How Private Health Insurance Really Works

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Private Health Insurance Markets: Facts, Fables, and Fixes

American Enterprise Institute
Washington, D.C.
October 21, 2009

Overview

- Where the money goes
  - *Medical costs, administrative expenses, and profit*
  - *CEO compensation*
- Point of sale and point of service
  - *Underwriting*
  - *Nature and scope of policy rescissions*
  - *Service quality and complaints*
- Insurance pricing and healthy behavior
  - *How insurance can promote health and help control costs*
  - *Effects of Democrats' proposed restrictions*

Where the money goes: the AFL-CIO view

Health Insurance Profits Soar as Industry Mergers Create Near-Monopoly

by Mike Hall, May 27, 2009

Profits at 10 of the country's largest publicly traded health insurance companies rose 428 percent from 2000 to 2007, while consumers paid more for less coverage. One of the major reasons, according to a new study, is the growing lack of competition in the private health insurance industry that has led to near monopoly conditions in many markets.

The report says such conditions warrant a Justice Department investigation and, says Sen. Charles Schumer (D-N.Y.), provide compelling evidence of the need for a public health insurance plan option as part of the health care reform initiative President Obama and Congress are developing.

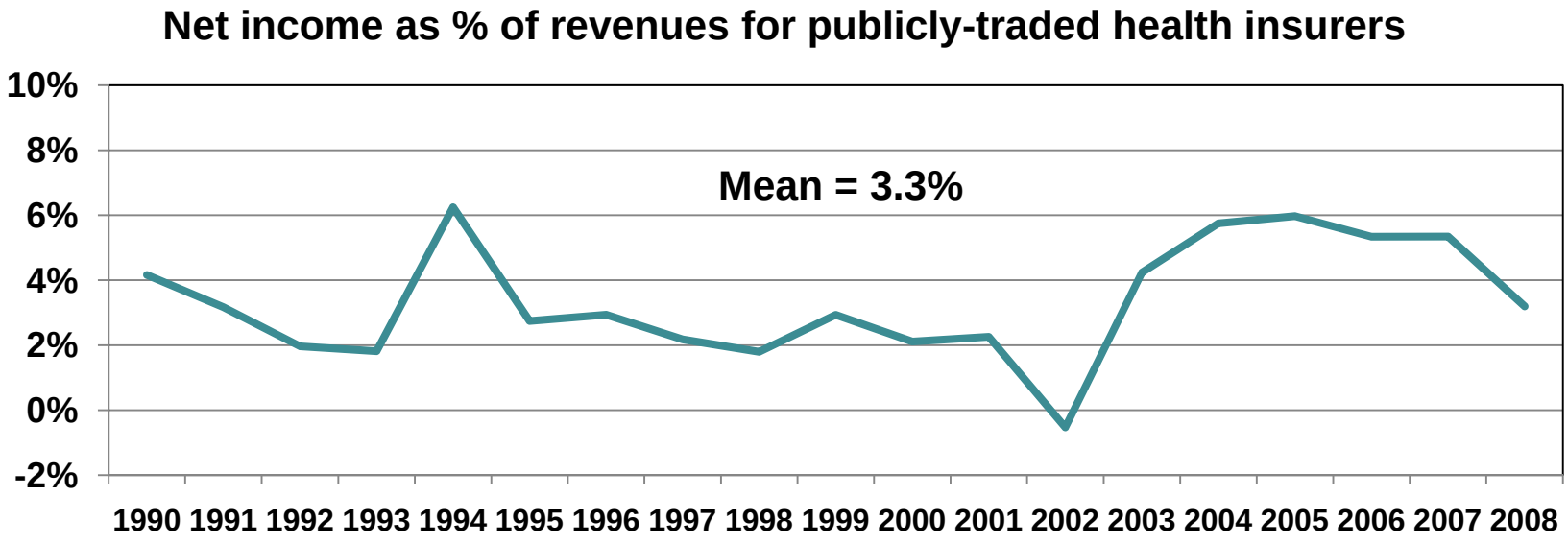
http://blog.aflcio.org/2009/05/27/health-insurance-profits-soar-as-industry-mergers-create-near-monopoly/

Publicly-traded health insurers' profit margins

Fortune industry rankings: net income as % of revenues

	2005	2006	2007	2008
Net income margin	7.1%	5.8%	6.2%	2.2%
Industry rank	21	33	28	35

