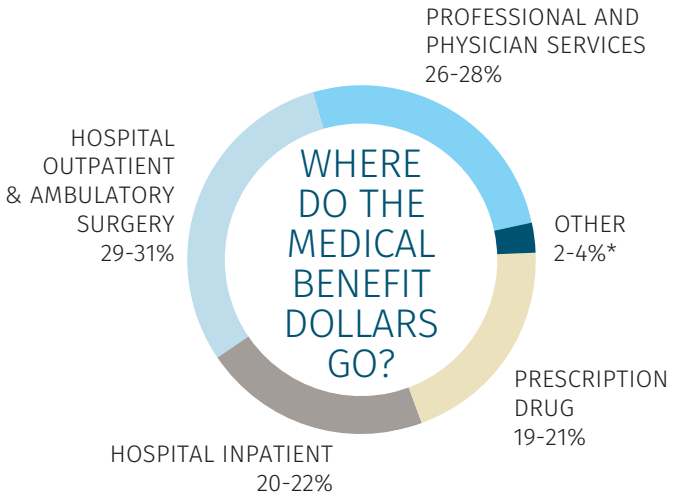
The Facts about

# HEALTH INSURANCE PREMIUMS




Most Americans receive financial protection against the devastating expense of a serious disease or injury with health insurance provided through their employment. Health insurance is one of the most treasured benefits of American labor, but it is one of the least understood.

In part, this misunderstanding is based on the fact that many Americans are insulated from most – if not all – annual premium increases that result from rising health costs. In contrast, consumers are much more informed about auto or homeowner's insurance because they pay directly for such coverage.

According to surveys, many Americans – including business leaders and media – are under the false impression that health insurers keep nearly half of the premiums they collect. In reality, health plans in New York state spend about 88 cents of each premium dollar to pay hospitals, doctors, pharmacists and others for the services, drugs and medical goods their members receive.

Where does this money go? The chart above shows a breakdown of benefit expenses for a typical health plan that offers medical, hospital and prescription drug coverage.

It's a common misconception to believe that increases in health insurance premiums are driven solely by the price increases that insurers pay hospitals, physicians and pharmacies. That's why it can be confusing when premium increases are substantially higher than the rate of inflation. In reality, the price of goods and services is only one of several factors that collectively determine the size of insurance premiums.

What additional factors go into determining a premium increase? While the specifics vary by the type of health coverage and marketplace conditions, this fact sheet explains the basic concepts of health care premiums, whether one lives in Niagara Falls or San Francisco.

The following pages show the factors that would drive a 10 percent premium rate increase. Percentages used are provided for illustrative purposes only and are not connected with a particular health plan or product.

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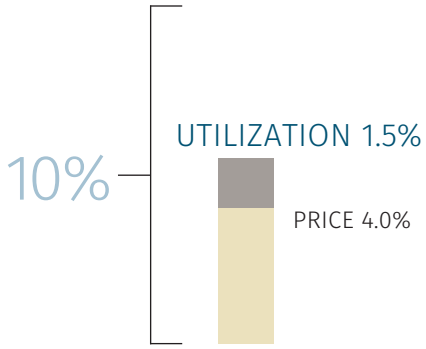
# PREMIUMS ARE ABOUT MORE THAN PRICE

## MULTIPLE FACTORS THAT WOULD DRIVE A TYPICAL 10 PERCENT PREMIUM INCREASE


### PRICE

In health care, price reflects the payment rates that health insurers negotiate with hospitals, physicians, pharmacies and other health care providers. Price also includes the increasing cost of purchasing prescription drugs; durable medical equipment (DME) such as wheelchairs, crutches and oxygen tanks; and other items.




### UTILIZATION

Utilization is the number of medical services and prescription drugs that people use. The use of health care services is increasing because of several factors, including:

- New technologies. Medical advances are continuously being introduced to improve care and outcomes. As one example, years ago few people received a knee or hip replacement. Today, the procedures are commonplace.
- Consumer demand. As new treatments are developed and as pharmaceutical companies aggressively advertise new drugs, consumers increasingly seek more care.
- An aging population. As people are living longer and as the “Baby-Boom” generation ages, more people are using more health care services than ever.

