Rakesh Khandelwal suggests that in light of the obsession of the Indian masses towards tangible gains, a Health Savings Account rather than a reimbursement type of product, would be better suited for the Indian domain.

Way Forward?

- HSA Issues and Applicability

1. Background

Mediclaim, the traditional health insurance product accounting for more than 80% of total health insurance market in India, is short-term in nature and covers only inpatient costs. More than 70% of the total health spend (Rs.1700 crores-WHO-2007 estimates[1]) is for outpatient cost and there are literally no, or very few, products to cover these costs in India today. Further, Mediclaim falls under the category of 'protection' products where there is no payment from the insurer if no claim is made. Many Indian people consider the endowment insurance policies provided by life insurers as the only insurance in India where sum assured with accumulated bonus is paid at death or at the end of policy term. They see less value in protection products like Mediclaim as compared to savings products like endowment policies.

It also seems that there is need for long term health products to enable customers to provide for their health and long-term care costs, particularly the high costs after retirement. The insurers are shying away from introducing guaranteed long term health products because of very high risk in guaranteed long-term pricing. There are challenges to price long-term products due to higher degree of uncertainty in pricing assumptions including persistency, interest rates, mortality, morbidity incidence and severity, expenses, capital requirements and taxes. It is difficult to design a product with level pricing for long term durations, but it is possible to structure a product that achieves some of the objectives of a long term insurance policy by incorporating a significant savings component. Health Savings Account, a saving vehicle by its very nature, is prevalent in various parts of the world. It enables an insured to save his money until he is sick and the accumulated amount can be used to meet expenses when he is sick. This article discusses health care spending accounts and the issues in launching such products in India.

Mediclaim falls under the category of 'protection' products where there is no payment from the insurer if no claim is made.

2. Health Savings Account

A health savings account (HSA) is an account that a person can put money into to save for future medical expenses. Unlike traditional savings vehicles, a health savings account allows an insured to make contributions (tax free in most cases) to the account. In the US, a health saving account is paired with a high deductible health plan. A high deductible health plan is a health insurance plan covering the expenses in excess of the deductible. This protects an insured against the risk of very high medical expenses by passing the risk of medical expense amounts in excess of deductible to the insurer.

Individuals without a health insurance plan pay all of their medical expenses out of taxable income. Even with a traditional Mediclaim health insurance policy, individuals pay for outpatient expenses out of post tax income. Tax can be saved by paying expenses for outpatient cost, chronic and pre-existing conditions and non-standard illnesses out of HSAs, which is made up of contribution out of pre-tax income.

It should be noted that HSAs reduce the incentives for health insurers to directly manage health care service providers by shifting the risk and cost to policyholders. Further, reliance on an HSA to help fund retirement needs is somewhat problematic as it assumes that the individuals would not require the access to these funds prior to retirement. This will likely be the case only if they are fortunate enough to be generally healthy throughout their pre-retirement years and/or are able and willing to pay for un-reimbursed medical expenses with other funds.

Now, employers have also started contributing to HSAs combined with high deductible health plan on behalf of employees.

3. Result of a study on use of Health Savings Accounts in USA

Several studies[2] done in US to determine the characteristics of HSA enrollees indicated the following trends.

Initially, the individual market was the predominant source of contribution to HSAs. Now, employers have also started contributing to HSAs combined with high deductible health plan on behalf of employees.

The enrolled population in HSA plans has increased from about 1 million in 2005 to 6 million by the start of year 2008[3].

It was expected that young people would be attracted to this product more than the people in older age categories as the older people would have less time to accumulate funds as compared to those at younger ages. However, the evidence on the age of HSAs enrollees compared to those in traditional health insurance plans is mixed and utilization of HSAs seems to be spread throughout the age bands.

The average income of those with an HSA-qualified plan tends to be slightly higher than the average income of those who are not in an HSA-qualified plan. Preliminary enrollment trends suggest that individuals with an HSA account are more likely to choose family coverage than those in traditional plans. The initial trends suggest that a significant number of enrollees in these plans were previously uninsured.

4. A Possible "HSA" product design for India

In the USA, HSAs were created as part of the Medicare Modernization Act of 2003. This law required that HSAs must be paired with a high deductible health plans to be eligible for tax relief. It further sets the limits for tax exempt contributions and the minimum deductible and maximum out-of-pocket expenses in a year. Prior to introduction of HSAs, there were other types of tax-advantaged health care spending accounts including Health Reimbursement Accounts, Medical Savings Accounts and Flexible Savings Accounts.

