Supplemental Health Industry for Small Companies: Challenges and Opportunities

By Jennifer Howard and Stacy Koron

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Supplemental health products have experienced consistent market growth over the years, most noticeably since the implementation of the Patient Protection and Affordable Care Act (ACA). This growth has been particularly strong for hospital indemnity, critical illness and accident products, and there has been a significant increase in the number of companies selling these products. Small companies in this market need to understand the unique challenges these products present in order to compete effectively.

RATE CHALLENGES

In developing premium rates for supplemental health products, understanding the market landscape is an important component, as is understanding the assumptions that are required in order to develop the premium rates. In fact, these items are interrelated. The assumptions to take into consideration include morbidity, underwriting selection, persistency and interest, and these assumptions often vary by market segment. Statutory requirements, which may vary by product, should also be considered.

Three areas that frequently create rate challenges for insurers in supplemental health markets are states with (1) high minimum loss ratio requirements, (2) ongoing monitoring requirements and (3) the need for rate flexibility. With regard to loss ratios, a 50 percent to 55 percent minimum loss ratio is generally acceptable and most companies price their products within this range. However, a number of states have adopted higher minimum loss ratio requirements. These requirements not only vary by state but, depending on the state, may vary by product as well. Washington state, for example, may require a loss ratio as high as 80 percent on group coverage, New Jersey requires a 75 percent minimum for certain group critical illness coverage and several states require 65 percent for some or all of these products. In these states, insurers have to determine the impacts to profitability, expenses and commissions in order to lower premium rates and justify these higher loss ratios.

Concerned that companies are not attaining these loss ratios, a growing number of states also require that insurers report and monitor their supplemental health experience and make adjustments to rates or benefits when the required loss ratio is not being met. Some states, like North Carolina and Florida, have specific regulations requiring annual rate certifications. Other states, like Colorado and Kentucky, have been implementing these requirements informally when a new product filing is submitted to the state. In either case, this ongoing monitoring and reporting can be a significant challenge for companies that do not have procedures in place to ensure that this work is handled on a routine basis.

Finally, competitive pressure is pushing insurers to be more flexible in rating than in the past. This is particularly important in the group market where takeovers make up a significant percentage of an insurer's new business. Filed rates need to be designed to account for a particular group's experience and risk, and insurers need skilled group underwriters who understand how to appropriately rate each group. In addition, carriers need to be flexible in rate structure, especially in takeover situations. Most companies have developed issue age and attained age rates for group critical illness plans. Group accident and hospital indemnity plans generally require composite rating. Unlike the group market, rate flexibility is limited in the individual market due to the filing requirements associated with filing on an individual chassis. Although flexibility may not be as important on an individual product, companies can generally have some flexibility in commissions and other expenses so long as premiums and loss ratios are not adversely impacted.

VOLATILE REGULATORY ENVIRONMENT

Since enactment of the ACA, states have been concerned with stabilizing their medical insurance markets. This concern has led to increased scrutiny and regulation of supplemental health insurance products in states that worry these products will be marketed as substitutes for medical insurance or that consumers will be confused about their coverage. It can be a struggle for insurers to keep up with these regulations and, when needed,

respond to changes in law by revising existing products or procedures. In the past year, for example, Idaho has issued guidance that, among other things, limits hospital indemnity coverage to confinement benefits only; they recommend that "carriers review against this guidance both existing policies and any policies that will be filed with the Department." Other states have taken action to limit the benefits in supplemental health products, sometimes by law, regulation or other published guidance, sometimes through an unpublished department position based on a new interpretation of state law.

In addition to the challenges state law provides, insurers need to understand federal law and regulation to ensure that supplemental health products continue to qualify as excepted benefits and, if sold to consumers who have health savings accounts (HSAs), are HSA compatible. There has been less regulatory action in this area, but insurers continue to struggle to ensure that their interpretations of the federal guidance are correct and consistent with competitors and evolving types of care. For example, currently, there is some discussion about HSA compatibility of observation unit stays. Such stays can last several days, even without admissions, and regulations and guidance from the U.S. Department of the Treasury are unclear about whether or not they could be HSA-compatible benefits.

Dealing with this regulatory volatility can be a particular challenge for small companies, which may not have enough staff to dedicate someone to monitoring these changes and revising forms, rates and marketing materials in response. Trade associations and other third parties frequently provide materials related to regulatory changes.

PRODUCT FLEXIBILITY

One way that insurers can deal with regulatory volatility is by having significant flexibility in their product designs. This flexibility is also helpful to keep up with an increasingly competitive market, with new benefits and plan features that are constantly evolving. For individual products, it may mean offering certain benefits as riders, so they can be more easily amended or removed from the product if regulatory changes are needed. For group products, it generally means significant variability embedded in the contract and, as noted, in the rates.

The fact that all of this variability is allowed, and filed in the contracts, does not mean that it should always be offered. Allowing individual insureds or even group policyholders to elect each specific benefit or feature of a plan may introduce additional anti-selection. Further, administering significant variability can be difficult and result in errors if plans have to be manually created. Most companies in the supplemental benefit market have a limited number of standard plan designs, but allow broader variability to gain access to specific markets or for takeover situations where they need to match an existing plan. Often, the amount of flexibility offered will depend on the size and opportunity of the case in the group market.

DISTRIBUTION

Consumers generally understand the need for life insurance, health insurance and disability income insurance; however, they typically do not understand the need for critical illness, accident or hospital indemnity insurance. As a result, insurers in the supplemental health market must have distribution partners that understand the value of these products and are motivated to communicate this value to consumers. For those carriers that utilize an agent distribution system, producers may have a particular area of focus, and do not have the expertise to understand these supplemental health products. Additionally, producers may not want to make the effort to prioritize or learn about these new products. This has been a particular challenge for smaller carriers entering the supplemental health market, as these carriers often have a distribution channel that is resistant to change. Such carriers may need to seek out alternative marketing opportunities, such as contracting with broker groups that have the knowledge and understanding of supplemental markets.

COMPETITIVE ADVANTAGE

With an increase in the number of carriers competing in the supplemental health space, smaller companies are also challenged to find ways to stand out. Often, smaller companies lack the name recognition that companies with larger market share have. Faced with this challenge, smaller carriers are working to provide better customer service and education to consumers. This includes a focus on premium payment methods and claims processing.

In addition, small carriers entering this market can leverage their reputation with core products. For example, a carrier that specializes in disability insurance may cross-sell a suite of supplemental health products with a current disability insurance offering, as these supplemental health products can assist with additional costs that disability insurance or major medical insurance does not cover. A small carrier with a solid presence in a niche market has the ability to develop products designed for that market. Such a market focus can lead to some innovative product designs or marketing approaches.

However, companies do not need to be innovative to be successful. Many small carriers struggle with limited staff and resources, which make it impossible to make rapid product changes and innovations. These companies have found success by letting larger carriers test the market. By taking a "sit back and watch" approach as the larger carriers either succeed or fail, smaller companies can consider the lessons learned and structure their product development approaches accordingly.

CONCLUSION

All companies in the supplemental health market face unique challenges, but small companies have many challenges that larger carriers may not face. To overcome these challenges, those working with small companies need to be creative, as a one-size-fits-all approach often will not work. The strategic plan and product offerings must be developed based on the company's background and focus, which in itself could introduce unique opportunities. With the increased demand for supplemental health products, carriers are continuing to develop new and innovative products, and small companies are large contributors in this exciting time! ■

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