Withering on the vine: the decline of indemnity health insurance

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Withering On The Vine: The Decline Of Indemnity Health Insurance

Employees are just as responsible as employers are for the decline in indemnity coverage.

by Jon R. Gabel, Paul B. Ginsburg, Heidi H. Whitmore, and Jeremy D. Pickreign

Among Americans with job-based coverage, the percentage of employees with indemnity insurance coverage declined from 95 percent in 1978 to 71 percent in 1988, then to 14 percent in 1998.1 Also known as traditional fee-for-service (FFS) or conventional insurance, indemnity plans do not restrict choice of providers or use extensive care management procedures. This transition from relatively “unmanaged” indemnity coverage to managed care coverage has turned the economics of health care upside down. The rate of increase of medical costs has slowed to unprecedented lows.2 However, Americans are more concerned about restrictions on freedom to choose providers, access to specialist services, and overall quality of care.3

This paper examines the decline of indemnity coverage and the implications of this decline during the latter part of the period 1995–1998. Our analysis addresses four research questions: (1) How much of the decline in indemnity coverage came from employers’ actions to drop indemnity coverage versus employees’ choosing managed care plans? (2) What types of employers dropped indemnity coverage? What were the characteristics of the plans they dropped? (3) Among those employers that dropped indemnity plans, how similar is employee cost sharing for out-of-network use in the preferred provider organization (PPO) and point-of-service (POS) plans that employers offer instead? (4) To what extent has the decline in indemnity market share contributed to the slowing of growth in health insurance premiums?

Study Data And Methods

Study data are from KPMG’s annual Health Benefits Surveys from 1995 to 1998.4 KPMG asked each participating employer as many as 400 questions about its largest conventional or indemnity, health maintenance organization (HMO), PPO and POS plans. During the study period KPMG consistently included core questions on topics such as premiums, employee cost sharing, benefits, employers’ plan offerings, market share, and plan choice annually.5 This permits tracking of trends in employer-based health benefits.

KPMG draws its sample from a Dun and Bradstreet list of the nation’s private and public employers with 200 or more workers. For increased precision, the sample is stratified by industry, number of workers in the firm, and region. KPMG attempts to repeat interviews with firms interviewed in the previous year and replaces nonresponding firms with randomly selected ones from the same strata. The overall response rates have ranged from 52

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percent to 70 percent.

Because KPMG selects firms randomly, it is possible through the use of statistical weights to extrapolate the results to national (as well as regional, industry, and firm-size) averages. We are able to present findings from the perspective of the typical worker or the typical employer. Findings in the subsequent analysis, unless otherwise noted, are from the perspective of the typical employee.

In contrast to our previous work, this study is based on a panel of employers that offer health benefits—the 286 firms that responded to the survey each year from 1995 through 1998. We used a panel so that we could track developments in firms that decided to drop or continue their indemnity plan in 1995, 1996, or 1997. We examined whether the panel was representative of the entire sample by comparing firms’ characteristics including size category, industry, region, premiums, plan offerings and market share, and employees’ earnings. None of the differences were statistically significant at $p = .05$. Firms in the panel were more likely to offer indemnity coverage than nonpanel firms were, however.

**The Decline Of Indemnity Coverage**

We have organized our findings around the research questions raised in the introductory section.

- **Employer terminations versus employee choice.** As the percentage of workers enrolled in indemnity plans has declined over the past ten years, many policy- and opinion-makers have expressed their concern about employees’ being “forced into managed care plans.” This concern is twofold. First, many workers may have to sever ties with their current providers. Second, some employees’ desire to have a broad choice of providers may be thwarted.

  We decomposed the decline in indemnity enrollment by calculating what the change in enrollment would have been if there had been no change in the proportion of workers selecting indemnity coverage (the offer component); we then calculated what the change would have been if there had been no change in the proportion of employees offered indemnity coverage (the selection component).  

  Overall, among firms in the panel, the percentage of employees enrolled in indemnity plans declined from 46 percent to 25 percent from 1995 to 1998 (Exhibit 1). The percentage offered indemnity plans fell from approximately 72 percent to 58 percent over this time span. Sixty-four percent of those offered an indemnity plan chose it in 1995; this figure declined to 44 percent in 1998. Thus, 38 percent of the decline in indemnity enrollment was attributable to the declining number of employees who had the option of enrolling in an indemnity plan, while 62 percent was attributable to employees’ choices.

- **Characteristics of firms dropping indemnity coverage.** We examined characteristics of firms that dropped indemnity coverage over the years 1995–1998, comparing them with firms that did not drop indemnity coverage. Sixty-five percent of the firms in the sample in 1995 dropped coverage at some point during the period. Based on logistic regression analysis, Exhibit 2 shows the probability of dropping indemnity coverage for

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**EXHIBIT 1**

**Percentage Of All Covered Workers Offered And Enrolled In Indemnity Plans From 1995 To 1998, And The Indemnity Selection Rate**

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<tr>
<td>Percent offered conventional plan</td>
<td>72%</td>
<td>63%</td>
<td>67%</td>
<td>58%</td>
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<tr>
<td>Percent enrolled</td>
<td>46</td>
<td>35</td>
<td>32</td>
<td>25</td>
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<tr>
<td>Percent selecting indemnity</td>
<td>64</td>
<td>56</td>
<td>48</td>
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This “indemnity selection rate” is defined as the percentage of covered workers enrolled in an indemnity plan divided by the percentage of workers who can select such a plan.
various subgroups of firms, holding other characteristics constant.

