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The Myth of the Underinsured Crisis

Critics of the U.S. health care system often claim that while there may be 45 million Americans without health insurance, there are perhaps another 16 million Americans (by one estimate) who are "underinsured," meaning they have insurance but are still exposed to very high out-of-pocket costs.

The fact is that most Americans are "overinsured," not underinsured, because they have insurance to cover bills they could easily, if albeit reluctantly, pay for out of pocket.

This paper looks at the underinsured, the proper role for health insurance, and why most of the concerns about the underinsured are overblown.

Who Are the Underinsured? There is no widely accepted definition of what it means to be underinsured because it would depend on numerous factors such as income, assets and policy coverage. A working family with an annual income of $25,000 and a $10,000 deductible insurance policy could reasonably be considered underinsured, but what about a family making, say, $200,000?

Yes, there are people — or their employer — who make a trade-off, choosing reduced coverage for lower health insurance premiums. And if a very expensive medical event occurs, they could face significant out-of-pocket expenses. Those situations are certainly unfortunate, but they also represent a very small percentage of the population.

For example, a 2006 Kaiser Family Foundation study found that the top 1 percent of people who spent money on health care (in 2003) spent, on average, $4,331. And the top 1 percent of the non-elderly with health insurance spent only $2,467. That can pinch the budget, but it hardly qualifies as an underinsured crisis.

What Is the Purpose of Insurance? Many Americans have come to think that the only good health insurance policy is one that covers virtually anything a person could spend on health care.

However, the real purpose of insurance — whether auto, life, property or health — is financial protection against unforeseen, catastrophic events that the individual couldn't be expected to plan for financially. Insurance was never intended to cover small, predictable and routine expenses. And for good reason: Insurance is both affordable and efficient when its purpose is covering large, catastrophic events. It is very costly and inefficient when covering routine expenses. That's why auto insurance doesn't cover oil changes and homeowners' policies don't cover house painting.

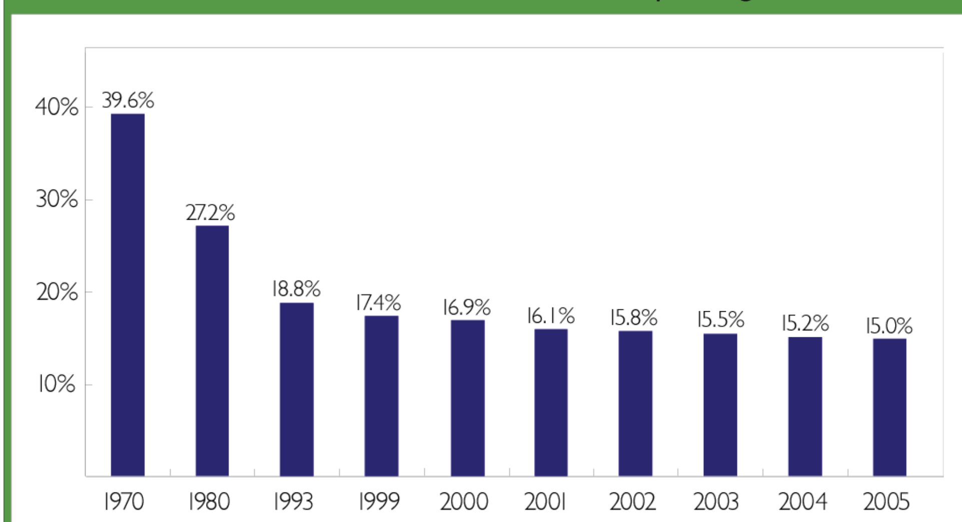
Insurance is simply a pass-through mechanism. The money going out has to be matched by the money coming in, plus processing fees and administrative costs (which include profits). If lots of routine expenditures are added to insurance — as every state does when it passes a "mandate" requiring insurers to cover specified expenses — the premiums go up because:

- The insurer is paying the bill that consumers were paying out of pocket;
- Consumers are less value-conscious shoppers because they aren't actually paying for the service; and
- Insurers have to add in processing costs on top of the cost of the service.

