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# *Health Care Cost Trends 2002 – An Insurer´s/Reinsurer´s View on Cost Increases for Group Medical Business*

***by Achim M. Dauser***

When an actuary considers how to set rates for group medical business for the upcoming renewal period, it is critical to know how health care costs are developing. A profitable block of medical business can quickly turn into a substantial underwriting loss when cost trends for the different components of medical business are underestimated. This is particularly true for Employer Stop Loss Reinsurance, which is generally protected on an excess basis. Cost trends for claims that exceed the deductible usually are a multiple of the base medical trend as a result of the leveraging effect.

## Current Market Environment

In the early 1990s, medical inflation decreased and reached a low of 2 to 4% in the mid 1990s. Since then, medical inflation has been increasing and the new millennium marked a return to double-digit increases. Aside from the inherent reasons of an aging population, high cost therapies and new technologies, the current drivers of soaring health care costs are prescription drug cost increases, a managed care backlash and the economic downturn. Undoubtedly, the events of September 11th will impact certain components of healthcare. The implications are numerous—increases in prescription drugs for depression, stress, anxiety and sleep problems and the development of a completely new consumer behavior, the hoarding of antibiotics due to the perceived threat of a chemical attack or bioterrorism.

## Prescription Drugs

Over the last several years, the cost of prescription drugs was the fastest growing component of trend and one of the main drivers of increased costs. Pharmaceutical industry marketing to providers and patients has significantly driven trend. According to a study prepared by the National Institute for Health Care Management, consumer drug advertising rose 35% last year from $1.8 billion in 1999 to $2.5 billion in 2000. Increases in the sales of the 50 drugs that were most heavily advertised to consumers accounted for almost half of the $20.8 billion increase in drug spending last year.

The spending increase can be attributed to a boost in the utilization of the 50 drugs, and not to a rise in price. There are several studies predicting cost increases for prescription drugs of between 17 and 20%. These numbers take into account the fact that—other than last year—many employers have put in place a wide variety of alternatives to take control of prescription drug costs. With a slowing economy and lessening pressure on employers to provide attractive reward packages, health plans now include higher co-pays, three-and four-tier plans and lifestyle drug exclusions.

On the other hand, a slowing economy with layoffs centering on young and single employees will result in an increase in drug costs for the "remaining" active group of employees.

The impact of September 11th on cost increases for prescription drugs could be significant. Increased drug utilization of antibiotics, antianxiety and antidepression medications already can be noted. If we assume that two out of ten employees will receive antibiotics related to the current anthrax scare and the war on terrorism at a cost of $100 per employee, drug costs for the insurers will go up by more than 2.5% over the next year. Additional screening, testing and other treatments triggered by the new uncertainties the patient now has to overcome will result in a further drug cost increase.

Overall, with drug spending still being the fastest growing sector, it can be assumed that cost increases for prescription drugs in the current environment will be between 25 and 30%. It remains to be seen how quickly the consumer will react in these times of uncertainty and how soon the economy will rebound. Both factors will have a significant impact on trend for drugs.

## Base Trend

Wide spreads in premium rates can exist within geographic areas, industries and within health care delivery systems. However, significant increases in medical costs appear across all plan types without regard to industry or geography. Recent HMO price increases have exceeded those of many PPO plans and even some traditional indemnity plans. Managed Care Organizations have increased hospital and physician reimbursements and eased the restrictions on access resulting from gatekeepers, preauthorizations and capitation (managed care backlash).

Outpatient treatment will increase due to the recession and individuals facing unemployment who will seek medical care before their health insurance runs out. According to several surveys for the year 2002, a medical base trend between 13 and 15% can be assumed with some variations depending on the type of plan. However, the survey results do not take into account the events of September 11th or the deepening economic downturn. Counseling, treatment of mental illness

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and other stress-related physician visits have likely increased across the country and are not necessarily limited to the geographic areas of the attacks. Physician visits for screening and testing to exclude anthrax will increase. Higher utilization will correlate with increased diagnoses of more severe diseases and will result in further treatment costs. The extent of these factors is unclear at this point in time. However, in constructing scenarios assuming how many individuals out of a hundred will receive mental treatment, how many will see their doctors for anthrax checks or other testing, and how many of those will require further treatment due to an unclear diagnosis, I am able to develop about a 3 percentage point additional cost increase, with even higher results for the New York area. Based on these factors, it seems appropriate to expect a medical base trend in the neighborhood of 16 to 18% depending on the plan type.

