

Excerpt

The Changing Landscape Within the U.S. Individual Medical Market

The U.S. individual major-medical market is evolving toward consumer-driven products as a natural reaction to the growing number of self-employed, uninsured people, along with a segment of the working class that can't afford health coverage.

According to a special report released this week by A.M. Best Co., the individual indemnity industry, which includes non-health maintenance organizations and non-Blue Cross/Blue Shield plans, was enhanced with the enactment of health savings accounts in 2003 that make the individual major-medical market more attractive to those who would be uninsured otherwise, while also offering a lower-priced alternative for price-conscious consumers.

Several insurance companies are either entering or re-entering the marketplace, which will ultimately increase the level of competition in a historically volatile business. Success in the coming years will be measured by how determined players are in maintaining stringent risk management, while preserving distribution channels and controlling expenses. This gives an inherent advantage to the established companies within the individual major-medical segment, along with the organizations entering the market that already have scale and a capital position to survive a downward cycle.

During the past few years, A.M. Best has observed that most individual writers are continuing to report good earnings. Unlike previous experience in

which companies cautiously entered the market because of its volatility and regulatory constraints, a number of organizations have entered the market for profitability, growth opportunities and market position. Not all new entrants fully understand the risks associated with the individual major-medical marketplace, while others could be focusing on market share rather than profitability. Given the changing competitive environment, companies that always have operated in the individual market will need to maintain pricing discipline and be able to sacrifice market share to preserve margin.

Among the largest impacts on the individual market was the introduction of health savings accounts late in 2003 with the passage of the Medicare Modernization Act. These tax-enhanced accounts are similar to individual retirement accounts and are intended to encourage individuals to take a greater stake in their medical spending by managing their own health-care expenses. They primarily are utilized by individuals who participate in high-deductible medical plans, with deductibles starting at \$1,000 and most commonly at about \$2,500. Insured members managed their health-care money tax free from their accounts and spend it on insurance co-payments, prescriptions and various qualified medical expenses. Any funds not utilized are allowed to collect interest on a tax-deferred basis. In addition, the health savings account assets can be used in retirement for long-term care or prescription

drugs. Further, assets could be withdrawn as from a 401(k) for nonmedical expenses; however, policyholders would need to pay income tax, most likely at the post-retirement rates.

A.M. Best views the overall outlook for individual indemnity major-medical companies as stable. However, there will be additional challenges for companies that have limited experience or lack sufficient size in this ever volatile market. Already there are signs that the market is entering a downward cycle, although the profitability to date has remained good. A.M. Best has noticed organizations loosening their underwriting margins and focusing on market share.

Features of a Health Reimbursement Arrangement

- Tax-free withdrawals for qualified medical expenses;
- Carryover of unused monies, without limit, from year to year;
- Credits do not earn interest;
- Credits are forfeited if the individual switches health plans; and
- The health reimbursement arrangement is administered by the insurance company.

Features of a Health Savings Account

- Personal contributions are tax-deductible;
- Interest earned on the account is tax-free;
- Withdrawals for qualified medical expenses are tax free;
- Unused funds and interest are carried over, without limit, from year to year;
- The insured owns the health savings account and can keep it even when the insured changes plans or retires; and
- The health savings account is administered by a trustee/custodian.

This special report was written by Christopher Formica, senior financial analyst, in the life/health division of A.M. Best Co.