



The Inefficient Individual Market

Higher Administrative Costs on the Individual Market Will Mean \$3.0 Billion in Extra Expenses for American Families in 2009

By Peter Harbage

The federal government projects that Americans will spend over \$2.5 trillion on health care in 2009 alone; roughly \$100 billion of this goes to the cost of administering private insurance.¹ And nowhere are those costs higher than in the individual market—that is, when people purchase coverage directly through the insurer and not through an employer.

There are a variety of reasons why the individual market is more expensive, including that insurers screen those applying for individual insurance to make sure they are a “good risk.” In other words, the insurers spend a significant amount of money to insure only the healthiest people. Sometimes called the nongroup market, more than 14 million Americans get their health coverage on the individual market.²

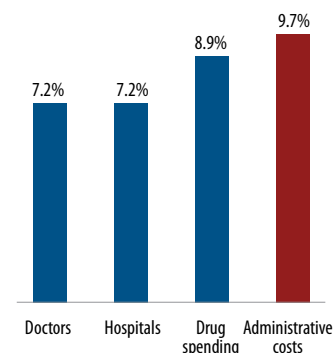
Health reform is an opportunity to drastically reduce administrative costs in the individual market. Progressives have called for health reform where all individuals would be able to purchase coverage through an exchange in which individuals could be pooled together to purchase insurance through a common marketplace. This could greatly reduce—if not eliminate—the individual market’s extra costs. In fact, the Center for American Progress Action Fund projects that it is possible to reduce health care administrative spending by more than \$3.0 billion in 2009 and more than \$40 billion over 10 years if all Americans had the option—and chose to—purchase coverage through a group market, such as an exchange or an employer.

The individual market’s high administrative cost

Most Americans obtain their insurance through the “group market” where employers work with an insurer to offer coverage to employees and dependents. This leverages economies of scale and allows for those covered to share health risk broadly. In contrast, the individual market does neither. As a result, insurers work hard to attract and enroll only the lowest risk individuals.

Growth in total health spending

Average annual growth rate, 1999 to 2009



Source: CMS National Health Expenditures.

The Congressional Budget Office estimates that 29 percent of premium dollars in the individual insurance market go toward administrative costs on average.³ This is more than double the average rate in the group market, where roughly 12 percent of employer-sponsored insurance premium dollars are spent on administrative costs.⁴ This has a real cost: The average policyholder on the individual health insurance market will spend roughly \$300 more on administrative costs each year than if they purchased coverage through a group policy.

Some of the specific insurer activities in the individual market that drive up administrative costs are:

- **Underwriting.** Insurance companies in the individual market evaluate each applicant's health status in order to price the health policy. This research is expensive and performed by medical providers. The group market, particularly for large businesses, does not have underwriting because risk is shared and all employees are automatically eligible for enrollment.
- **Marketing.** The individual market requires hands-on marketing to a wider audience. Insurers in the group market have a relatively limited number of customers: employers' human resources departments.
- **Rescission.** Those on the individual market are subject to medical review after the policy is purchased. Insurers typically look for evidence of pre-existing conditions in order to disallow coverage retroactively for patients with high costs. The practice has come under scrutiny and some insurers have had to pay not only for the review, but also legal fees for challenges. In some cases this means millions in penalties after regulators determined there was wrongdoing. These extra costs are passed along to their consumers.
- **Paperwork.** Paperwork and recordkeeping can be aggregated in the group market. Yet paperwork and recordkeeping in the individual market are significantly higher because the insurer must track independently. This analysis only accounts for insurer costs, but there are also additional costs to individuals who must put forth extra effort to complete the paperwork and providers who may have to provide documentation.

Unnecessary administrative spending costs

Administrative costs are already the fastest-growing part of the health care system. Health reform would mitigate this under proposals commonly discussed by progressives, which include provisions such as eliminating underwriting, offering standardized and easy-to-understand plan information, and providing consumers with options like Massachusetts's approach. This health plan uses an exchange, called a connector, to create a group market for the purchase of insurance, among other things, and to ensure consumer protections and reduce overhead costs.

It is critical that health reforms enable individuals to continue to have the same coverage they have today if they choose to do so. Yet it is reasonable to assume that the vast majority of those on the individual market would choose an exchange approach, if it is available, to reduce paperwork costs and grant the benefits of group purchasing.

