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Sent: Thursday, December 11, 2008 8:59 AM
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Subject: Today's Inflation Outlook for EconoPlay Subscribers (healthcare)

PPI/CPI:

Some Healthcare Execs Foresee a Return of Medical Inflation in 2009

- Cost Pressures on the Rise as Insecure Workers 'Use or Lose' Health Benefits
- Businesses, in Survival Mode, Seen Slashing Jobs to Contain Healthcare Costs
- In an Unprecedented Cost Shift to Workers, the Unacceptable Becomes Everyday

By Gary Rosenberger

NEW YORK (EconoPlay) Dec. 11 – Medical inflation could roar back in 2009, reversing a six-year cooling trend, as legions of insecure workers use their benefits while they can – placing a financial strain on a dysfunctional system at a time of peak vulnerability, industry officials say.

Insurance providers say that, so far, underlying cost trends are about equal to, or slightly above, last year. But much of their data was gathered prior to the global financial collapse in September and doesn't yet speak to a world that has been turned upside down.

Even so, some would argue that it is difficult to raise prices for anything, including healthcare, during a time of economic contraction.

Yet benefits consultants are again seeing double-digit increases on renewals for 2009. They've seen companies rip apart benefit plans in ways that would have been unacceptable only months ago, while resorting to layoffs as the ultimate cost-containment tool.

The coping mechanisms are being further undermined by a tanking investment market, which no longer provides a cushion against rising healthcare costs for businesses, insurers or healthcare providers alike.

"It's a wild ride, you bet. Everyone is hunkering down," said Jim Watt, president of Employee Benefit Solutions, a Houston-based consultancy. "Nobody kept last year's plan."

He is anticipating healthcare cost increases of 13% to 15% – adjusting for modifications. "On a same-policy basis, I would expect 17 to 18 percent increases," Watt said. A year ago, he was looking at increases of just below 10% on a same-policy basis and mid-single digit increases after buy-downs.

One constraint on healthcare costs over the last six months was layoffs, which are now hitting Houston in a big way. "The energy sector was the last sector to feel the downturn, and it is now fully immersed in it," Watt said.

"People that anticipate their company is in trouble will utilize healthcare services much more aggressively than if they feel secure in their employment," he explained. "Basically, people use the hell out of their benefits before they go into COBRA or drop out of the system." (COBRA gives the newly unemployed a temporary extension of group health coverage at their own expense.)

None of his clients have ended their commitment to health benefit programs, but "they're all much more cost-conscious about the programs they have in place – and they're modifying benefit levels to soften the increased costs."

Watt sees employers moving into high-deductible health plans in numbers he never witnessed before. "Sure there's sticker shock. Workers are raising questions about affordability. But you're talking about business survival now," he said. "Companies can no longer absorb the cost increases associated with the healthcare system."

Accepting the Unacceptable

Aaron Berg, president of HealthPlan Manager Corp. in Mount Arlington, New Jersey, said the January renewals he's seen show about a 13% increase "apples to apples." Last year, the increases were on the order of 8%.

But there are ways to reduce that 13% to, perhaps, 5% or 6% by increasing co-pays for hospitalization, doctor's visits and pharmaceuticals. "The next step after that is letting people go," Berg said.

He has seen an "avalanche" of employers moving into high-deductible HSA's and HRA's (health savings accounts and health reimbursement arrangements) in recent months. "You don't have to twist arms on that anymore," he said. "Employers really have no choice. You can't continue to pay 13 percent increases in a down economy when you're overstaffed. So you cut costs and cut staff and hope you can ride out the downturn."

With all the bailout money going to the politically connected and powerful, "the little guy is left to fend for himself," Berg said. "That $700 billion would have completely solved the healthcare problem in this country and fixed so much more."

As he projects outward, he thinks one casualty of the recession will be the employer-based insurance system. "At some point businesses will go to government and say if you don't do something about health insurance we will just eliminate plans," Berg said. "How it all ends, I don't know. Maybe the answer will be national health insurance or a single-payer system."