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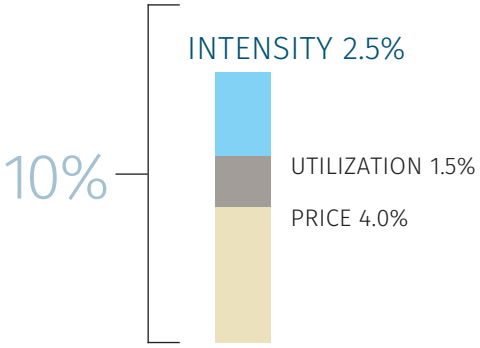
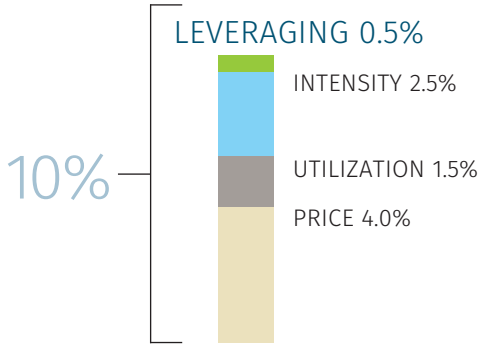



## INTENSITY

Intensity is when a treatment or procedure is replaced by a more expensive treatment. For example:

- Today, magnetic resonance images (MRIs) are frequently used instead of less expensive X-rays, thereby increasing costs. In some cases, MRIs are being used in addition to X-rays, increasing costs even more.
- New biotechnology products are expanding the arsenal of drug therapies available to treat both rare and common conditions. Some new drug treatments can cost tens of thousands of dollars.




## LEVERAGING

When the cost of a service increases while the health plan members' copay remains constant, members receive a richer benefit. The resulting increase in expense is often absorbed by the employer in the form of a higher premium. This impact is called leveraging.

In the example below, if a prescription costs $50 and a member's co-payment is $15, the benefit expense would be $35. If the drug's price increases by 10 percent to $55 and the member still pays $15, the benefit expense would be $40, a 14 percent increase. This means that the 10 percent price increase has a 14 percent effect on premiums.

| | Current | New | Increase |
|---|---|---|---|
| Prescription Cost | $50 | $55 | 10% |
| Member Copay | $15 | $15 | |
| Benefit Expense | $35 | $40 | 14% |

4% "LEVERAGING" EFFECT

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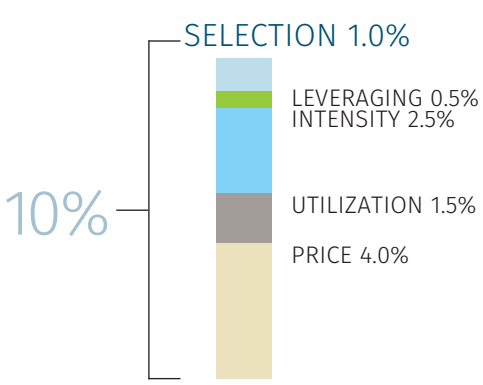


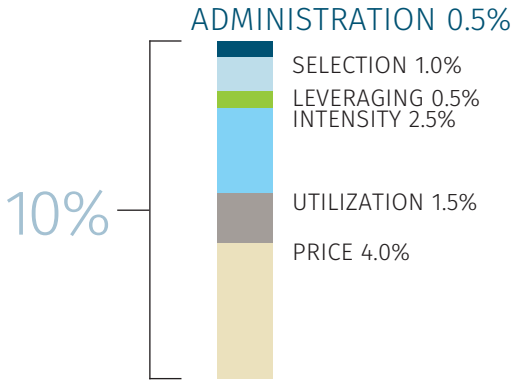


## SELECTION

Health insurance premiums are based on the average benefit expenses for a "pool" of people who are enrolled in a specific product. Enrollment shifts by healthier people cause premiums to increase.

In the "before" example below, the monthly medical expenses for those enrolled in Pool #1 average $104. Pool #2 has an average cost of $80. If the two healthier people in Pool #1 (with the $90 expenses) switch to Pool #2, the average cost for both pools will increase even though the total expenses for all ten people remains unchanged.