Absent health reform, the United States will likely continue to unnecessarily spend dollars on excessive administrative costs. Roughly 14 million individuals in today's nongroup market will face administrative costs of about \$13.3 billion in 2009. If all these same people had purchased coverage in a group market setting (such as would be created by an exchange), their total administrative spending would likely fall by \$3.0 billion. This administrative savings could total \$40 billion over 10 years, given National Health Expenditure inflation data. If anything, this underestimates the future cost as employers drop more individuals from coverage in the weakening economy, leaving more and more people to try to obtain coverage on the individual market.

Methodology

The Center for American Progress relied on a multistep calculation to calculate the administrative spending in our current health system.

Average administrative cost of a 2009 family policy in the group market: \$1,043

The Kaiser/Health Research and Educational Trust 2008 Employer Benefits Survey found that the average premium in 2008 for single plan was \$4,704, and the average family premium was \$12,680.⁵ To determine 2009 administrative spending, we grow the premiums by the National Health Expenditure data. We then combine this estimate with the CBO's estimate that an average of 12 percent of premium dollars spent on the group market is used for administrative costs.⁶ This results in an administrative cost of about \$600 for single plans in the group market and about \$1,600 for family plans. We then use national enrollment by insurance and family type to calculate the number of policies that exist nationally and then calculate that the weighted average of administrative costs in employer sponsored insurance is \$1,043.⁷

Average administrative cost of a 2009 family policy in the individual market: \$1,346

The individual market premiums for single plan and family coverage in 2006-2007 were \$2,613 and \$5,799, respectively, according to the Association of Health Insurance Plans.⁸ Policyholders in the individual market actually pay more in administrative costs despite the lower total premium costs. To determine 2009 administrative spending on the individual market, we grow the premiums by the National Health Expenditure inflation data.

We then combine this estimate with the CBO's estimate that an average of 29 percent of premium dollars spent on the individual market is used for administrative costs.⁹ This results in an administrative cost for single plans in the group market of about \$880 and family plans of about \$1,900. Using national enrollment by insurance and family type,¹⁰ we calculate the number of policies that exist nationally and then calculate that the weighted average of administrative costs in employer-sponsored insurance is \$1,346.

The individual market's administrative burden: \$3.0 billion in 2009 and \$39 billion over 10 years

AHIP 2006-2007 survey data collected on premiums found 2.9 million nongroup policies for 4.2 million people; we estimate that the 14.4 million people in that market (per U.S. Census data) are spread across 9.9 million policies.¹¹ There is a \$3 billion dollar difference between the administrative cost of the 9.9 million policies using the average group market administrative payment amount (\$1,043), versus the average individual market rate (\$1,346). Given health care inflation, that means there is \$40 billion in unnecessary administrative spending over 10 years due to the additional costs in the individual market.

Endnotes

- 1 Centers for Medicare and Medicaid Services, "National Health Expenditure Data, Amounts by Type of Expenditure and Source of Funds: Calendar Years 1965-2018," available at http://www.cms.hhs.gov/NationalHealthExpendData/03_NationalHealthAccountsProjected.asp#TopOfPage
- 2 Statehealthfacts.org, "Health Insurance Coverage of the Total Population: 2007," downloaded March 20, 2009.
- 3 Congressional Budget Office, "CBO's Health Insurance Simulation Model" (October 2007).
- 4 CBO estimates that administrative costs range from 9 percent for firms with less than 100 workers to 27 percent for two-employee businesses. Using 2006 Census data on the distribution of covered workers by firm size, and assuming firms with less than 100 have administrative costs at the midpoint of the CBO range, the average for administrative costs for employer-based coverage is 12 percent.
- 5 Kaiser Family Foundation and the Health Research and Educational Trust, "2007 Employer Health Benefits Survey" (September 11, 2007), available at <http://www.kff.org/insurance/7672/index.cfm>.
- 6 Congressional Budget Office, "CBO's Health Insurance Simulation Model."
- 7 Paul Fronstin, "Sources of Health Insurance and Characteristics of the Uninsured," EBRI Issue Brief (October 2007), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_10-20073.pdf.
- 8 AHIP Center for Policy and Research, "Individual Health Insurance 2006-2007: A Comprehensive Survey of Premiums, Availability, and Benefits" (Washington, DC: America's Health Insurance Plans, December 2007).
- 9 Congressional Budget Office, "CBO's Health Insurance Simulation Model."
- 10 Fronstin, "Sources of Health Insurance and Characteristics of the Uninsured."
- 11 Statehealthfacts.org, "Health Insurance Coverage of the Total Population: 2007."