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University of California Berkeley

Personal Finance Course

How Health Insurance Works

Guest Lecture by
Robin Flagg

So we're going to talk about health insurance. And before we do that, I want to back up and talk about insurance, because many of you have a lot of experience or have seen other videos in this series or others about insurance. And you're thinking, oh, I understand insurance. So what's the difference with health insurance? Well, I'm going to suggest to you that it's very different.

So first of all, the concept of insurance-- the whole idea of insurance is that someone is worried about a random event happening, a fire, an earthquake, a flood, a car accident. And they want to protect themselves against that random event happening. And so they buy insurance, and a bunch of people buy insurance, and they basically pool the risk. Insurers want to get a risk pool that has a diverse population, in fact, a population that represents the general population. And you don't want just the sick people to come in. They're the ones that want insurance. Because if only the sick comes in, then you have adverse risk. Everybody who's coming in is adverse selecting you. These are different insurance terms. The insurance companies are trying to avoid adverse risk. Here's an example. If I'm an insurance company and I have the best HIV doctor in my network, who's going to want to buy my insurance? Everybody with HIV. Well, they're very expensive, because they are going to be sick. Or at minimum, they're going to be on medication. That costs a lot. So I don't want to just have the HIV persons in my plan. I want to have a lot of young, perhaps teenagers, who never go to the doctor and never get sick. Or maybe I don't want that HIV doctor in my plan. These are all considerations that health plans think about when they think about bringing people into their insurance pool.

If you get a big group of people together, you have what's called group insurance. So employers, as I talked about in my other video, who insure their whole population in a health plan, they say take it or leave it. You have all of us. And the insurance company assumes there are some older people. And there are some younger people. There are sick people. There's healthy people. There's male. There's females, because men and women cost different amounts. For example, a 26-year-old girl costs about twice as much as a 26-year-old boy. Why? Pregnancy. Women are likely to get pregnant at that age and pregnancy, although it's a healthy, everyday part of life, is more expensive than not being pregnant and so forth. So if you're going to have a bunch of 26-year-olds, and you have men and women, you want more men than women. Or at least an equal amount. And that's the idea, is this risk pool. And so big companies buying insurance have a built in risk pool, or at least that's the assumption.

Well, what happens if an individual is to buy health insurance? Someone works for a place that doesn't offer insurance. Remember, employers are not required to offer insurance pre-ACA. So what happens? Well, they try to buy insurance on their own. Well, a health plan wants to make sure that they charge enough to cover this individual's health care costs. So what do they do? They do a process that's called underwriting. And the purpose of underwriting is to assess the risk, to figure out what this individual's health care risk is. So like I talked about with car insurance, if it's a boy, they cost more than a girl. If you have better grades, you cost less than if you have worse grades, and so forth. By gathering that information, that's called the underwriting process.

So underwriting happens in all types of insurance. And health care is no exception to that. So when an insurance company does a risk assessment, does underwriting of an individual, they make it easy for you. They say, I'll come to your house. And they send a nurse to your house to fill out paperwork. And guess what? The nurse takes some blood. And what do they do? They do blood tests. They see if you drank a lot. They see if you have any medication in you. They see if you have any other types of drugs, if you smoke. They also get your health history. And you sign somewhere in that paperwork that you give permission to them to call your doctor to get your health records. In other words, they are collecting all this information about you to assess what your risk is for health care. They get your age. They get your gender. They get your occupation, because different occupations have different risks associated with that. They figure out where you're located. And in the 2000s, with our new technology, they take a swab of your saliva. Maybe they can figure out your genetic makeup. And know if you have a gene that would lead you to Alzheimer's or something. In other words, they're gathering all this information.

Now, I need to stop here and put parentheses around what I'm about to say. This all predates health care reform. When I talk about health care reform in another lesson, we'll understand why health care happened. And understanding the underwriting process and the individual purchase pool will help us understand better why health care reform is the way it is. Close parenthesis. OK, so pre-ACA, there's underwriting if you buy insurance on your own. If you buy it in a group with your employer, not only do you get the tax break, not only does your employer help pay for it, but the employer makes it so that if you wouldn't pass underwriting otherwise, that you can get it. Insurance, when they do underwriting, they're trying to decide if they can insure you. And, if so, how much they should charge. Because they don't want to lose money on insuring me, you, whomever. So they want to know, are you prone to get sick? Do you have breast cancer in your family? Do you have other diseases? They will charge you enough to cover the anticipated costs of you being sick, actuarial science again. But they're going to make money. So they're going to charge you a little extra. Or they might just say, I am sorry. Your mother, your aunt, your grandmother, all have breast cancer. The likelihood of you getting breast cancer is 90%, or 80%, or whatever. The risk for us insuring you is too high. We're not going to insure you. Or maybe they'll say, we'll insure you. But we'll charge you a $1,500, $2,000, $5,000 a month. In other words, they're going to only insure you if they can make money on you. And so the irony of what happens is people who are healthy have no problem getting insurance. People who are sick, who, by the way, are often the people who can't work because they're sick, they're the ones that have to go find insurance on their own. They go to an insurance company. They go into the underwriting process. And the insurance company says, we're not going to insure you. Or they'll say, we'll insure you. But you're very expensive.

