Colorado Association of Health Plans

HEALTH CARE COSTS 101

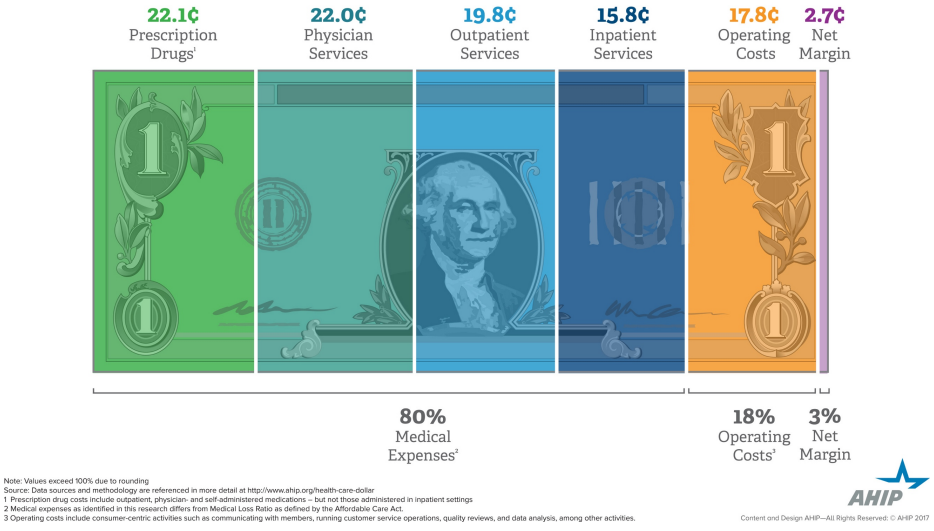
News coverage about health care reform has focused on the increasing cost of health insurance premiums, but fails to explore the link between higher health insurance premiums and hospital, physician, and drug costs. The ACA and Colorado have enacted numerous insurance regulations – including mandatory medical loss ratios (how much of the premium dollar is spent on health care), required benefits, and rate review. Yet, insurance premiums continue to rise ***because premiums are based on the prices charged by health care providers.***
It is the price of a surgery, a medication, a visit to the doctor that have the greatest impact on the price tag for health care and health insurance premiums.

OVERVIEW: THE HEALTH CARE DOLLAR

Last fall, the U.S. Labor Department reported that spending on health care increased "by the biggest amount in more than three decades."[1] Increased spending on health care = higher premiums.

In a 2015 Health Cost Report given to the Colorado Legislature, the Division of Insurance reported that the average mandatory loss ratio in Colorado in the individual market was 114.3%.[2] That means of every dollar being paid in premiums, $1.14 was being spent on hospitals, doctors and pharmaceuticals. Insurers were paying out more than they were bringing in with premiums for the individual market.

Of course, the individual market is a small piece of the health insurance pie. When small group and large group are thrown into the mix, insurers are paying an average of 80 cents per dollar on health care. The chart below illustrates how each premium dollar is spent:



[1] David Lazarus, "Sick: The biggest increase in healthcare costs in 32 years," http://beta.latimes.com/business/lazarus/la-fi-lazarus-rising-healthcare-costs-20160920-snap-story.html, (Sept 20, 2016)
[2] Health Insurance Cost Report to The Colorado General Assembly for Calendar year 2015, https://drive.google.com/file/d/0BwguXutc4vbpbUhJTnRnT01DSTg/view, Colorado Department of Regulatory Agencies, (Jan 3, 2016)

PHARMACEUTICALS

While drug prices appear to be a small chunk of the health care dollar, they are currently the fastest growing health care cost in the United States. From 2012 to 2015, pharmaceutical prices increased by 27 percent in Colorado. Compare that to the four percent increase in provider services over the same period, and it becomes very clear that the continued escalation of drug prices is unsustainable. A "study published in the journal *Neurology* in April 2015 found that the cost of first generation disease-modifying medications for MS increased from between $8,000 to $11,000 annually in the 1990s to approximately $60,000 per year currently. Newer disease-modifying drugs can cost even more."[3] A new leukemia drug is currently predicted to cost $649,000 for treatment, three times the average cost of melanoma drugs, which still come in at a whopping $250,000 per person per year. In October, the FDA approved a $1 million drug — a sign that drug prices will continue to spiral upwards and become increasingly unaffordable for both patients and their insurers.