### Leveraged Trend

For insurers and reinsurers in the stop loss market, the question "What is the trend for large health claims?" is crucial. The experience of the last two years shows that rate increases of 25 to 30% have not necessarily improved underwriting results. Currently, rate increases between 40 and 50%, depending on the deductible level, are not uncommon. Most of the factors described above including uncertainties related to the war on terrorism and the current bioterrorism scares will have a small impact on leveraged trend.

However, an increased utilization of outpatient care can trigger expensive treatments, which will exceed the employer's retention. Furthermore, the managed care backlash has caused managed care organizations to increase payments to providers and it is doubtful whether outlier thresholds have been adjusted adequately.

In this environment, it can be expected that particularly the number of large claims will increase, thereby resulting in an increase in leveraged trend. Trend assumptions of up to 30% at a deductible of $50,000 and up to 35% at a deductible of $100,000 do not appear overly conservative.

### Future

The managed care backlash and recent events are further driving health care costs. Many companies will pass along cost increases to their employees. This cost shifting could accelerate in 2003, since many health care cost decisions for 2002 were made earlier this year when no recession was expected. Considering the current social and economic market environment there is no end in sight to double digit increases in health care costs.

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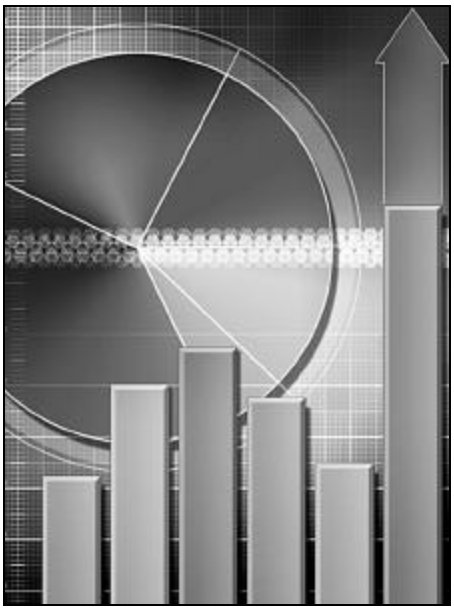
# *Investigation of High Deductible Trend*

***by G. Russel Hugh***

Each year health actuaries repeat the activity of assessing and revising rate manuals for the upcoming year, and thus commences the annual debate over the elusive and decidedly significant figure of trend. This year, perhaps the result of uncertainty created by a few years of poor experience, estimates of trend have varied widely, especially at higher specific deductible levels. In an attempt to find some conclusive evidence to support a concrete figure for high deductible trend, I have examined large claim data with an eye on the variance in frequency and severity. As a result of this study I have noted some fluctuations in the last few years that deserve additional attention. The data, which I will detail below, bears out the reality that trend had increased dramatically since 1998. This increase was surprisingly large at the highest deductible levels, and was impacted by both the frequency and the severity of claims at these levels.

To conduct my study I have used a reasonably credible database of large claims spanning a six-year period from 1995 through 2000. The database, though not as large as the exposure base for the upcoming Society of Actuaries Large Claims Study, had a total certificate count of approximately five million. Claims represent amounts in excess of a minimum retention of $250,000 and a maximum retention of $750,000. Claims were limited to a total annual figure of $1,000,000. Completion factors were applied to more recent data to reflect expected claim reserves.



From my database, I have observed that since 1998 PEPM costs have increased by 30%, 74%, and 157% per year for the $250,000, $500,000, and $750,000 deductible levels, respectively.