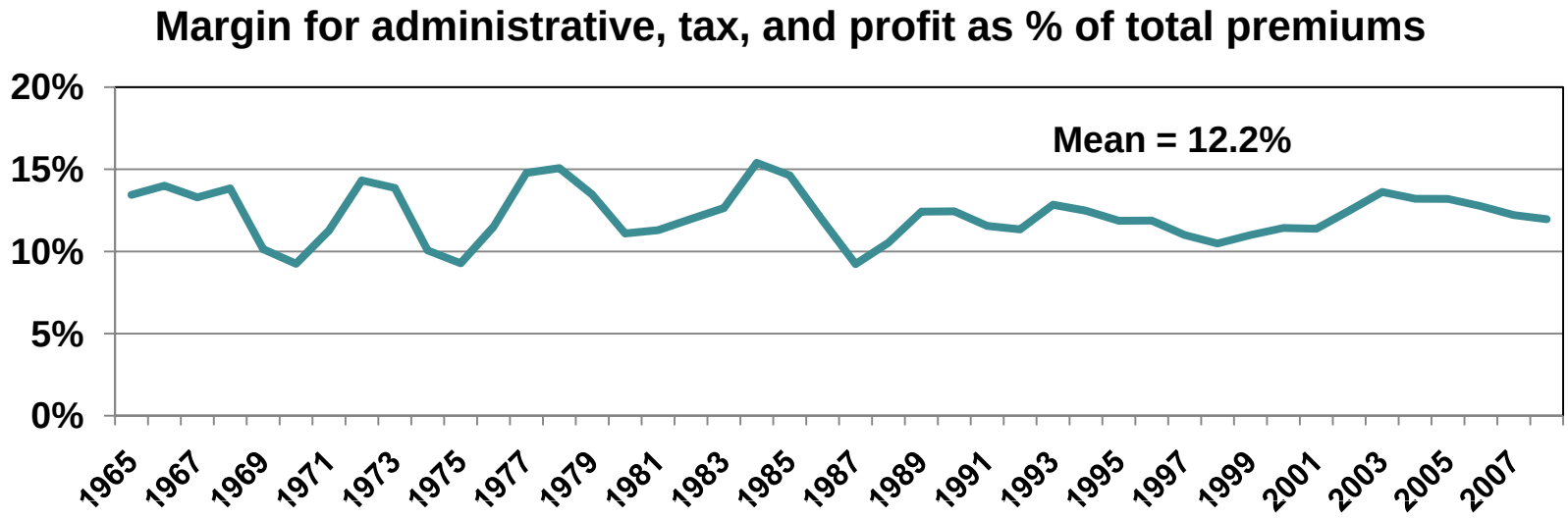
Fortune shows rankings for approximately the top 50 industries out of about 75 total industries.



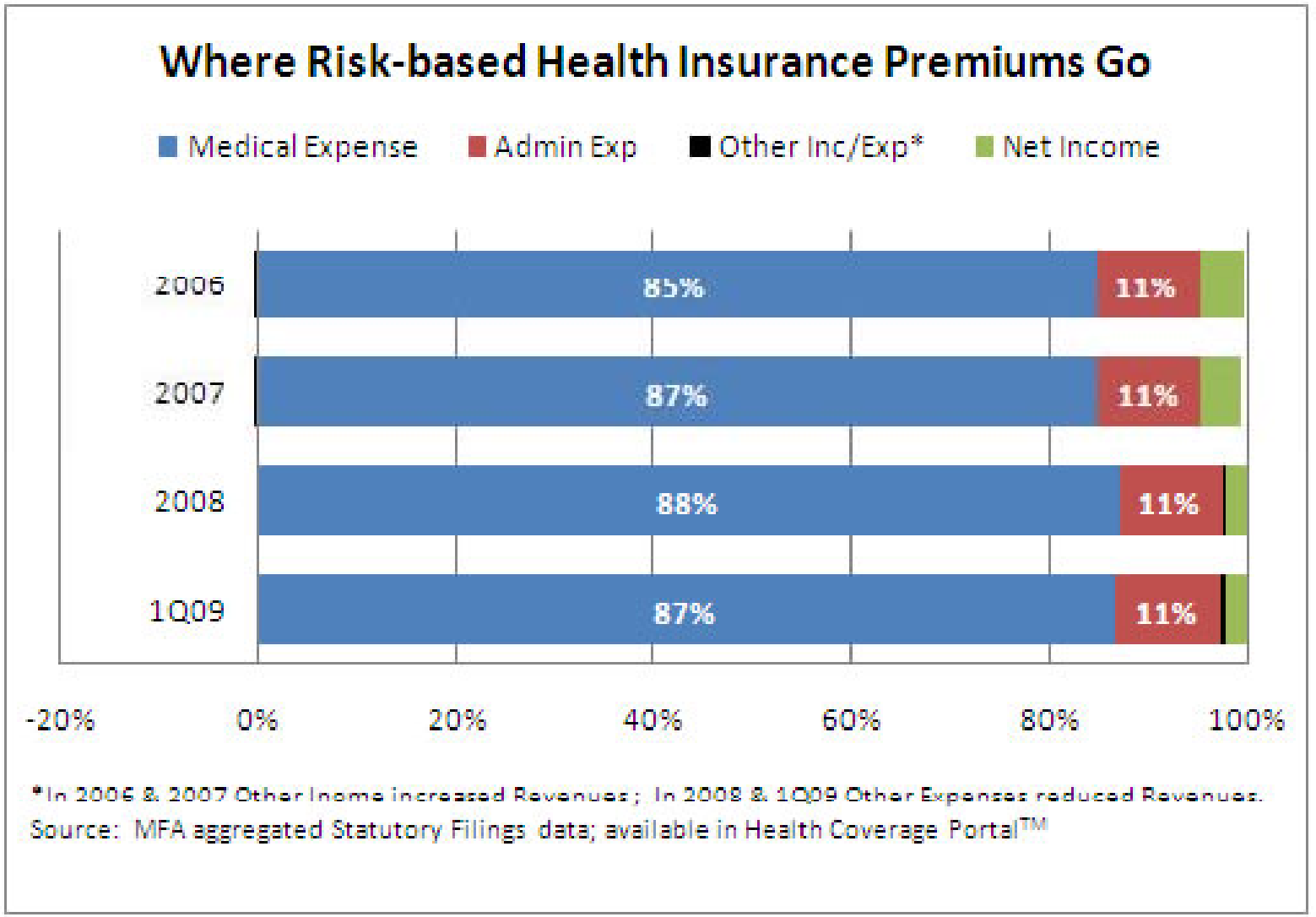
Compustat, SIC 6324, hospital and medical service plans