According to the Kaiser Family Foundation, the typical annual premium in 2016 for an employer-sponsored health plan was $6,690. **That means an average of 63 premiums are needed to pay the bill for a single patient's treatment with only one of these very expensive drugs. When you consider how many drugs on the market are now hitting the six-figure mark, it becomes very clear why premiums continue to rise.**

New medications aren't the only culprits stretching the collective pocketbook. Insulin was created over a century ago and there are three major manufacturers selling different versions. Yet, despite competition (which should DECREASE costs) and unchanged formulas, the price has increased over 1,124% since 1996.[4]

HOSPITAL CARE

Hospitals absorb the largest chunk of the health care dollar for inpatient services, outpatient services, hospital physicians, and prescription drugs provided within the facility. In fact, PricewaterhouseCoopers (PwC) predicts that by next year, "hospital spending will likely account for half of all medical costs."[5] The majority of this cost increase will probably stem from the increasing cost of drugs and higher outpatient procedure utilization.

Additionally, the recent market trend of hospitals consolidating with other hospitals and acquiring physician practices often results in much higher reimbursement rates and charges. According to the Robert Wood Johnson Foundation, **"[t]he magnitude of price increases when hospitals merge in concentrated markets is typically quite large, most exceeding 20 percent**."[6] In Colorado, one insurer calculated that only five hospital systems account for 77 percent of its total hospital spend.

Physician acquisition also helps hospitals create a captive market and increase their bottom lines. Physicians within a hospital system must refer patients to specialists within that same hospital system, whether or not it is the most cost-effective and highest-quality option. This practice guarantees that more money stays within hospital systems – creating a greater incentive to acquire even more physician practices.

PHYSICIANS

Many physicians' practices are benefiting from hospital acquisitions, using the increased market power to set their own reimbursement rates.

Moreover, the moment a physician's office becomes part of a hospital entity, that office has the ability to tack on a "facility fee" charge to their bill, even when the patient hasn't used any hospital services. These fees can increase bills by thousands of dollars. The actual service provided to the patient has not changed, but the prices charged to that patient and his or her insurer can triple. Jeff Shellan, a Colorado heart patient, received two cardiac stress tests from the same physician within a year. When the physician was independent, the test cost $2,100. A year later, after the physician's practice was purchased by Boulder Community Hospital, the same test cost more than $8,000. That's a **380 percent increase for the same test after only one year**![7]

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[3] Alisa Woods, PhD, "The Costs of Multiple Sclerosis Treatment," https://www.everydayhealth.com/multiple-sclerosis/treatment/costs-of-ms-treatment, (March 8, 2016)
[4] Lydia Ramsey, "There's something odd about the way insulin prices change," http://www.businessinsider.com/rising-insulin-prices-track-competators-closely-2016-9, (September 17, 2016)
[5] "Medical Cost Trend: Behind the numbers 2018," https://www.pwc.com/us/en/health-industries/health-research-institute/behind-the-numbers/reports/hri-behind-the-numbers-2018.pdf, (June 2017)
[6] Martin Gaynor, PhD and Robert Town, PhD, "The impact of hospital consolidation – Update," June 2012
[7] Michael Booth, "Facility fees inflate hospital prices for common services," http://www.denverpost.com/2013/05/13/facility-fees-inflate-hospital-prices-for-common-services, (May 13, 2013)

THE FUTURE

PwC's most recent medical cost trend analysis should be especially concerning to Colorado small businesses. Small businesses not only face the pressure of increasing health care cost trend, but they are uniquely affected by insurance administrative mandates passed at the state legislature. Colorado insurance laws and regulations only apply to 25 percent of the insurance market, most of which are small group plans provided by small businesses with tight margins.[8]

Businesses of all sizes have used numerous strategies to attempt to keep costs under control, including high-deductible plans, generic-only drug plans, and high-value networks. Unfortunately, according to PwC, financial benefits from these policies are nearly maxed out. The value of these strategies has largely been achieved, and the increasing prices of health care services surpasses the savings.

Unless the business community becomes involved in encouraging policy that addresses health care pricing and the actual costs of health care, PwC foresees costs will continue to escalate at ever-increasing rates. "For medical cost trend to sink lower than its 'new normal,' health organizations and **businesses will have to consider tackling the price of services** as well as the rate of utilization."[9]

[8] Health Insurance Cost Report to The Colorado General Assembly for Calendar year 2015, https://drive.google.com/file/d/0BwguXutc4vbpbUhJTnRnT01DSTg/view, Colorado Department of Regulatory Agencies, (Jan 3, 2016)

[9] "Medical Cost Trend: Behind the numbers 2018," https://www.pwc.com/us/en/health-industries/health-research-institute/behind-the-numbers/reports/hri-behind-the-numbers-2018.pdf, (June 2017)