Another alternative – if you don't like *anyone's* insurance plan – is to create your own insurance company. That's precisely what Working Today, the freelancers' union, will do when it inaugurates the Freelancer's Insurance Company in January, said Sara Horowitz, the union's founder.

"The current for-profit insurance model is no longer sustainable," Horowitz said, arguing the system had been broken from the time the old "mutuals" were "demutualized" in the 1980s – essentially transferring "ownership" of insurance companies from policyholders to shareholders.

“Policyholders want affordable insurance. But shareholders want profit, short term and lots of it,” she said. “When the investors took over, they went after the most profitable segments of the market and dropped the rest.”

A second trend working against the self-insured was the merger of insurance providers, which stifled competition and enabled them to scrape up “the 18 to 30 percent returns that investors demanded,” Horowitz said. “You can only get that kind of return by raising premiums. That was such a big driver of cost.”

To get around that “you have to innovate and take risk – you have to try new things,” she added. “You have to figure out a new paradigm for insurance. You don’t have to accept the current frame, which is ludicrous.”

But she concedes it came at a heavy cost to its 19,000 subscribers. The monthly payment on the FIC’s top plan is $455 a month, a 19% increase from the Empire Blue Cross Blue Shield plan that cost members $383 a month in 2008 and that provided more benefits.

The new plan increases co-pays for office visits and drugs – and adds a new kink in a 15% hospital coinsurance fee (45% for out-of-network hospitals). “I’d be angry, too, if my insurance costs went up like that and I was getting less benefits,” Horowitz said. “But what we had before was not sustainable. If we didn’t change the plan, eventually we would have *no* plan.”

Independent consultants we contacted thought the program was a good deal overall. One said the 15% hospital coinsurance, while a relatively new feature in insurance plans in the Northeast and a non-starter in other union plans, is a bargain compared to the 20% hospital coinsurance fees in much of the rest of the country.

Another thought the freelancers “got slammed” – and suspects the organization ran into an “adverse selection problem” where claims outpace premiums. (He said a typical plan he would provide might have a $500 deductible for in-network hospitalization and cover 100% thereafter, instead of that 15% coinsurance.) Still, he advises anyone in the FIC program to stick with it, based on overall value.

Horowitz denies there was a problem with adverse selection. “The original predictions of adverse selection never came to pass,” she insists. “More people are career freelancers because the nature of the workforce has changed.”

She has taken flak for her vision. Members have taken issue with the $70-plus monthly increase and especially that 15% hospital coinsurance. “I don’t blame them for being upset that their rates went up and their benefits decreased,” Horowitz said.

But the old plan was losing money, and was at risk. “For any insurance plan, you add up all the premiums and add up all the expenses. It doesn’t matter if you have a million people. If your expenses outrun your premiums, it is not sustainable and that’s what was happening with this group,” Horowitz said.

Stability, For Now

Regina Nethery, vice president of investor relations for Humana Inc., a major healthcare benefits provider based in Louisville, Kentucky, said healthcare cost trends have shown little change despite the economic storm. “We are not anticipating any significant changes to commercial medical cost trends in 2009 from those we have experienced in 2008,” she said.

“Same-store benefit expense trends (including buy-downs) were in the range of 6 to 7 percent in 2008 and will be about the same in 2009,” she said.

The components of the medical cost trend before buy-downs are also largely unchanged from 2008. Inpatient hospital utilization is flat to up 1%; inpatient and outpatient hospital rates are up mid to upper single digits; outpatient hospital utilization are up low to mid single digits; physicians are up mid single digits; and pharmacy is up mid to upper single digits, Nethery said.

She sees “no major changes in buy-downs at this point,” nor does she see “anything unusual at this point” regarding utilization of healthcare benefits in a weakening economy.