	Public Co. (GAAP)		Non-profit Blues (SAP)	
	2008	2007	2008	2007
Premiums ($bill.)	$251.8	$230.8	$99.5	$93.0
Medical loss ratio	82.9%	81.6%	86.5%	87.3%
Admin. expense ratio	18.0%	16.8%	11.9%	12.2%
Net income / revenues	3.1%	5.3%	1.4%	1.0%

A.M. Best Co., *U.S. Health: 2008 GAAP Review*, May 4, 2009; *U.S. Health – Blue Cross Blue Shield 2008 Market Review*, August 10, 2009



http://www.cms.hhs.gov/NationalHealthExpendData/03_NationalHealthAccountsProjected.asp



Debra Donahue, Medical Expense Trend Stabilized, Health Care Business Strategy, Mark Farrah Associates, June 25, 2009 http://www.markfarrah.com/healthcarebs.asp?article=63

Other analyses of administrative expense ratios

- Sherlock Co., BCBS and other plans, 36 million lives, 2007

  Commercial insured: 11%

  Commercial ASO: 7% (of premium equivalents)

  Small group (2-50): 11.1%

  Individual: 16.4%

- Oliver Wyman study for Massachusetts Division of Insurance, 2002-2007

  Massachusetts: 10.9%

  Other Northeast: 11.1%

  Nationwide: 11.6%

CEO compensation: Graef Crystal analysis, Aug. 12, 2009

Companies with market cap above $5 bill. (trend controls for size and options/total pay)

2008 PAY:		TOTAL PAY	PCT ABOVE (BELOW)	
COMPANY	CEO	(millions)	TRENDLINE	PCT REV.
AETNA	WILLIAMS, RONALD	$21.7	21%	0.07%
CIGNA	HANWAY, EDWARD	$12.2	-15%	0.06%
HUMANA	MCCALLISTER, MICHAEL	$5.3	-71%	0.02%
WELLPOINT	BRALY, ANGELA	$6.1	-73%	0.01%
UNITEDHEALTH GROUP	HEMSLEY, STEPHEN	$3.3	-81%	0.004%
	MEDIAN	$6.1	-71%	0.02%

2007 PAY:		TOTAL PAY	PCT ABOVE (BELOW)	
COMPANY	CEO	(millions)	TRENDLINE	PCT REV.
CIGNA	HANWAY, EDWARD	$15.3	20%	0.09%
AETNA	WILLIAMS, RONALD	$19.9	14%	0.07%
HUMANA	MCCALLISTER, MICHAEL	$10.8	-26%	0.04%
WELLPOINT	BRALY, ANGELA	$14.2	-48%	0.02%
UNITEDHEALTH GROUP	HEMSLEY, STEPHEN	$4.6	-68%	0.006%
	MEDIAN	$14.2	-26%	0.04%

http://graefcrystal.com/images/CRYS_REP_HLTH_INS_8_12_09.pdf

Antitrust exemption red herring

During his weekly radio address (Oct. 17), the President attacked health insurers for allegedly making excessive profits and paying excessive bonuses, for spreading "bogus" and "smoke and mirrors" misinformation about the impact of Democrats' reform agenda on the cost of health insurance, and for "figuring out how to avoid covering people."