In contrast with the strict regulatory requirements for HSA plan design in USA, HSA products evolved in South Africa with less regulatory involvement. The result was introduction of products targeted for various segments of people. The Indian regulatory environment is similar to the South African insurance market and it is expected that HSA plans will grow with the introduction of products of varied designs that cater to various segments of the Indian market. There are currently products similar to health savings accounts available in India, being marketed by some life insurers. However, the products are available in limited variations and they do not satisfy the needs of the various segments of the market. It is my belief that insurance penetration can be increased with the bundling of a health savings account with various coverages like a Mediclaim benefit with different deductible levels, critical illness insurance and long-term care insurance.

Possible benefit configurations for HSAs in India

Health savings accounts can be provided in various forms. For example:

- **HSA with traditional Mediclaim coverage benefit with no deductible.** A significant part of the contribution will go towards the cost of Mediclaim benefit coverage and very little will be left for accumulation for future.

- **HSA with high deductible health plan.** This product could attract uninsured lower and middle income families as the cost of coverage would be lower as compared to a traditional Mediclaim plan. A small part of the contribution will go towards the cost of high deductible health plan.

- **HSA with critical illness coverage.** This product will fit with the need of accountholder(s) against the risk of very high treatment/procedure cost arising out of diagnosis of a critical illness. This variant will also fit with the needs of customers covered by group Mediclaim coverage provided by their employers.

- **HSA with hospital cash plan.** The hospital cash plan would cover the cost of hospitalization to a limited extent and is suitable where the insured is in a better position to deal with the medical service provider himself.

- **HSA with long-term care insurance plan.** This product will attract people who are reaching retirement age and wish to be protected against the risk of disability cost in old age.

Utilization of funds in an HSA

The balance in health savings accounts may only be used to pay medical expenses at any time during the account holders' life-time such as:

- Medicines and drugs
- Diagnostic expenses
- Dental expenses
- Co-pays or deductibles as part of the medical insurance cover
- Other miscellaneous medical expenses not covered under medical insurance like medical cost for pre-existing diseases, maternity related expenses.
- Specialist consultations fees
- Long-term care expenses

The amount can also be withdrawn for expenses other than health; and the withdrawal could be treated as taxable income in the hands of account holder. These savings plans can be made portable

The hospital cash plan would cover the cost of hospitalization to a limited extent and is suitable where the insured is in a better position to deal with the medical service provider himself.

so that amount held in the saving account can be transferred to a similar account with another insurer/fund manager. Any residual amounts remaining in the health fund at death can be transferred to the legal heirs for the health needs. If the amount remaining in the fund is not utilized towards health expenses, such withdrawal would be treated as taxable income in the hands of legal heir/ nominee.

5. Issues in the introduction of HSAs in India

Tax incentives

At present, once a health product is approved by the IRDA, the annual premium paid by an individual is tax exempt up to Rs.15,000 (Rs. 20,000 – if parents are covered). The present exemption limit is very low especially when the only earning member of the family is taking care of living costs including medical costs of his/her parents, spouse and children.

Low penetration

Some of the health saver plans in the Indian insurance market had a combined premium income of Rs. 154 crores (2008-09). These premium figures are very low as compared to the total health premium of about Rs. 7000 crores during the year (2008-09). It would appear that there is an opportunity for higher growth in this segment of the health insurance market considering the very low penetration level at present.

Capital requirement

Every Indian insurance company is required to maintain at all times an excess of the value of its assets over its liabilities of not less than the required solvency margin (RSM). This is in addition to other reserves like mathematical reserves, outstanding claims reserves, IBNR etc. RSM needs to be kept for both linked as well as non-linked business though the investment risk lies with the insured for the funds held as a part of linked business. There is interest cost involved in keeping RSM and this cost is embedded in policy premium.