Humana CEO Mike McCallister is “encouraged that President-elect Obama has indicated he intents to enact significant healthcare reform during his first term” and sees “strong prospects for incremental reform,” beginning with reauthorization and expansion of the SCHIP program.

Beyond that, “many key Congressional leaders have put healthcare reform high on their list of priorities …to, not only cover everyone, but also address the concerns many Americans have about healthcare affordability.”

Humana supports “individual mandates within a framework of comprehensive reform” that would require “everyone to purchase coverage and thus bring younger and healthier individuals into the health insurance system.”

‘No Escape Hatch’

Doug Sherlock, president of the Sherlock Company, a financial services firm for the healthcare industry in the Philadelphia suburb of New Wales, said his September survey of insurance providers indicates average commercial premiums will increase by 9.9% before buy-downs and 8.0% after buy-downs in 2009 – up about half a percent from 2008.

Employment weakness is at the forefront among challenges facing insurance providers. “Fewer employees mean fewer people under employer-sponsored health plans,” Sherlock said. “A certain percentage will find alternative plans, including government plans like Medicare and SCHIP or else they’ll purchase health insurance on their own. But, even with that, total enrollment will decrease.”

Another issue is bad investment returns. “The equities market has been really volatile, and really weak, and we see no reason why that won’t continue into 2009,” he said. “If you have a good investment environment you're better able to manage non-operating expenses, like insurance. That escape hatch is now gone."

Nor is the Federal Reserve helping matters as it pursues low-interest policies that reduce returns on fixed-income assets, exacerbating the crunch from the equities market.

Another cause for worry is the prospect that the government will reduce funding for Medicare Advantage plans, as Obama promises to do. "Private insurance companies would then have to figure out ways to reduce costs and manage expenses because in a recession it's hard to raise prices," Sherlock added.

Finally, there's the credit crunch, which has thrown the entire economy off its axis and taken healthcare with it. Companies that have the credit window shut on them might move to ASO plans (Administrative Services Only) – an extreme option where the employer carries the risk for claims, leaving only administrative responsibilities to the insurance companies.

Robert Drucker, president of RxUSA, an Internet-based pharmacy, and an activist, sees generic drug prices coming down dramatically in response to the recession and political pressures from a new Democratic Administration.

"It's unlikely the big pharmaceuticals will be getting a very sympathetic hearing under Obama," Drucker said, noting he expects Congress and the Food and Drug Administration to follow the lead of the European Union in an aggressive "crusade" against price collusion.

Until then, the big pharmaceutical companies will continue with their bag of tricks, such as making minor changes to their formulas to extend their patents. Recently, he has seen makers of branded prescription drugs actually raising prices after their patents expire.

"What they lose in market share, they'll try to make it up with even bigger margins," he asserts. "There are still plenty of union plans that pay top dollar for the brand drugs."

One of the major offenders is Zoloft, the antidepressant that that costs, $331 for 100 tablets, ten times the price of Sertraline, the generic version at $33 for 100 tablets, he said.

"Generic drug manufacturers are facing an increasingly large problem with consumers who used to have health insurance and who wind up unemployed with no benefits," Drucker said. "Prices will go down because there is no disposable income and people will aggressively shop for lower prices."

Construction costs for health facilities are also coming down, yet there are fewer hospitals being built, said an executive for a California-based healthcare provider. "I am worried in this economy that short-term capital constraints will disrupt the capital improvement pipeline and have a long-term impact on the healthcare delivery infrastructure," the source said.

"The general contractors I've spoken to are burning through their backlog and are looking at a bleak 2009 and 2010. Now is the time they should be filling that backlog and no work is coming in," he said.

He recently saw a parking structure come in for half of the expected price as subcontractors "bought the work" in order to keep their valuable talent employed.

The U.S. Labor Department is scheduled to release the producer price index for November on Friday at 8:30 a.m. ET and the consumer price index for November on Tuesday at 8:30 a.m. ET.