> "They're earning these profits and bonuses while enjoying a privileged exemption from our antitrust laws, a matter that Congress is rightfully reviewing."

Senator Harry Reid testified as a witness before the Senate Judiciary Committee (Oct. 14):

> "Exempting health insurance companies has had a negative effect on the American people."
>
> "There is no reason why insurance companies should be allowed to form monopolies and dictate health choices."

Individual market offers: AHIP survey, 2006

(excludes guaranteed issue states; 1,547,247 million offers)

OFFER RATES (PERCENT OF APPLICANTS)			
Age of Individual Applicant	Medically Underwritten	Denials	Offered
Under 18	100.0%	4.0%	96.0%
18 - 24	100.0%	9.3%	90.7%
25 - 29	100.0%	10.6%	89.4%
30 - 34	100.0%	9.7%	90.3%
35 - 39	100.0%	10.0%	90.0%
40 - 44	100.0%	11.3%	88.7%
45 - 49	100.0%	13.4%	86.6%
50 - 54	100.0%	17.4%	82.6%
55 - 59	100.0%	22.3%	77.7%
60 - 64	100.0%	28.7%	71.3%
All Age Groups (non-elderly)		11.3%	88.7%

Standard premium	Higher premium	Preferred premium	Condition waiver	Waiver & higher prem.
40.2%	11.3%	48.6%	7.5%	4.2%

http://www.ahipresearch.org/pdfs/Individual_Market_Survey_December_2007.pdf

The President's view on rescissions

"More and more Americans pay their premiums, only to discover that their insurance company has dropped their coverage when they get sick, or won't pay the full cost of care. It happens every day."

"One man from Illinois lost his coverage in the middle of chemotherapy because his insurer found that he hadn't reported gallstones that he didn't even know about. They delayed his treatment, and he died because of it."

"Another woman from Texas was about to get a double mastectomy when her insurance company canceled her policy because she forgot to declare a case of acne. By the time she had her insurance reinstated, her breast cancer had more than doubled in size. That is heart-breaking, it is wrong, and no one should be treated that way in the United States of America. (Applause.)"

REMARKS BY THE PRESIDENT TO A JOINT SESSION OF CONGRESS ON HEALTH CARE, September 9, 2009

Fact-checking

The [Illinois man's] deceased's sister testified . . . her brother received a prescribed stem-cell transplant within the desired three- to four-week "window of opportunity" from "one of the most renowned doctors in the whole world on the specific routine," that the procedure "was extremely successful," and that "it extended his life nearly three and a half years."

The [Texas] woman's testimony at the June 16 hearing . . . suggests that the dermatologist's chart may have described her skin condition as precancerous, that the insurer also took issue with an apparent failure to disclose an earlier problem with an irregular heartbeat, and that she knowingly underreported her weight on the application.

These two cases are presumably among the most egregious identified by Congressional staffers' analysis of 116,000 pages of documents from three large health insurers, which identified a total of about 20,000 rescissions from millions of policies issued by the insurers over a five-year period. Company representatives testified that less than one half of one percent of policies were rescinded (less than 0.1% for one of the companies).

S. Harrington, Fact-checking the President on health insurance, *WSJ,* Sept. 14, 2009

July 27, 2009

CASE STUDIES: Examples of Health Insurance Companies Rescinding Individual Policies

Committee on Energy and Commerce

As part of a year-long investigation into business practices in the individual health insurance market, the Committee examined more than 116,000 pages of documents from three of the country's largest health insurance carriers, Assurant Health, WellPoint Inc., and UnitedHealth Group. The investigation revealed that these companies retroactively terminated, or "rescinded," nearly 20,000 policies over the past five years based on omissions in applications that the companies identified only after the policyholders became ill. These rescissions resulted in savings to the companies of more than $300 million.

