltry 2% (in a good year) goes to insurance company profits, it's axiomatic that the cause of skyrocketing premium costs is medical costs. From the $59,236 air ambulance flight from Boise to Salt Lake City; to the $84,000 12-week once-a-day prescription drug cost to treat hepatitis C; to the $54,952 hardware charge for an artificial hip and related screws (which only cost the hospital $5,780); and the $185,572 charge from a surgeon for an 88-minute surgery to remove some fatty tumors; the health care providers are the prime beneficiaries of the American health care system. Unfortunately, there's no end in sight to these obscene charges. *(Incidentally, all of these examples are actual claims received by WMI!)*

It is undeniable that runaway healthcare costs in the U.S. are the primary reason annual medical inflation is three times general inflation. I would also argue that out-of-control medical costs are the main reason the ACA is unsustainable and will never work. Obamacare was concerned with one thing: ***access*** to healthcare. It did nothing to reduce health care costs, and it might have even caused them to rise.

In fairness to the President, his signature law accomplished the access goal fairly well. The uninsured rate is at its lowest level in decades, and many who have never had meaningful access to health care are finally able to access the system. Unfortunately (and fatally); in the name of access, the President threw the health insurance industry under the bus and neglected to address the delivery-side of the equation. The ACA was so focused on reigning in anecdotal and imaginary health insurer profits, it totally ignored the problem of unfettered medical and prescription drug costs *(i.e., the true driving force of health insurance unaffordability)*.

As health insurer losses continue to mount, and health insurance carriers abandon ACA marketplaces, and politicians get skittish about their ACA support, the Obamacare house of cards will fall and the chickens will come home to roost. I submit to you that until the policymakers in Washington, the media, and the American public realize that bending the healthcare cost curve downward must necessarily (albeit uncomfortably) address the ultimate and true cost drivers *(i.e., the cost of medical care and prescription drugs),* we'll never see meaningful healthcare reform in our country. Instead, we'll see health insurance premiums continue to rise 5-10% every year, provider access shrink, and health insurance deductibles increase 10% per year.

If you have questions about this article or would like to discuss your company's health insurance progam, feel free to contact me at ***(801) 263-8000*** or ***davidleo@wmimutual.com.***