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Health Insurance Must Change: Here's How To Change It

By: John C. Goodman **June 26, 2012**

One of the biggest problems plaguing the U.S. health care system is the fact that "insurers" have gotten into the business of managing our medical care, rather than insuring us against risk. Without correcting this anomaly, most measures intended to fix the system are doomed to fail, if not make things worse. The Supreme Court's pending decision on the Patient Protection and Affordable Care Act (Obamacare) won't change that.

Casualty insurance – homeowners' and auto insurance, for example – is different. In the casualty market the product being bought and sold is real insurance, providing protection against unanticipated catastrophic loss.

Homeowners insurance, for example, typically pays for losses due to theft, wind, hail, fire and so on. But it doesn't pay for the normal wear and tear of daily living, such as replacing worn-out carpet or repairing a leaky faucet or an air conditioning system that's on the blink. Similarly, automobile insurance pays for collision damages, but it doesn't pay for oil changes, new tires, tune ups or normal maintenance.

Further, casualty insurance typically has a deductible, which makes the policy holder responsible for paying a set amount before the insurance coverage kicks in. A $1,000 deductible, for example, makes a car owner responsible for the typical minor fender bender. By adjusting the amount of the deductible, drivers can decide how much risk they're willing to accept. In general, the higher the deductible, and the greater the assumed risk, the less the policy holder has to pay per dollar of coverage.

Health insurance is different. The typical employer plan, for example, covers general checkups and such routine screenings as mammograms, Pap smears, and PSA testing for prostate cancer. These may all be worthwhile tests, but they are not the result of some unpredictable, costly event.

In addition, many health plans cover the full cost of such tests, with no deductible or co-payment. Under the Affordable Care Act, first-dollar coverage for routine primary and preventive care is required by law.

The perverse nature of health insurance goes further. Many employer plans that provide first-dollar coverage for routine care at the same time leave employees exposed to tens of thousands of dollars of out-of-pocket expenses in the case of catastrophic illness. In other words, the policies pay for routine expenses most families easily could pay themselves, but leave the families exposed to large bills – and possible bankruptcy –in the event of a major accident or illness.

Another unique feature of health insurance is the degree of control insurers have over the services that are provided.

If you're in an automobile accident, you typically take your car to an approved auto body shop. The insurance company doesn't tell the auto body shop how to make the repairs, it merely pays for the loss. Similarly, if your house is destroyed by a fire, the insurer doesn't insist that you rebuild it exactly as it was; it writes you a check for the value of your loss.

Modern health insurance, by contrast, doesn't write checks based on loss, it writes checks to doctors, hospitals and other providers based on the services they provide. Instead of reimbursing for losses, health insurance pays for consumption – and the amount it pays depends on how much we consume.

But since the insurance company is acting as the agent of somebody else, rather than the insured (typically an employer), it also will attempt to limit what we consume, which is how the health insurance industry got into the business of managing care, rather than merely providing insurance.

The insurer's job, in other words, as the agent of a third party payer, is to limit the payer's financial liability by rationing care and limiting what they pay to doctors, hospitals, diagnostic facilities and other providers. So, if your doctor says you need an operation, you typically need the pre-approval of the insurance company; if your doctor prescribes a medication, the insurance company may second guess her and steer you to a lowest-cost generic, even if the doctor prefers a newer drug that costs more; if your doctor wants to see you every three months, to see how you're progressing, the insurer might disagree and decide that every six months is enough.

Homeowners' insurers are not in the home repair business. Auto insurers aren't in the car repair business. And health insurers shouldn't be in the business of prescribing – or proscribing – medical treatment; they should be in the business of insuring individuals and families against large financial losses owing to medical conditions.

The way to fix the health care problem is not with more regulation or tighter controls, but with a new two-tiered insurance system that would combine casualty insurance –consisting of a high-deductible catastrophic insurance policy to protect against the cost of a major accident or illness – with a Health Savings Account (HSA), which could be used to pay for many, if not all, routine medical expenses.

Like homeowners' and auto insurance, health insurance should have a limited purpose: providing protection against financial loss. Medical decisions should be left to the experts.