- 13 cases (at least 5 reinstated)

  Diagnosis after application (reinstated after appeal)

  Misdiagnoses / diagnosis not disclosed to patient (2)

  Agent misrepresentation (2)

  Misrepresentation or concealment unrelated to claim (5)

  Rescission of family coverage based on applicant misrepresentation (2)

  Applicant previously treated for Barrett's Esophagus who did not disclose "stomach or ulcer symptoms"

Evidence from Texas

Table 1. *Rescission Rates in the Texas Individual Health Insurance Market*[8]

	Total Number of Policies in Force	Total Number of Rescissions	Percent of Total Policies Rescinded
2003	451,148	880	0.2%
2004	467,238	927	0.2%
2005	479,162	1,326	0.3%
2006	528,192	1,700	0.3%
2007	506,791	1,544	0.3%

Source: Author calculations based on Texas Department of Insurance, Office of the Commissioner data provided to Congressman Henry A. Waxman on October 31, 2008

Haycock, Ledford, and Harbage, *Primer on Post Claims Underwriting and Rescission Practices, Findings from Texas in the Individual Insurance Market*, Robert Wood Johnson Foundation, 2009.

- Frequency will be higher for:
  - *New business*
  - *New policyholders that present large claims*
- Fraudulent vs. other

Rescission in context

- Hundreds of years of common law, statute
  - *Contracts of "utmost good faith"*
  - *Contract invalid if material misrepresentation or concealment*
  - *State variations, including some that require relation to cause of the loss or claim*
- Helps encourage accurate disclosure / deter fraud
- Lowers premiums and speeds coverage
  - *Lower upfront underwriting costs*
  - *Less adverse selection*
- Discipline: (1) reputation, (2) regulation, (3) litigation
- States can take action to tighten criteria or otherwise change the rules

California Dept. of Managed Health Care: 2008 Complaint Results

- 6 plans with enrollment > 400,000
- 15.6 million members
- 3,864 complaints
- 2.47 complaints per 10,000 members

Issue	Count
Access	115
Benefits/coverage	1405
Claims/financial	1475
Enrollment	322
Care coordination	474
Plan attitude/service	319
Provider attitude/service	103

- Independent medical reviews (IMRs)
- 5 plans with enrollment > 400,000; 14.9 million members
- 1,900 IMRs resolved

Category	Withdrawn	Upheld	Overturned
Experimental/investigative	104	248	163
Medical necessity	294	477	381
ER reimbursement	120	50	63

http://www.hmohelp.ca.gov/library/reports/complaint/2008.pdf

Insurance pricing and incentives

- Proposed underwriting and rating restrictions
  - *Guaranteed issue at rates that do not reflect health status*
  - *Coverage of pre-existing conditions*
  - *Limited variation for age (House vs. Senate)*
- Controversy over impact on costs
- Individual market analyses:

Study/analysis	**Projection**
PWC (AHIP)	Premiums 47% higher by 2016 – does not consider premium subsidies
CBO / J. Gruber	Premiums 23% lower for comparable coverage by 2016, even without subsidies – does not consider adverse selection
Oliver Wyman (BCBS)	Avg. medical cost 50% higher after 5 years

(Un)healthy behavior externalities

1. Employee / policyholder turnover reduces incentives for employers / insurers to invest in health

2. Crude or non-existent risk-rating (ex ante moral hazard)

   - Healthy (unhealthy) behavior creates a positive (negative) externality for the risk pool
   - Too little (much) incentive for (un)healthy behavior
   - Average health of insured population declines; average cost of coverage increases
   - Those with healthy behaviors buy less coverage; more sorting by amount of cost-sharing

Internalizing the costs of unhealthy behavior

- Cost-sharing reduces externality: another argument for high deductible plans, HSAs
- Optimal contracts would link premium payments to behavior
- Potential practical approaches

  Discounts for healthy behavior

  Discounts for "markers" of healthy behavior

- Innovation

  Discounts for participation in wellness programs; more generous coverage

  Safeway: 20% premium reduction for no tobacco, control of weight, blood pressure, cholesterol

  Lower deductibles if meet health behavior targets

- Should encourage rather than stifle this type of innovation

Effects of Democrats' reform proposals

- Allow some degree of cost-sharing, but constrained choice
- Prevention, education, wellness programs, disease management
- Would forbid risk rating in individual market , reducing incentives for healthy behavior and killing innovation
- Senate bills

  Increase limit on employer-sponsored plan premium incentives from 20% to 30% (with regulatory authorization to increase to 50%)

  Senate Finance: pilot programs with wellness incentives for individuals, 10 states

- Reflects view that people are not accountable for their health

  Poor health is beyond individual control

  Financial incentives have little effect on behavior that affects