If midsize firms (200–999 workers) had had the same characteristics as larger firms, 70 percent would have dropped coverage; thus, the marginal effect of midsize firm status was to increase the probability that a firm would drop coverage by five percentage points. In contrast, large firms (1,000–4,999 workers) were eighteen percentage points less likely to drop indemnity coverage, and jumbo firms (5,000 or more workers) were twenty-seven percentage points less likely to do so.

Two other sets of variables affected the likelihood that a firm would drop coverage. First, earnings of a firm’s workforce were an important determinant of the firm’s decision to drop indemnity coverage. Standardizing for other characteristics, only 2 percent of firms where more than 35 percent of the workforce earned more than $75,000 per year (standardized for other characteristics) were likely to drop indemnity coverage. In contrast, 67 percent of firms with few high-earning workers were likely to drop coverage. On the other hand, firms with many low-earning workers were less likely to drop coverage than were firms with few low-earning workers. Forty-seven percent of firms with many low-income workers were likely to drop coverage, compared with 67 percent of firms with few low-earning workers.

Second, firms with high-deductible indemnity plans in 1995 were more likely than firms with low-deductible plans were to drop indemnity coverage. A firm with standardized characteristics and a $500 deductible had a 73 percent chance of dropping indemnity coverage; a firm with no deductibles had a 54 percent chance of doing so. Actuaries commonly use deductibles as a proxy measure of the richness of a plan’s benefit package.

**EXHIBIT 2**


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<td>65</td>
<td>70</td>
<td>47</td>
<td>38</td>
<td>54</td>
<td>58</td>
<td>73</td>
<td>2</td>
<td>47</td>
<td>70</td>
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**SOURCE:** KPMG Annual Health Benefit Surveys, 1995 and 1998.

**NOTES:** Average probability is the predicted probability when a standardized set of values is applied to the independent variables in the logistic regression model. Midsize is 200–999 workers, large is 1,000–4,999 workers, jumbo is 5,000 or more workers. Firms with many high-earning income workers are those with 35 percent or more of their workforce earning $75,000 or more; those with many low-earning workers have 35 percent or more of their workforce earning $20,000 or less.

*Statistically different from average probability at the .05 level.*
Financial barriers to out-of-network use in PPO and POS plans. Among firms dropping indemnity coverage, 97 percent of employees could choose either a PPO or a POS plan in 1998. So employees who lost the option to choose indemnity coverage almost always had the option to choose a PPO or POS plan instead. The shift from indemnity to PPO or POS coverage would reduce employees' ability to choose their providers if out-of-network deductibles and coinsurance exceeded those in their former indemnity plans. On the other hand, if out-of-network cost sharing were the same as under the previous indemnity plan, financial barriers to care would decline. Employees would face lower deductibles and coinsurance when using preferred providers and similar cost-sharing requirements when using nonpreferred providers.

Our analysis indicated that shifting employees from indemnity to PPO and POS coverage did not affect the deductibles of employees who used nonpreferred providers, but it did result in an increase in coinsurance. In terms of deductibles, the switching of coverage did not impose greater financial barriers to care when nonpreferred providers were used. Among firms that dropped indemnity coverage between 1995 and 1998, deductibles in the baseline year for indemnity coverage were $337. By 1998 deductibles for out-of-network use for PPO and POS plans offered by these same employers were $297 and $316, respectively. These differences were not statistically significant ($p = .10$ and $p = .54$ for the respective differences).

In contrast, the switch from indemnity to PPO and POS plans did increase coinsurance when out-of-network providers were used. Only 3 percent of workers in the firms that dropped indemnity coverage faced coinsurance rates greater than 20 percent in 1995. By 1998, however, roughly 30 percent of workers encountered coinsurance rates of 30 percent in their PPO and POS plans when using out-of-network providers. On the other hand, when employees used in-network providers, they typically faced copayments of $10 in POS plans and coinsurance rates of 10 percent in PPO plans. The net effect of these changes was a modest increase in financial barriers for employees using nonpreferred providers.

Lower premium inflation. Throughout the 1980s and 1990s there were recurrent large shifts in enrollments from indemnity into managed care plans. One school of analysts views this shift to managed care as yielding one-time savings, as employees move from higher-cost indemnity to lower-cost managed care plans. Because the supply of indemnity enrollees has been virtually exhausted, future inflation will be greater. An alternative scenario is that managed care reduces the rate of inflation relative to indemnity plans.