Health products can be launched by both life-insurance and non-life companies. A standalone health insurance company is treated as a non-life insurance company in terms of regulatory requirements in India. The rules for calculation of RSM are different for life-insurance and non-life insurance companies. There are two major differences in RSM calculation if HSAs are launched by both life and non-life insurance companies. RSM requirement is same irrespective of the type of business, be it linked or non-linked for a non-life insurance company. It is based on premiums written or claims incurred each year and ranges between 15-20% of the written premium/22.5%-30% of claim incurred depending upon the reinsurance ratio. For life insurance companies, the amount of RSM is lower and ranges between 1-2% for linked business and 3-4% for non-linked business depending upon reinsurance ratio and guaranteed/non-guaranteed business. This requirement puts a non-life insurance company at a disadvantage as it is required to keep full RSM on the linked part of the business and at a higher rate.

A standalone health insurance company is treated as a non-life insurance company in terms of regulatory requirements in India.

Secondly, as the products written by non-life insurance companies are without profit in nature, the present solvency margin regulation is silent about the fund lying as units for policyholders of non-life insurance companies. There is no regulation at present to cover this fund towards solvency regulation ambit. For life insurance companies, the carried forward amount in the unit fund is used in the calculation of mathematical reserves at the end of each financial year and consequently forms part of solvency margin requirement.

Fund Management expertise

Health savings accounts will have a large amount of funds to manage for long term durations on behalf of account holders. Life insurance companies possess significant expertise in managing funds on behalf of policyholders. Presently non-life companies may not have that expertise.

Higher Fund Management and initial charges

There is an increased emphasis on the part of regulating agencies in India to reduce the charges on financial products including insurance products as is evident from their actions about administrative charges on mutual fund products, ULIPs and New Pension Scheme. Presently, the charges per policy and the management charges are higher as compared to the contribution amount especially initial charges. This tends to reduce the amount available for contribution to the HSA. These charges need to be reduced to an affordable level to make it more financially attractive to the policyholders.

Underwriting and Claims Management expertise

Hitherto, life insurance companies used to issue health policies as a rider which requires little expertise in underwriting and have claims management processes like critical illness riders, personal accident riders etc. However, the introduction of health products providing hospitalization benefits will require not only expertise in underwriting to prevent selection against the company but claims management to manage large number of small claims including dealing with providers of health services. Hence, life insurance companies need to build medical underwriting and claims management expertise to manage these products successfully. However, the claims management requirement can be reduced significantly with the launch of high deductible coverage along with the health savings accounts which reduce the number of small claims. Non-life companies have an edge in this area by virtue of their long experience of managing their Mediclaim portfolio.

6. Conclusion

Health business is written as a protection product in India and not as a saving vehicle to cover the medical cost in future. With increasing medical costs, it is imperative to incentivize the launch of these types of products because HSAs can have an enormously beneficial effect on the design of health insurance in this country. Instead of relying solely on third-party insurance, people could partly self-insure through these accounts. They also have the potential to increase the affordability of health insurance to uninsured low and middle-income families. It can be safely said that though a lot has been done, still a lot more remains to be done to increase the reach of health insurance. Certain steps can be taken to increase the awareness and affordability of this product. Some such steps are:

- It has been a well known fact that tax advantages play a big role inincreasing the penetration of an insurance product. An increase in the exemption limit would increase the affordability and attractiveness of this product.

- Regulatory steps should be taken to enable/encourage non-life insurance companies to write these saving products. Similarly, life insurance companies need to be allowed/ encouraged to outsource the claims management task to a third party.

- A change in solvency margin regulation is needed to make all the insurance companies at par in terms of calculating the Required Solvency Margin for the same product. This will result in reducing the capital cost of health savings product for a non-life insurance company and enable them to launch products in this segment.

- Insurance penetration can be increased with the bundling of health saving accounts with varied coverages like Mediclaim benefit with various deductible levels, critical illness insurance, long-term care insurance, hospital cash etc.

It can be safely said that though a lot has been done, still a lot more remains to be done to increase the reach of health insurance.

- Steps should be taken to increase the awareness and attractiveness of these products. The regulator and the insurance councils can join together to launch special awareness programmes in an effort to accomplish that goal.

Sources:

1. WHO estimates for country NHA data-(http://www.who.int/nha/country/ind/en/)

2. FAQs on Health Savings Accounts- (http://www.actuary.org/pdf/health/hsa_oct07.pdf)

3. Latest HSA- Plans Enrollment- (http://www.markfarrah.com/healthcarebs.asp?article=59)

The author is Actuarial Analyst, Milliman India, Gurgaon.