The point is that people don't escape health care costs when insurers are required to cover more providers and services, they eventually pay those costs in the form of higher premiums.

While most people recognize these principles with regard to other types of insurance, many

Out-of-Pocket as a Percent of Total Health Care Spending, Selected Years



Source: CMS

ignore them when health insurance is concerned. The same people who might be comfortable with a $1,000 deductible on their car or a $2,500 deductible on their house can be outraged at anything more than a $500 deductible for their health coverage. They want a third party paying the bill — all of it.

The Decline in Out-of-Pocket Costs. Although there is widespread concern that the public is more exposed than ever to high out-of-pocket health care costs, the data tell another story. As the figure shows on the opposite page, total out-of-pocket spending has been steadily declining over the years, from about 40 percent in 1970 to 15 percent in 2005. Americans today are more insulated than ever from the cost of health care.

Why Have Out-of-Pocket Costs Declined? In a word (or two to be exact): managed care. Traditional health insurance included a deductible and a copayment dependent on the amount of the medical bill. However, managed care introduced a nominal copay largely unconnected to the deductible or the actual amount of money spent on care. So a person seeing a doctor or buying a prescription drug may pay a flat fee of, say, $10 or $20, even with a high deductible policy.

The result has been a steady increase in patient insulation from the cost of care, which has led to increased health care spending while perpetuating the notion that someone other than the patient can and should be paying for most of the patient's care.

The Rise of the Consumer Driven Movement. That growing shift to higher deductibles upsets those who think we face an underinsured crisis. They believe a high deductible policy that covers, say, 100 percent of costs above a $2,500 or $5,000 deductible, up to $2 million, is nearly as bad as having no coverage at all — maybe worse. Because the high deductible policy could delude the insured into thinking he really has coverage when insurance might only cover the remaining $1,997,500 of his costs!

The Missing Discussion: Premium Costs. What's been missing in this debate is the recognition that people are making conscious tradeoffs. Low deductible policies usually cover more, but they also cost more than high deductible policies — sometimes a lot more. Prudent consumers weigh those types of tradeoffs and make a decision based on their own circumstances, willingness to bear risk, expectations of medical needs, etc.

In virtually any type of insurance, there is a point where a one-dollar increase in coverage will result in *more than a dollar* increase in premiums. That's a bad deal, and yet workers whose employer is paying most or all of the premium are more than willing to take it. And that's why so many Americans are *overinsured*.

Moving from a low to a high deductible policy often saves enough money to cover any additional out-of-pocket costs. And if the individual doesn't incur those costs, the leftover money belongs to him rather than the insurer.

The fact is that anyone expressing a blind commitment to low deductible policies simply hasn't done the math, and he, or an employer, may be spending a lot more than necessary to get good coverage.

HSAs and High Deductibles. Prior to the passage of the Health Savings Account (HSA) legislation in 2003 — and before that, the more limited Medical Savings Accounts in 1996 — money not spent on health insurance was taxable as income. Now HSA deposits compete on a level tax playing field with employer-provided health insurance.

High deductible policies that include an HSA or another consumer driven health insurance option, such as Health Reimbursement Arrangements (HRAs), have been growing dramatically. An America's Health Insurance Plans (AHIP) survey estimates that there are 4.5 million Americans covered by HSA-qualified policies. And there are millions more covered if HRAs are included. Funds from HSAs and HRAs, often provided by the employer with the savings from switching to a less-expensive high deductible policy, are used to pay for those smaller and routine health care expenditures under the deductible, rather than running that bill through the third-party process.

However, because people who don't like high deductible policies generally like HSAs even less, they ignore their role in covering some of the out-of-pocket costs. The point is that stories about the out-of-pocket costs faced by people with high deductibles may be overblown. Funds from an employer-provided personal account may be covering those out-of-pocket expenses.

Conclusion. While there are too many Americans without health insurance, there is no "underinsured crisis" in the U.S. The vast majority of insured Americans have coverage that will protect them from large catastrophic losses, and that's what insurance is supposed to do.

For further reading . . .

To find out more about the uninsured, see CAHI's "Understanding the Uninsured" at www.cahi.org.

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