To explore this issue, we assessed how much lower premiums were as a result of the shift from indemnity to managed care plans. Restated, we calculated how much lower the cost of a market basket of health plans was in 1998 as a result of substitution of lower-premium managed care plans for higher-premium indemnity plans. Recall that from 1995 to 1998, among the firms in the panel, the percentage of workers enrolled in indemnity plans fell from 46 percent to 25 percent. We attempted to decompose the increase in the average cost of a family and single plan that occurred from 1995 to 1998 by examining how much of that increase was a result of changes in enrollment in different plan types as opposed to general premium increases. We did so by estimating what overall 1998 premiums would have been if the mix of plan types had not changed from 1995. In other words, what would the premium of the average family plan have been in 1998 if employees were enrolling in various types of health plans in the same proportions as they were in 1995? We found that 1998 premiums at the 1995 market-share rates would have been $478 for family cover-
EXHIBIT 3
Decomposing Premium Increases From 1995 To 1998 For Single And Family Coverage

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<tbody>
<tr>
<td>Single coverage</td>
<td>$164</td>
<td>$172</td>
<td>$180</td>
<td>3.1%</td>
</tr>
<tr>
<td>Family coverage</td>
<td>428</td>
<td>453</td>
<td>478</td>
<td>3.8%</td>
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NOTES: Actual 1998 premiums (column 2) were compared with estimated 1998 premiums with 1995 market-share rates (column 3). Percentage increase in premiums with current market shares was compared with percentage increase in premiums with fixed 1995 market shares. Overall premiums are a weighted average of indemnity, HMO, PPO, and POS premiums. “1995 market shares” refers to the distribution of enrollment in indemnity, HMO, PPO, and POS plans in 1995. “1998 market shares” refers to the distribution of plan enrollment in 1998.

age, which differs significantly from the actual 1998 overall family premium cost of $453 (Exhibit 3). Thus, the increase in the average cost of a family plan during the four-year period would have increased by 3.8 percent per annum rather than 2 percent had there been no movement to lower-cost managed care plans. For single coverage the annual increase in premiums would have been 3.1 percent rather than 1.6 percent. Thus, in the absence of a shift to managed care, increases in premiums would have been significantly higher. However, these increases still would have fallen to unprecedented low rates of increase.

Conclusions

By following a panel of 286 employers who offered indemnity coverage in 1995 over four years, this paper arrives at findings that challenge conventional wisdom. To what extent does the decline of indemnity coverage reflect employers’ forcing employees into managed care plans, and how much greater are financial barriers when workers use out-of-network providers in hybrid plans? We find that 62 percent of the decline in indemnity enrollment is due to employee choice, and 38 percent is due to employers’ no longer offering indemnity coverage. Firms most likely to drop indemnity coverage were midsize firms rather than jumbos and firms without substantial numbers of high-earning workers. In firms that dropped indemnity coverage, 97 percent of employees worked in a firm offering out-of-network coverage through either a PPO or a POS plan. Financial barriers to out-of-network providers were slightly higher as a result of higher coinsurance rates. The declining market share of indemnity coverage contributed to the slowdown in premium growth, but by a small amount. Indeed, one of us (Ginsburg) has always tracked premiums using fixed market shares of plan types.

Opinion leaders and policymakers need not agonize over the demise of indemnity insurance. Employees are as responsible for the collapse of the indemnity world as are employers. When employers have dropped indemnity coverage, they have substituted PPO and POS plans with little increase in the financial burden for using non-network providers.

The authors are grateful to the Robert Wood Johnson Foundation for the financial support that made this paper possible. They thank Samantha Hawkins for her research assistance and Jenna Rabideaux for her administrative support.
NOTES


4. In 1999 KPMG contributed the survey and historic data files to the Health Research and Educational Trust (HRET) as a charitable donation. The Kaiser Family Foundation and the HRET now conduct the survey each year.

5. During the study period there was no change in the wording of the questions to determine if an employer offered indemnity coverage.

6. The decomposition is obtained by using the following identity: \( O_1 S_1 - O_2 S_2 = (O_1 - O_2) S_1 + (S_1 - S_2) O_1 - (O_1 - O_2) (S_1 - S_2) \), where \( O_1 \) and \( O_2 \) are the percentage of employees offered at time 1 and time 2, and \( S_1 \) and \( S_2 \) are the percentage selecting indemnity among those offered. For ease of calculation we ignore the relatively small cross-product term (that is, the last term on the right-hand side of the equation). The term is so small that it does not change the result. Thus, the total decline in enrollment (again, ignoring the cross-term) can be represented as the portion of the decline due to decline in offer, 0.0896, or \( (0.72 - 0.58) * 0.64 \), plus the decline due to the decline in selection, 0.144, or \( (0.64 - 0.44) * 0.72 \). So these proportions account for, respectively, 38 percent and 62 percent of the decline.

7. This figure is for firms that had complete data and therefore that we could use in the regression analysis.

8. We used the statistical package SUDAAN to estimate logistic (and later ordinary least squares results). SUDAAN makes corrections in standard errors that occur due to the complex sample design. The logistic regression included the independent variables in Exhibit 2 as well as region, industry, and urban or rural location. None of the independent variables excluded from Exhibit 2 had important effects. Readers interested in viewing the actual logistic regressions should refer to the following Web sites: www.aha.org or www.hschange.org.

9. Only nine firms in the sample had “many high-earning workers,” so readers should take the 2 percent estimate with caution.