So a lot of people think of the insurance company as the bad guy. And I don't love the fact that a lot of them are making a lot of profit on not helping people who are sick. But the reality is it's a business. And their goal is to pool risk. And in order to pool risk, they need to have healthy and not healthy people together. Well, who's going to come and buy insurance if it's really expensive? Not the healthy person who never goes to the doctor, but the sick person. So insurance companies are worried they're only going to get sick people. Now, I'm going to take a few minutes here to talk about cost sharing in health care. It's not different than cost sharing in other insurance, but particular to health care. There are different places in the process of insurance and accessing health care where you the consumer, you the patient, might have a share of costs.

The first place that costs are accrued is the premium. It's where the employer is paying a premium to the insurance company to cover the employees. Or if you buy it in the individual market, it's where you are paying a monthly premium to Blue Cross, to Health Net, to Aetna, to Kaiser, whatever your insurance company. Every month you pay a premium. And that's a share of costs. If you buy it on your own, you have 100% of the premium cost. If you buy it through your company, some companies they charge you 50%. Some it's 20%. Some companies don't offer, so it's kind of 100%. So that's the first place where you have a share of cost. That's a cost that accrues monthly. A premium is a monthly payment, whether or not you use any insurance, whether or not you use any health care.

Another place where you can have another form of cost sharing is called the deductible. The deductible is the first amount of money that you're responsible for before your insurance kicks in. A lot of people understand a car insurance deductible. You have a car accident. And you pay a premium. You get your car insurance. You have an accident. You might be responsible for the first $500. You pay $500, and the insurance pays the rest. It's the same concept in health care. Deductibles in health care can range anywhere from $200 all the way up to $10,000. And we'll talk about a different kind of health plan called a health savings account and high deductible health plan in a different video. But my point here is that deductibles have huge ranges.

What's the purpose of this range? It's putting more costs on the individual. It's a different kind of cost sharing. So you pay a premium every month, and then you pay a deductible. And then there are point of service payments, where every time you go to the doctor you pay $10, or $15, or $30. Those are called co-payments. It's a dollar amount. Or there is co-insurance, where you pay 10%, 20%, and that is a percentage. It's called co-insurance. These are all different types of cost sharing. Now, I once had a plan with my husband's company. Now he works for a big garbage company and their Teamster union and so forth. We had zero premiums, zero deductible, and $5 co-pays. Guess what? I went to the doctor any time my son or anybody had a problem. I had a son who had an ear infection the first two years of his life. And every time he pulled on his ear, I'd run to the doctor. Why not? It cost me $5. I don't care how much it cost the insurance company, how much the doctor charged, how much it cost the employer, I only paid $5. So the issue with cost sharing is the more you pay, the less you might use insurance. And we will talk about this concept again in my video on high deductible health plans and health savings accounts.

So just to bring it all together, there are different forms of cost sharing. There's premiums, where you pay a share of the premiums. There's a deductible, that you pay after the premium but before your insurance kicks in. There's co-payments, where it's a dollar amount at the doctor's. I think now it's $25 is about average. And then there's co-insurance, where you can pay any percentage 10%, 15%. I think 20% is what I have seen to be very common, where the insurance pays 80% of the charges, and you pay 20%. So that's how the the health care insurance market works, the share of savings. I want to talk very briefly about what's going to be covered in more detail in other videos, the types of insurance. There are indemnity plans, where basically, very, very rare. Most people don't have it anymore. But when I was a kid, that's all that existed. Then there's health maintenance organizations, HMOs. Managed care plans, I have a video on that that explains how that works. There are preferred provider plans. I have a video that talks about that. And there are health savings accounts. There will be a video on that. These are all different options you might be faced with to buy insurance either on your own or through your employer, or through the new exchanges of health care reform. And for that you can see my video on health care reform. Thank you.