"BEFORE"

| POOL #1 | POOL #2 |
|---|---|
| $120 | $100 |
| $110 | $90 |
| $110 | $80 |
| $90 | $70 |
| $90 | $60 |
| $104 avg. | $80 avg. |

"AFTER"

| POOL #1 | POOL #2 |
|---|---|
| $120 | $100 |
| $110 | $90 |
| $110 | $90 |
| $113 avg. | $90 |
| | $80 |
| | $70 |
| | $60 |
| | $83 avg. |

## ADMINISTRATION

Administrative costs are the normal expenses needed to run a health insurance business, including the costs associated with processing claims, customer service, hospital and physician contracting, enrollment and billing, and some government taxes and fees. Administrative costs for this example account for less than one percent of the increase.

## THE IMPACT OF PREMIUM PRICING

Out of the final process of collecting premiums and paying for medical benefits and administrative costs, any net income is returned to an insurer's reserves for the protection of customers against unforeseen circumstances, such as a large influx of medical claims due to an epidemic or acts of terrorism. In the case of for-profit insurers, some of those gains are also returned to investors.

When premium increases do not adequately cover the cost trends that are driven by these factors, the shortfall must be covered by future increases.

### WHY PREMIUM RATES INCREASE: A DINNER ANALOGY

For a brief animation that uses a dinner analogy to explain the factors that affect premiums go to:
https://tinyurl.com/PremiumAnalogy-UN

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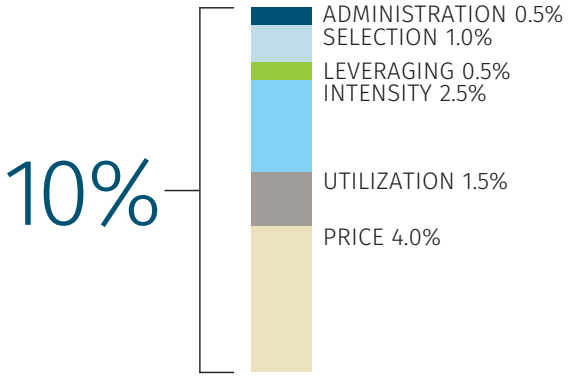
# SO WHY DO PREMIUMS GO UP?

When health insurance premiums increase, the size of the increase is driven by several factors beyond simply price. Utilization, intensity of services and other factors build upon each other to arrive at what it costs to maintain adequate financial protection through insurance.

As a nation, we will spend about $3.5 trillion on health care goods and services in 2017, much of it financed through private health insurance.

In addition to the premium drivers already explained here, there are other considerations as well.




## FRAUD

The National Health Care Anti-Fraud Association estimates that 3 to 5 percent of our national health care spending – or about $105 to $170 billion – is lost to fraud in a year.

## GOVERNMENT ACTIONS

Year after year, federal and state governments force those who voluntarily purchase health coverage to add more and more benefits. Employers say these government mandates result in higher premiums, which cause businesses to drop coverage and more people to become uninsured.

Some governments impose taxes on the privately insured to finance various health initiatives. In New York, for example, the privately insured are required to pay $4.7 billion in state taxes on their coverage.

Government also imposes new regulations that add billions of dollars in costs. And, hospitals report that Medicare and Medicaid reimbursements don't cover their costs, so they turn to the privately insured to make up the difference.

## PERSONAL BEHAVIORS

Americans are living longer and healthier lives because of advances in medical science and an explosion of knowledge. Life expectancy at birth has reached 78.8 years. But too often, we rely on science and technology to compensate for poor lifestyle choices. Our personal choices are one of the greatest cost drivers and offer the most potential for cost containment.

Studies show that personal behaviors like poor diet and nutrition, lack of exercise, alcohol and substance abuse, smoking, avoidable injuries, and failure to take proper vaccines are behind the leading causes of death, as well as hundreds of billions of dollars in health care spending.

To keep health insurance affordable, government must stop mandates and cost shifting, reduce taxes, combat fraud, and most importantly, consumers must make smart health care and lifestyle decisions.

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